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Dividends Attributable to Additional Shares Acquired After Tax Incentive Approval Deemed Ineligible for Tax Exemption Under the Restriction of Special Taxation Act

(Supreme Court Decision 2022Du31112 rendered on January 8, 2026)

Overview

The taxpayer was a foreign-invested company established as a joint venture between Swedish Company A and Korean Company B. At the time of establishment, Company A acquired a 65% equity interest and obtained approval for tax incentives under the former Restriction of Special Taxation Act (referred to in this newsletter as the "Special Tax Measures Act"). In 2007, Company A acquired the remaining 35% equity interest from Company B and became the taxpayer's sole shareholder. Company A did not, however, obtain separate tax incentive approval for the additional acquisition.

The taxpayer later distributed retained earnings to Company A and withheld tax on the dividends by applying the foreign investment tax incentive provisions under the Special Tax Measures Act to the portion of dividends attributable to Company A's original 65% shareholding and generated from tax-exempt business income. With respect to the dividends attributable to non-exempt income and to the remaining 35% of the shares, the taxpayer applied the reduced withholding tax rate under the applicable tax treaty.

The tax authorities challenged that approach and assessed additional corporate income tax. They asserted that the taxpayer's withholding tax liability must equal the lesser of two calculations: (i) the amount derived by applying the domestic tax rate after accounting for Special Tax Measures Act incentives, or (ii) the amount derived by applying the applicable tax treaty's reduced withholding rate to the gross dividend amount.

The principal issues before the court were whether the tax incentives provided under Articles 121-2(2) and 121-2(3) of the former Special Tax Measures Act, before the amendments effective January 1, 2014, extended to shares acquired after the original tax incentive approval, and how withholding tax should be calculated where both domestic tax incentives and treaty benefits were potentially available.

Court's Decision

The court held that the additional 35% shareholding acquired from the domestic shareholder did not qualify for tax incentives under the Special Tax Measures Act because Company A had not obtained separate tax incentive approval for that acquisition.

The court emphasized that the original tax incentive approval applied only to Company A's initial 65% investment made at the time of the taxpayer's establishment. Because the later share acquisition was a separate investment transaction not covered by the original approval, dividends attributable to the additional shares were not eligible for the statutory tax exemption.

The court further held that the taxpayer's withholding tax liability should be determined by comparing two figures: (1) the amount calculated by applying the domestic tax rate after taking into account the tax incentives available under the Special Tax Measures Act; and (2) the amount calculated by applying the reduced withholding tax rate under the applicable tax treaty to the gross dividend amount. The court ruled that the lower of those two amounts should apply, and on that basis, upheld the assessment issued by the tax authorities.

Practical Implications

This decision confirms that tax incentive approval procedures under the Special Tax Measures Act are substantive requirements for obtaining tax benefits, not merely administrative formalities.

Foreign investors should exercise caution when increasing their ownership interests in existing Korean investments. Tax incentives granted in connection with an initial investment do not automatically extend to subsequently acquired shares, even where the subsequent acquisition results in a wholly owned subsidiary structure.

Before acquiring additional equity interests, foreign investors should assess whether the transaction falls within the scope of an existing tax incentive approval and whether a separate application or approval process is required. The decision also highlights the importance of reviewing the interaction between domestic tax incentives and treaty benefits when determining withholding tax obligations on dividend distributions.

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