On September 30, the Korean Ministry of Strategy and Finance submitted to the National Assembly the government’s proposed tax law amendments (the “Proposal”) for 2014. Below is an overview of two of the six major Proposal items that may affect foreign-invested companies or foreign corporations conducting business in Korea. The remaining four items will be reviewed in next month’s article. The Proposal, following revisions necessitated during the legislation process, is expected to be enacted by the National Assembly by the end of this month.

The Proposal focuses on tax reform that expands the tax base in order to secure revenues for the realization of welfare pledges of the Park Geun-hye administration. In connection with international taxation, the key features of the Proposal include a reduction in the scope of tax incentives for foreign investment and reinforcement of provisions to supplement a preventive regime for offshore tax evasion and aggressive tax avoidance.

1. Discontinuance of tax exemptions on dividends received by a foreign investor from a foreign-invested corporation that received approval of tax incentives

A foreign-invested corporation that received approval of tax incentives for its investment in Korea usually receives 100 percent exemption of its corporate income tax for three to five years and 50 percent exemption of the same tax for the next two years. In addition, a foreign investor that is a shareholder of the foreign-invested corporation may receive tax exemptions on the dividends from the foreign-invested corporation that has won approval for tax incentives.

However, the government pointed out that no country of the Organisation for Economic Co-operation and Development other than Korea exempts tax on dividends of a foreign investor and raised the issue that such tax exemptions provide excessive benefits to foreign investors. Consequently, the Proposal discontinues the above tax benefits on the dividends a foreign investor receives. (The provision providing for the benefit has been deleted).

The amendment applies to foreign-invested corporations that will have obtained approval for tax incentives after January 1, 2014. However, foreign investors may still receive tax exemptions on dividends relating to the existing tax incentives the foreign-invested corporations obtained prior to January 1, 2014 in accordance with the provisions currently in effect.

Therefore, it would be advantageous from a tax perspective for a foreign-invested corporation considering new investment or capital injection into Korea to receive approval of tax incentives from the Ministry of Strategy and Finance before December 31, 2013.

2. Elimination of tax incentives for foreign investment from a country without a tax treaty with Korea

The Proposal adds the case where foreign investment is made through a country or region with neither a tax treaty nor a bilateral investment treaty with Korea to the list of cases in which tax incentives for foreign investment are not permitted. In addition, the Proposal requires an additional submission of a list of the substantive shareholder(s) of a foreign investor as part of the documents required to be submitted for application of the tax incentives.

The proposed change will be applicable to the applications for tax incentives filed after January 1, 2015. However, the obligation to submit the list of substantive shareholder(s) of the foreign corporation will be applicable to applications for tax incentives filed after January 1, 2014.

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