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법무법인(유) 세종

Special Relationship Found Between Affiliated Foreign Corporations Located in the Same Jurisdiction for Purposes of Korea's Constructive Dividend Rules

(Supreme Court Decision 2023Du38295 rendered on January 8, 2026)

Overview

The taxpayer was the sole shareholder of Company A, a Malaysian corporation. Company A, in turn, owned 100 percent of Companies B and C, each of which was also incorporated in Malaysia. Company C engaged in a wholesale business purchasing petrochemical products from Company B and exporting them to third countries and generated substantial earnings. The National Tax Service ("NTS") imposed a corporate income tax on the taxpayer, deeming Company C's distributable retained earnings as constructive dividends under Korea's controlled foreign corporation ("CFC") regime.

The constructive dividend rules under the CFC regime generally do not apply where a specified foreign corporation maintains a fixed place of business in the relevant foreign jurisdiction and conducts substantive business activities. However, the constructive dividend rules may apply where the specified foreign corporation engages in wholesale or similar business activities and the amount of its transactions with companies having a special relationship exceeds 50% of the total transaction amount from such business activities.

The dispute concerned whether a special relationship existed between Company B and Company C as contemplated in the constructive dividend rules under the former Enforcement Decree to the Law for the Coordination of International Tax Affairs ("ED-LCITA"). The plaintiff argued that, for purposes of the constructive dividend rules, no special relationship could exist between foreign corporations established in the same jurisdiction.

Court's Decision

The Supreme Court held that, for purposes of the constructive dividend rules under Article 2(1)(3) of the former ED-

LCITA, a special relationship may exist between foreign corporations established in the same jurisdiction.

The Court reasoned that neither the text nor the purpose of the provision supported limiting its application to corporations located in different jurisdictions. The provision was intended to prevent the artificial shifting or retention of profits within multinational corporate structures. A narrower interpretation, the Court found, would undermine that anti-avoidance objective.

Accordingly, the Court concluded that a special relationship may exist among foreign corporations located in the same country where the relevant ownership and control requirements are satisfied.

Practical Implications

This decision clarifies the scope of Korea's CFC regime and confirms that the constructive dividend rules may apply even where affiliated entities are located in the same foreign jurisdiction.

Multinational groups with extensive overseas operations should carefully review their ownership structures, intra-group transaction flows, profit-retention arrangements, and supply-chain models to assess potential exposure under Korea's anti-deferral rules. The ruling also underscores the importance of evaluating substance, control, and economic relationships within a corporate group, rather than relying solely on the geographic location of affiliated entities.

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