SHIN&KIM
법무법인(유) 세종

Clarification of the Scope of Korean-Source Dividend Income for Foreign Corporations

(Article 93, Subparagraph 2 of the Corporate Tax Act)

Overview

Korean tax law generally treats dividends paid by Korean corporations as Korean-source dividend income subject to Korean taxation. However, the tax treatment of payments arising from certain derivative transactions linked to dividend income has been less clear.

In particular, questions have arisen regarding whether amounts received by foreign corporations under over-the-counter ("OTC") derivative contracts referencing Korean-source dividends should be characterized as Korean-source dividend income for tax purposes.

Legislative Change

The amended Corporate Income Tax Act clarifies that profits distributed or paid under OTC derivative transactions that are economically linked to Korean-source dividend income will be treated as Korean-source dividend income.

Under the prior law, such payments were not expressly included within the definition of Korean-source dividend income, creating uncertainty regarding their tax treatment. The amendment eliminates this ambiguity by expressly bringing within the scope of Korean-source dividend income amounts derived from OTC derivative transactions whose underlying return is based on Korean-source dividends.

The amendment applies to income received on or after January 1, 2026.

Practical Implications

This amendment reflects the Korean government's continuing efforts to align the tax treatment of economically equivalent transactions and prevent taxpayers from obtaining different tax outcomes through the use of derivative structures.

Foreign investors frequently use equity derivatives, total return swaps, dividend swaps, and other OTC instruments to gain economic exposure to Korean securities without directly holding the underlying shares. Under the amended rules, the Korean tax treatment of returns generated through such arrangements may increasingly resemble the treatment of direct dividend income where the economic substance of the transaction is linked to Korean-source dividends.

Foreign investors, financial institutions, and investment funds should review existing derivative arrangements involving Korean equities to assess whether payments received under such contracts could be recharacterized as Korean-source dividend income. Particular attention should be paid to the potential impact on withholding tax obligations, treaty-based relief claims, and overall investment returns.

The amendment also illustrates a broader legislative trend toward substance-based taxation and the expansion of source rules to capture income that is economically connected to Korean investments, even where the legal form of the transaction differs from a direct shareholding structure.

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