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Tax haven crackdown in South Korea

By Anna Fifield in Seoul
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South Korea’s finance ministry is to announce a list of “tax havens” through which foreign investors will no longer be able automatically to claim double-taxation treaty benefits.

However, banks and multinational companies warn that the move could significantly damage investor confidence in Asia’s third largest economy.

From July 1, investment income derived in Korea – including interest, dividends and capital gains earned by foreign investors in designated havens – will be subject to domestic Korean withholding tax at a usual rate of 27.5 per cent, regardless of double taxation treaties.

Ireland, Belgium and the Netherlands are being considered for the list of havens, along with controversial offshore centres such as Labuan in Malaysia.

Lawyers say tax authorities will be able to review all transactions conducted through the listed havens during the previous five years and it is possible taxes could be charged retroactively, even for companies which have already been audited.

European multinational groups and banks such as Standard Chartered, Deutsche Bank, ING and BNP Paribas could be hit by the inclusion of EU countries, but the changes may also affect US banks including Citibank and JPMorgan.

“This will be regarded as a slap in the face for foreign investment,” said one banker in Seoul. “Foreign investors see this as a step backwards in trying to become a financial hub.”

The finance ministry has defended its plans to impose tax on Korea-sourced income derived by foreign investors through tax shelters, saying they are in line with international standards and are aimed only at preventing the abuse of treaties.

“What we have introduced is a mechanism to safeguard Korea against treaty-shopping attempts by unqualified investors from a third country,” said Lee Kyung-geun, director of international tax in the ministry.

The row is the latest divergence between foreign investors in Korea, who increasingly feel they are being victimised for being profitable, and the authorities, who are trying to manage the results of rapid liberalisation after the 1997 financial crisis.

The conflict is exemplified by the case of Lone Star, the US private equity fund being pilloried for a probable $3bn in tax-free profits it will make when it sells its majority stake in Korea Exchange Bank. Its investment was conducted through Belgium.

The finance ministry is now finalising the list, Mr Lee said. “If a country has a regime that allows very low tax burdens – especially for specific regions or specific types of companies – that investors from a third country can use as a stepping stone, then those countries would be candidates for the list,” he said.