

Meaning and Basis of Judgment on “Place of Effective Management” under the Corporate Income Tax Law of Korea: Judgment of January 14, 2016, 2014Du8896, Supreme Court of Korea

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Abstract

Previously, the Korean Corporate Income Tax Law considered the head office location as a standard for determination of a domestic corporation. While it additionally introduced the concept of place of effective management in 2005, its relationship with the existing determination standard, that is, location of head office, as well as definition and relevant standards were not clearly defined. Once a foreign corporation is treated as a domestic corporation, it faces a significant tax effect as it bears, among others, unlimited tax liability toward the domestic tax authorities. Place of effective management is a general concept which has great influence on the status of taxpayers under tax laws and may result in serious infringement of predictability and legal stability of international investments. Since the definition of place of effective management is too broad, it needs to be narrowly interpreted. In order to derive a reasonable interpretation of the definition and judgment standard regarding place of effective management, it is necessary to conduct a comparative analysis by reviewing i) Discussions of the Organization for Economic Cooperation and Development (the “OECD”) on the concept of “place of effective management” under tax treaties, which is the origin of the term, ii) relevant legislation of other countries, and iii) the permanent establishment taxation (the “PE taxation”) and controlled foreign corporation taxation (the “CFC taxation”), which are directly related to the new standard under the domestic tax laws for both inbound and outbound transactions.

First, in relation to the concept of place of effective management under tax treaties, the factors used to determine the residency of dual resident entities, that is, intent or purpose of tax avoidance, may be considered to restrict the applicable scope of the principle of place of effective management. Further, based on the fact that the place of effective management principle has a more severe tax effect than PE taxation and CFC taxation, the requirements for PE taxation and CFC taxation shall also be fulfilled for inbound transactions and outbound transactions. Therefore, in order to apply the place of effective management principle, a tax evasion purpose

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needs to exist, and there must be additional and important circumstances in addition to the requirements for PE taxation and CFC taxation.

Recently, the Supreme Court rendered that the place of effective management refers to a location where key management and commercial decisions necessary for business operations are implemented, and factors such as the location where meeting of the board of directors is held, location where the chief executive officer performs, etc. shall be taken into account. In particular, with regard to a foreign corporation's transfer of residence to Korea, the ruling is significant in that it imposed a strict standard by requiring discontinuance of relevancy with the previous place of effective management. This, while not being explicit, conforms with the discussions in this study to the effect that the place of effective management principle shall be deemed as a restrictive concept which supplements the head office location standard.

KEY WORDS: place of effective management, domestic corporation taxation, controlled foreign corporation taxation, permanent establishment taxation, tax treaty, residency

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I. Introduction

Since Korea's liberalization of foreign direct investments in 1984, inbound investments by foreign investors have gradually increased, whereas outbound investments of residents have also increased with the economic development in Korea beginning from the 1990s onward. At the end of 2017, the volume of foreign direct investment by residents and domestic direct investment by foreigners reached USD 355.8 billion and USD 230.6 billion, respectively.¹⁾ A majority of cross-border investments are made by large-scale corporations, which are classified either as domestic investment by foreign corporations ("inbound transaction") or foreign investment of domestic corporations ("outbound transactions"). As cross-border transactions are accompanied by cross-border business activities of corporations and generate a large amount of income both in Korea and overseas, the Korean Government's right to tax such income has emerged as a major discussion topic in the field of international taxation.

Previously, the Corporate Income Tax Law (the "CITL") determined

1) "International Investment Position (IIP) as of end of 2017," <http://ecos.bok.or.kr/>.

domestic companies subject to taxation on their global or worldwide income, based on the head office location principle. Therefore, even in the case where a foreign corporation's material business activity took place in Korea in the course of an inbound transaction, often, the Korean tax authorities were unable to enforce the right to tax on the domestic source income earned by the foreign corporation due to the fact that the income was held by a foreign corporation. Moreover, in the case of outbound transactions, even if a domestic corporation performed key management activities of its subsidiary foreign corporation in Korea, the Korean tax authorities were generally not able to enforce the right to tax on the foreign source income generated by the foreign corporation due to the fact that the income was held by a foreign corporation.

Taking into account the restraints in the right to tax, as explained above, the CITL was amended in 2005 to introduce a new standard on domestic corporations to the effect that a corporation with its place of effective management in Korea may also be deemed as a domestic corporation ("place of effective management principle," taxation applying the foregoing judgment basis referred to as "domestic corporation taxation" or "DC taxation"). In other words, the place of effective management principle was introduced in addition to the head office location principle for the assessment of domestic corporations. The newly introduced place of effective management principle has the positive function of enabling domestic tax authorities to secure its right to tax once a foreign corporation may be deemed a domestic corporation. On the other hand, since "place of effective management" is a general concept, it may trigger confusion in the determination of the scope of domestic corporations; judging a corporation that is considered non-Korean under foreign law as a Korean domestic corporation under Korean law may result in the collision of the right to tax with the relevant authorities of another jurisdiction, which may give rise to double taxation issues.

A decade has passed since the introduction of DC taxation under the CITL, but the precise definition of place of effective management, as well as factors serving as the basis for its determination, have remained unclarified. This has led to numerous disputes over the existence of place of effective management under the CITL submitted to the lower courts of Korea, where the very first judgment on the definition of place of effective judgment, and

the relevant factors, was rendered by the Korean Supreme Court on January 14, 2016 (2014Du8896) (the “Judgment”). With a review of the Judgment, this article discusses the definition of place of effective management, as well as its standards, which is a newly introduced concept under the CITL.

II. An overview of the Judgment

1. Summary of facts and backgrounds of the assessment at issue

1) Position and status of the plaintiff

(1) Business and employees of the plaintiff

The plaintiff was incorporated under the Companies Act of Singapore in March 2000, with its head office in Singapore. Since its incorporation until 2008, the plaintiff was in the business of providing internet access and other services to hotels in Singapore. In 2009, the plaintiff purchased convertible bonds (the “CB”) issued by a Korean listed corporation held by a Hong Kong branch of a foreign financial corporation (the “HK branch”)², and in 2009 and 2011, the plaintiff also intended to commence business of agricultural production in Kenya, Africa. After 2010, it also provided services related to hotel management in the US.

The representative director of the plaintiff was “A”; in 2009, A’s son joined the plaintiff to take charge of general management activities, and another employee was made in charge of finance. In 2009, the plaintiff relocated its office to a house held by A’s son.

The board of directors of the plaintiff comprised 2~10 directors from its incorporation to FY2010, where A, B (A’s friend being a Korean resident), and C (A’s acquaintance, a US citizen) served as directors in 2008 and 2009. Board meetings were rarely held, as most resolutions of the board were made upon written consent of the directors.³

2) In the case subject to the Judgment, whether the CB purchase and collection activities formed place of effective management in Korea was at issue. A discussion on the details of this matter will follow.

3) In accordance with the Companies Act and the articles of incorporation of the plaintiff,

After incorporation, the plaintiff appointed a Singapore accounting firm as its external auditor in accordance with Singapore law for accounting audits and filed returns for corporate tax and other taxes with the Singapore tax authority. Meanwhile, the commercial books and transaction records of the plaintiff were kept in its office.

(2) Dominant shareholder and family members of the plaintiff

The plaintiff's shares were held by A, B, C, domestic corporation D (the "Company D"), etc., and since December 2008, almost all of the shares were held by A.

A moved to the Philippines with his spouse and children on May 1999, moved to Hong Kong on July 2001, and finally settled in Singapore on January 2003. Since then, A continued his business operation, including management of the plaintiff and filed returns and paid corporate taxes to the Singapore tax authority. A, his spouse, and children are all permanent residents of Singapore.

2) *The plaintiff's investment business in the CB since 2008*

(1) The plaintiff's purchase of the CB

The CB was offered in the market for urgent sale around 2008, which were foreign currency denominated bonds issued by a Korean listed corporation with the selling requirement of lump-sum purchase by a non-resident, as a majority of the CB were bonds unpurchasable by domestic residents.

Around October 2008, domestic corporation E (the "Company E") acquired information on the Hong Kong branch's intent for sale of the CB, visited the Hong Kong branch to directly negotiate transaction terms, and brokered the transaction to the plaintiff for purchase.

With regard to the CB purchase, A used the email account of the plaintiff, the server of which is located in Singapore, to exchange opinions with the employees and at the same time, at the end of 2008 and beginning of 2009, visit the US to obtain consent from C on the purchase of the CB and borrow USD 1.5 million from C to apply as part of the purchase price.

a written resolution of the plaintiff's board of directors has the same effect as a resolution of board meeting that was actually held.

The plaintiff entered into an agreement with the Hong Kong branch on the CB purchase at USD 9 million on February 23, 2009 and paid the purchase price through an overseas settlement institution around February 2009, which was considered a low price, amounting to 30% of the face value of the CB.

(2) Collection of the CB by Company E

The plaintiff delegated the CB collection activity to Company E, and Company E completed most of the CB collection in Korea from March 2009 to September 2009.

The collectability of the CB was very high as the CB was issued by a listed corporation, and the plaintiff collected the claims by receiving repayment at maturity from the issuer or selling the claims after conversion into shares.

(3) Involvement of the plaintiff's employees

A, the Plaintiff's representative, stayed in Korea for a significant period after 2008 mainly for personal reasons, and received reporting on the collection status of the CB during the period. A and his family members continued to maintain residence in Singapore and the plaintiff also maintained its office in Singapore as in the past.

The plaintiff's employee was reported on the collection status of the CB from Company E and reported on such status to A as well as made disclosures relating to the CB.

3) *Tax returns filed by the plaintiff and background of the assessment at issue*

As the income resulting from investment in the CB in FY2009 fell under non-taxable capital income under Singapore tax law, the plaintiff did not file separate returns or pay corporate tax to Singapore. Meanwhile, the plaintiff paid securities transaction tax and the issuer of the CB withheld interest income, thereby withholding tax in Korea in relation to its collection of the CB.

In this regard, on July 2, 2010 the defendant made an assessment of corporate tax for FY2009 on the plaintiff's income generated from investment in the CB on the grounds that as material decision of the CB investment business was made in Korea, the plaintiff had a place of

effective management in Korea and therefore should be treated as a domestic corporation.⁴⁾

2. Summary of the Judgment

With regards to the definition of place of effective management and its factors, the Supreme Court ruled that, “place of effective management, which is a basis for differentiation of domestic corporations from foreign corporations, refers to the place where key management activities and commercial decisions necessary for the business of a corporation is made. Key management activities and commercial decisions necessary for the operation of a corporation’s business relates to a corporation’s long term business strategies, fundamental policies, corporate finance and investment, management and disposal of key properties, essential income generating activities, etc. The place of effective management of a corporation shall be determined on a case by case basis, comprehensively taking into account the location where meeting of the board of directors or any other meeting of equivalent decision making body is held, location where the chief executive officer and other officers perform their normal daily duties, location where senior managers perform their day-to-day management duties, location where accounting records are normally recorded and kept, etc.”⁵⁾ However, the Court also added “since place of effective management of a corporation requires certain level of consistency in terms of time and location in light of the nature of relevant decision and managerial activities, if a corporation which has a place of effective management overseas, established/determined basic plan for its overall business activities overseas, and

4) Meanwhile, notwithstanding the fact that Company E did not charge VAT on the compensation for brokerage and collection service of the CB by deeming the transaction as overseas provision of services to foreign corporation, which is subject to zero-rating, the defendant imposed VAT on Company E based on the reason that the plaintiff is a domestic corporation and that zero-rate VAT is not applicable as the services were provided in Korea. The Korean Supreme Court ruled that in terms of judgment on overseas provision of service which is subject to zero-rate VAT, whether the recipient of such service is a domestic or foreign corporation is not taken into account, and that the compensation for service provision is subject to zero-rating, as a material and essential part of the service was provided overseas (Judgment of January 14, 2016, 2014Du8896, Supreme Court of Korea).

5) Judgment of January 14, 2016, 2014Du8896, Supreme Court of Korea.

limitedly performed the specific execution of its business activities in Korea for a short period of time afterwards, it may not be easily concluded that the corporation transferred its place of effective management to Korea unless there are special circumstances to deem that the corporation no longer maintains relation to its previous place of effective management.⁶⁾

Further, the Supreme Court explained that “taking into account that plaintiff generated significant amounts of revenue from its business operation mainly in Singapore since its incorporation to 2008, the plaintiff negotiated transaction terms of the CB in Hong Kong and settlement of the purchase price was made through an overseas settlement institution, the three directors which formed the board of directors of the plaintiff in FY2009 respectively resided in different countries and reached decisions by way of exchanging emails, the plaintiff’s representative director also made decisions both domestic and abroad, storage of accounting documents and payment of taxes were made in Singapore (except for the accounting documents relating to the CB), the plaintiff operated a variety of businesses in different locations including Kenya (other than the CB investment business), merely by the fact that part of the CB purchase and collection activities took place in Korea for a short period is insufficient to deem that key management and commercial decisions necessary for plaintiff’s business operation constantly took place in Korea, and it is also difficult to deem that the plaintiff, which has a place of effective management in Singapore, relocated itself to Korea.⁷⁾

III. Review of the Judgment

1. Issue and scope of discussion in this case

The issues were whether the plaintiff could be treated as a domestic corporation based on its place of effective management in Korea under the CITL. In other words, the main issue was whether the plaintiff, which had a place of effective management in Singapore, relocated its place of effective

6) Judgment of January 14, 2016, 2014Du8896, Supreme Court of Korea

7) Judgment of January 14, 2016, 2014Du8896, Supreme Court of Korea

management to Korea with regard to its investment business.⁸⁾

The plaintiff closed down its internet service business, which was mainly operated in Singapore, purchased the CB overseas, and representative A and another employee stayed in Korea to operate the CB investment business by collecting the CB through Company E. Whether the plaintiff’s place of effective management shall be deemed as Korea based on the above circumstances shall depend on the definition and scope of place of effective management based on DC taxation pursuant to the CITL.

While the CITL introduced the place of effective management principle as a basis for determining a domestic corporation, it is difficult to define the applicable scope as the concept is uncertain in nature. While some say that judgment may be made by reviewing the facts based on the term ‘substantial management’, such argument is barely adoptable as it is equivalent to non-provision of a legal guideline, which fails to secure the legal security and predictability required for international investments.

In general, it is necessary to review the foreign corporation taxation under the Korean tax laws to establish a meaningful and specific basis of judgment on place of effective management, which is a comprehensive concept. That said, the discussion must begin from reviewing the interpretation of current tax law and tax treaty provisions relating to the term “place of effective management” as well as review of the respective legislative background.

First, as the DC taxation or basis of effective place of management are for exercising tax assessment rights to a foreign corporation by treating it as a domestic corporation, it is necessary to review the standards on domestic residency and foreign corporation, effect of determination of residency, and the general taxation structure on foreign corporations under the domestic tax laws and tax treaties. Moreover, it is of utmost importance to compare and review the permanent establishment (“PE”) taxation rules and certain foreign corporation taxation, which may be subject to concurrent

8) In this case, whether a permanent establishment exists in Korea was a secondary issue, and the Judgment was rendered to the effect that since the business activities performed by the plaintiff in Korea through a permanent location in Korea or thorough an agent are secondary or supplemental, it may not be deemed that the plaintiff owns a permanent establishment or a deemed permanent establishment through dependent agent in Korea.

application with the DC taxation. While the substance-over-form principle under the National Tax Basic Law may also apply to this issue, since this is a comprehensive standard similar to the place of effective management principle, we exclude the topic from this discussion as it is difficult to serve as a guideline on the interpretation of the place of effective management principle. While the residency determination standards for individuals may also serve as a reference, we do not include this in our discussion as the standard for individuals is considerably different from that of corporations in terms of its nature and basis of judgment.

Moreover, it is necessary to understand the definition of place of effective management under different tax treaties that have been signed by Korea prior to the amendment of the CITL. Since the concept of place of effective management in Korea was coined by the term 'place of effective management' appearing under tax treaties, discussions regarding the tax treaties will also have meaningful implications. It is also necessary to take into account the OECD Model Tax Convention and examples of German and UK legislations as the concept of place of effective management under tax treaties are rooted in the aforesaid literature.

We will now discuss the definition of place of effective management under the CITL by looking into the determination method of residency for corporations and taxation structure on foreign corporations, comparing and reviewing the concept of place of effective management under tax treaties and the interpretation of PE taxation and CFC taxation under domestic tax laws from a viewpoint that takes into account the historical background, examples of foreign legislations, and structural interpretation of domestic tax laws and tax treaties, as well as provides detailed basis of judgment. Thereafter, we review whether the plaintiff's place of effective management is in Korea based on the definition and judgment standards derived, and finally, evaluate the Judgment and discuss the future outlook.

2. Determination of residence of corporation and taxation structure on foreign corporations

1) Significance of determining corporation residency

For a country that adopts the territorial principle and imposes tax on domestic source income, residency for taxation purposes serves as a basis

for determination of the tax treaty application, whereas for a country that adopts the residency principle that imposes tax on the worldwide income of a resident, residency for taxation purposes further serves as a basis for unrestricted tax payment liability. Unrestricted tax payment liability imposed on a resident is justified by the fact that residents enjoy the benefit of public goods provided by the country where they reside.⁹⁾ Korea adopts the residency principle and the territorial principle for non-residents.

Once a foreign corporation is treated as a domestic corporation, major changes occur in terms of tax law, as the foreign corporation becomes subject to obligations borne by domestic corporations – that is, becomes subject to most of the tax treaties signed by Korea, bears liability to pay taxes on its worldwide income to the Korean tax authority, obliged to issue tax invoices and charge output VAT under the Value-Added Tax Law (the “VATL”),¹⁰⁾ obligation of book keeping and record entry,¹¹⁾ and becomes excluded from the application of laws applicable to foreign corporations. This is a completely different issue from the denial of beneficial ownership status of the transaction or income.

2) Method for determination of corporation residency

(1) Factors for residency determination

As a corporation (legal person) is a personality formed by law, unlike natural persons, residency inevitably becomes a technical term and its manipulation is comparatively easier.¹²⁾ As a corporation consists of numerous factors, different factors may affect the determination of residency. A corporation is incorporated in the country that grants the corporation legal personality but may operate a board of directors that makes key decisions in multiple locations, performs management and business activities through its representative and employees, and has a shareholder which has ultimate control over these aspects. While it is not too complicated when all of the aforementioned factors take place in a

9) Chang-Hee Lee, *International Tax Law*, Parkyoungsa, 2015, p.18.

10) VATL, art. 31, 32.

11) CITL, art.112.

12) Chang-Hee Lee, *Dual Resident in Tax Treaty*, Seoul Law Journal Vol. 51 No. 1, The SNU Law Research Institute, 2010, pp. 222-223.

single country, if the factors take place in multiple countries, the residency for tax purposes may change depending on the incorporation procedure, management function, business activities and shareholder's controlling right, among other facts.¹³⁾ Based on comparative law, factors for determining corporation residency may be largely divided into a formality standard and substantive standard. More specifically, the basis may be divided into the following four principles depending on weight ascribed to the incorporation procedure, management function, business activities, and shareholder's controlling right.

(2) Place of incorporation principle

This principle deems the place of incorporation as the residency of a corporation. Residency is determined on the basis of the relevant country law that has been observed for the incorporation. The place of incorporation principle is adopted by many countries as it guarantees certainty to the taxpayer and the tax authority. Taking into account the fact that incorporation is a simple procedure in most countries, it is likely that the residency of a corporation in the economic sense may not be reflected. The US is a typical country which adopts the place of incorporation principle.¹⁴⁾ The head office or principal office location principle adopted by Korea and Japan may also be classified as a type of the place of incorporation principle, in a broad sense.¹⁵⁾

(3) Place of business management principle

The place of business management principle deems the corporation to be a resident where the central business management and control takes place, regardless of the place of incorporation. However, control is divided into ordinary control and high-level control, which is a jurisdiction under the director's authority, and the former does not form part of the central

13) Je-Heum Baik, Study on Taxation on Retained Income of Controlled Foreign Corporation, Ph.D. thesis, Graduate School of Law of Seoul National University, February 2005, p. 24.

14) Je-Heum Baik, *Ibid.*, pp. 24-25.

15) Kyung-Geun Lee · Deok-Won Seo · Beom-Joon Kim, Understanding of International Taxation and its Practices, Younghwa Jose Tongram, 2011, p. 394.

business management.¹⁶⁾ The UK Supreme Court ruled that "a corporation resides for purposes of income tax where its real business is carried out ... and the real business is carried out where the central control and management actually abides", rendering a judgment on the residency of a corporation based on the business management principle.¹⁷⁾ The newly introduced place of effective management principle also appears to be classified as a type of place of business management principle.

(4) Place of business activity principle

The place of business activity principle deems that the residency of a corporation is where the main business activity takes place. While a corporation's place of business is the appearance of its business activity and is an important basis of judgment, often there are multiple places of business. For example, in case of Israel, if a registered corporation proves its main domestic business activities, the corporation is deemed as an Israeli resident for tax purposes. In Italy, a corporation is deemed an Italian resident for tax purposes if the corporation's main business purpose and main business takes place in Italy.¹⁸⁾

(5) Residence of controlling shareholder principle

The residence of controlling shareholder principle deems the nationality or residency of the controlling shareholder as the residency of the corporation. For example, in Australia, if a corporation incorporated overseas operates a business in Australia and simultaneously a shareholder which resides in Australia has control over the corporation, the corporation is deemed an Australian resident. Further, in Sweden, if a foreign holding company that has business management control in Sweden is a portfolio company and a Swedish person directly or indirectly holds controlling right over the corporation, the corporation is deemed a Swedish resident.¹⁹⁾

16) Je-Heum Baik, *Ibid.*, p. 25.

17) *De Beers Consolidated Mines Ltd. v. Howe* (Surveyor of Taxes) (1906) A.C.455 (House of Lords).

18) Je-Heum Baik, *Ibid.*, p. 25.

19) Je-Heum Baik, *Ibid.*, pp. 25-26.

3) *Taxation on foreign corporations under Korean tax laws and tax treaties*

(1) Overview of taxation on foreign corporations

The term 'foreign corporation' means an organization that has its head office or principal office in a foreign country that meets the standards prescribed by the Presidential Decree, without a place of effective management in Korea.²⁰⁾ Corporations that meet the standards prescribed by the Presidential Decree include any of the following, that is, an organization endowed with legal personality pursuant to the laws of the country of incorporation (Item 1), an organization formed only with limited partners (Item 2), an organization that owns an asset, becomes a party to a lawsuit, or directly holds a right or owes an obligation, independent of its members (Item 3), or other foreign organization, if a domestic organization whose type of business is the same as, or similar to, the type of business of such foreign organization is a corporation under the Korean Commercial Code (the "KCC") or any other laws of Korea (Item 4).²¹⁾ Since the basis for determining a corporation's residency may vary by country, a corporation may be deemed as a domestic corporation of both Korea and another country. With regard to dual resident corporations, a majority of the tax treaties signed by Korea include a provision that deems the corporation to be a resident of a country where effective management takes place.

A foreign corporation bears tax liability that is limited to domestic source income.²²⁾ This applies to inbound transactions. Domestic source income includes interest income, dividend income, real property income, rental income from ship rental, etc., business income, labor service income, transfer income from real property transfer, etc., royalty income, transfer income from transfer of securities, etc., other income, etc.²³⁾ Even if a foreign corporation gains income from an inbound transaction, it does not bear any tax liability if the income is not listed under the CITL.²⁴⁾ If the country of

20) CITL, art. 1, item 3.

21) Enforcement Decree of the CITL, art.1(2).

22) CITL, art. 1, item 3. CITL, art. 2(1)2.

23) CITL, art. 93.

24) Judgment of June 9, 1987, 85Nu880, Supreme Court of Korea, a judgment rendered on a case regarding carrying charge.

residency of the foreign corporation has signed a tax treaty with Korea, the tax treaty supersedes domestic tax laws as a special law. In other words, the tax treaty supersedes the CITL with regard to the classification of domestic source income of the foreign corporation.²⁵⁾ Moreover, the lower value between the withholding tax rate under the tax treaty and the CITL is applicable to interest income, dividend income, and royalty income.^{26), 27)} Business income of a foreign corporation located in a country which signed a tax treaty with Korea is not subject to taxation in Korea, unless it is attributable to a permanent establishment in Korea.

The method of taxation on domestic source income of a foreign corporation differs based on the existence of a domestic place of business. Domestic place of business is a concept that is mostly identical to PE.²⁸⁾ A foreign corporation with a domestic place of business shall file tax returns and pay tax on the aggregate of domestic source income of the relevant place of business.²⁹⁾ The remaining portion of domestic source income shall be withheld by the payer based on each type of domestic source income.³⁰⁾

Although Korea does not have a right to tax the foreign source income of foreign corporations, upon exceptional application of CFC taxation on the outbound transaction, the domestic shareholder of the controlled foreign corporation is subject to tax on deemed dividends. Controlled foreign corporations are usually those that do not operate substantial business activities locally and have a domestic shareholder that holds control and dominance.

In summary, the concept of place of effective management under tax treaties are closely related to the taxation on domestic corporations and the basis of place of effective management in that the CITL also uses the same terminology, and domestic activities serve as grounds for taxation on the income of a foreign corporation since, based on domestic tax laws, taxation on PE is applicable to inbound transaction if a foreign corporation has

25) Adjustment of International Taxes Law (the “AITL”), art. 28.

26) CITL, art. 98(1).

27) AITL, art. 29.

28) Hereafter referred to as permanent establishment for convenience.

29) CITL, art. 97(1).

30) CITL, art. 98(1).

domestic business activities whereas taxation on controlled foreign corporation is applicable to outbound transactions if a domestic corporation has domestic management and control activities.

(2) Taxation on inbound transaction and PE

Pursuant to the CITL, domestic source business income of a foreign corporation is subject to 2% withholding tax if there is no domestic place of business.³¹⁾ However, if there is a domestic place of business, the foreign corporation should file a tax return and pay tax together with the other domestic source incomes relating to the domestic place of business.³²⁾ If there is a separate provision on PE under the tax treaty, such provision supersedes the provision on domestic place of business under the CITL.

PE is divided into fixed place PE and dependent agent PE. Fixed place PE is often the issue with regard to the place of effective management principle under the CITL. In order for a fixed place PE to exist, a place of business has to exist and the place has to be of a permanent nature, where business is operated and the nature of business shall be more than secondary or supplementary.³³⁾ Being permanent means that the place of business is immovable and fixed to a certain location, and such a status continues for a certain period of time.³⁴⁾ Core business activities have to take place at the PE, whereby secondary or supplementary activities do not constitute business activities that form a PE. Production, sales, and management are typical core activities,³⁵⁾ whereas storage, display, processing, delivery and purchase of goods, data collection, and research & development are typical secondary or supplementary activities.³⁶⁾

In case of an inbound transaction, if a foreign corporation has a domestic PE, the Korean Government may exercise its right to tax on the business income attributable to such place of business. If the corporation

31) CITL, art. 98(1)1.

32) CITL, art. 97(1).

33) Commentary on Article 5 of the OECD Model Tax Convention, Paragraph 6.

34) Hae-Ma-Joong Kim, *Theory and Issues of Taxation on Permanent Establishment*, Kyungin Publishing, 2017, p. 60.

35) Arvid Aage Skaar, *Erosion of the concept of permanent establishment: Electronic Commerce*, Intertax, Vol. 28, Issue 5, 2000, p. 192, OECD Model Tax Convention, art. 5(2).

36) OECD Model Tax Convention, art. 5(4).

does not have a PE, Korea may exercise its right to tax if Korea has signed a tax treaty with the country of residency of such corporation, even if the foreign corporation generates income by operating business through the input of human and physical factors in Korea.

(3) Taxation on outbound transaction and controlled foreign corporation

In principle, overseas source income of a foreign corporation may not be taxed in Korea. In case of an outbound transaction, when a domestic corporation incorporates a branch office overseas, income generated by the branch office may be taxed as income of the domestic corporation. On the other hand, when the domestic corporation incorporates a foreign corporation, the income generated may not be taxed unless it is distributed to the domestic corporation as dividend distributions. That is, even if a domestic corporation, which is a shareholder of a foreign corporation, conducts substantial business management and control activities in Korea, without the fulfillment CFC taxation requirements, it may not be taxed unless the foreign corporation's income is distributed to the domestic corporation. However, in accordance with the CFC taxation, as an exception, the Korean tax authority may exercise its right to attribute the foreign source income of the controlled foreign corporation to an applicable shareholder of the controlled foreign corporation. Such taxation was designed to regulate the practice of tax deferral, where a foreign corporation incorporated in a tax haven earns income and defers dividend distributions to the domestic corporation.

Controlled foreign corporations generally have their head office or principal office in a country or region where their tax burden is less than 15% of the actually generated income.³⁷⁾ However, if a controlled foreign corporation has a fixed facility necessary for its business operation at its head office or principal office and operates substantial business through such a facility, the CFC taxation is not applicable.³⁸⁾ The applicable shareholder shall directly or indirectly hold over 10% of the issued and outstanding shares of the controlled foreign corporation as of end of each business year. The amount attributable to the Korean national, out of the

37) AITL, art. 17(1).

38) AITL, art. 18(1), main clause.

controlled foreign corporation's retained earnings distributable as of end of each business year, shall be deemed as a dividend paid to the Korean national in accordance with the shareholding ratio as of the day falling 60 days from the following date of the end of business year, and shall be subject to taxation as dividend income.³⁹⁾

(4) Tax treaties and place of effective management

Currently, as of April 2018, Korea has approximately 93 tax treaties in effect, signed with different countries worldwide.⁴⁰⁾ The tax treaties are applicable to the resident corporations of the respective contracting state. As the standards for determining domestic corporations differ in every country, a corporation may include dual residents of two countries and consequently face the risk of double taxation. In order to prevent such double taxation, tax treaties have provisions on the determination of dual resident. For example, the Korea-UK Tax Treaty provides that if a corporation is a resident of both contracting states, then it shall be deemed to be a resident of the contracting state in which its place of effective management is situated and any doubt arising in relation to the aforementioned shall be resolved by mutual agreement.⁴¹⁾ Therefore, determination of the place of effective management of a dual resident corporation may be able to prevent double taxation.

3. Meaning of place of effective management under the CITL

1) Significance of place of effective management

(1) Legislative background of place of effective management

The CITL provides that the term "domestic corporation" means a corporation with its head office, principal office, or place of effective management of business located in Korea.⁴²⁾ While the CITL was amended to add the text "place of effective management of business," other than the

39) AITL, art. 17(1), Enforcement Decree of the AITL, art.33.

40) Ministry of Strategy and Finance, April 3, 2018 "Status of Tax Treaties and Agreement on Tax Information Exchange, etc. in effect as of April 2018" (www.mosf.go.kr)

41) Korea-UK Tax Treaty, art. 4(3).

42) CITL, art. 1, Item 1.

existing basis of location of head office, there are no specific provisions that explain the definition or standards of such a concept. The only explanation available is provided under the Enforcement Standard of the CITL by the National Tax Service (the “NTS”), which states that a place of effective management of business shall mean a place where key management activities take place and commercial decisions that are necessary for the conduct of a corporation are made.⁴³⁾ This appears to be a translation of relevant text from the Commentary of the previous OECD Model Tax Convention (amended as of July 15, 2014): “the place where key management and commercial decisions are in substance made that are necessary for the conduct of the entity’s business as a whole.”⁴⁴⁾ As mentioned above, the commentary provides a definition of “place of effective management,” which also appears in most of the tax treaties signed by Korea.

The place of effective management principle was introduced upon amendment of the CITL into Legislation No. 7838 on December 31, 2005, with the purpose of legislation being the prevention of tax evasion of foreign corporations that have their main office or principal office located in a tax haven, and substantially operate major business activities in Korea; the acceptance of place of effective management adopted by most of the tax treaties signed by Korea is the ultimate basis of determination of residency.⁴⁵⁾ While the CITL has traditionally judged residency of a corporation based on the location of the head office, it appears that the CITL intended for the expansion of tax base and flexible determination of domestic corporations to be through the introduction of the place of effective management principle. Although the place of effective management principle was introduced for the purpose of prevention of tax evasion in inbound transactions, it is construed to be applicable equally to

43) Enforcement Standard No. 1-0-1 the CITL (Differentiation of Domestic Corporation from Foreign Corporation). Authoritative Ruling to the same effect, *Seomyun2team-1989*, October 2, 2006.

44) Commentary on Article 4 of the previous OECD Model Tax Convention, Paragraph 24 (July 15, 2014). However, the current OECD Model Tax Convention, which was amended as of November 21, 2017, has deleted such provision.

45) Examination Report of the National Assembly’s Strategy and Finance Committee on the Proposed Amendment of the CITL (Agenda No. 172840), p. 23.

outbound transactions as the legal text does not limit the applicable scope.

(2) Relationship with the basis of location of head office

As the CITL determines whether a corporation falls under domestic corporation based on the location of its head office, upon the introduction of the new place of effective management principle, the relationship between the existing head office location standard and the new place of effective management principle is the issue here.

There are two different viewpoints on the issue. One is that, since the head office location standard judges the formal appearance and the place of effective management principle judges the substance, whether or not each of the basis is applicable may be determined in accordance with the interpretation of the respective text. According to this view, the place of effective management is an issue of acknowledgement of fact, due to which if there is a factual background demonstrating the existence of a place of effective management based on the literal interpretation of the legal text, a corporation should be determined to be a domestic corporation regardless of the existence of tax evasion purpose.

The other view is that, as the purpose of the place of effective management principle was to prevent a corporation from avoiding taxes in Korea by being classified as a foreign corporation having its head office in a tax haven while carrying out substantial management activities in Korea, the place of effective management principle shall be determined by taking into account the appropriateness of the tax burden in the country of incorporation and the taxpayer's intent of tax evasion.⁴⁶⁾ In other words, this is a view that states that once an intention for tax evasion is recognized, it is necessary to respond to such intention by applying an inclusive interpretation of the place of effective management, as taxation on domestic corporation is purposed to regulate tax evasions by foreign corporations.

The above views appear to share the assumptions that the tax base may be expanded through the place of effective management principle separate from the head office location principle; moreover, dual application is

46) Chang Lee, *The Standard of "Place of Effective Management" to Qualify as a Domestic Corporation under the Corporate Tax Act*, Seoul Law Journal Vol. 54 No. 4, December 2013, pp. 251-252.

possible in areas subject to PE taxation and CFC taxation, which are taxations applicable to foreign corporations, where the place of effective management principle should function as a response measure to tax evasions or deferrals that are not preventable by PE taxation or CFC taxation. According to the above views, the applicable scope of place of effective management under the CITL shall be broader than the place of effective management under tax treaties, and the issue of double taxation may be resolved even based on such interpretation, as the determination of dual resident is rendered afterwards based on the provision on place of effective management under tax treaties.⁴⁷⁾

However, it is necessary to restrict the applicable scope of place of effective management, as the exaggerated interpretation of the concept by deeming it as an independent basis for determination of domestic corporation may greatly infringe the legal stability and predictability of foreign corporation's domestic investment and domestic corporation's overseas investment. In other words, the views that call for an expanded interpretation based on the text of the place of effective management principle or expanded application of the place of effective management taking into account the intention or purpose of tax evasion, triggers material issues in the systemic interpretation of PE taxation and CFC taxation. Therefore, in order to seek reasonable implications, it is necessary to conduct a comparative analysis by taking into account the definition of place of effective management under tax treaties and the definition of PE taxation and CFC taxation under Korean tax laws.

2) *Place of effective management under tax treaties*

(1) Necessity of review

The concept of place of effective management under tax treaties signed by Korea is a concept borrowed from the OECD Model Tax Convention as a basis for determining dual resident corporations. Meanwhile, the OECD Model Tax Convention was influenced by multiple legislations, including the key management and control standards for establishment of residency of corporation under tax law of the UK and Germany at the end of the

47) Chang Lee, *Ibid.*, pp. 252-254.

nineteenth century and the beginning of the twentieth century. As the place of effective management under tax treaties is a concept rooted on the OECD Model Tax Convention and the legislation of various countries, we can analyze the definition of place of effective management under tax treaties by reviewing the Commentary of the OECD Model Tax Convention and the legislation of various countries; this may have implications on the specification of definition and applicable scope of place of effective management under the CITL.

(2) OECD Model Tax Convention

(a) Place of effective management as a basis of determination of dual resident

In order to provide a guideline on interpretation of the OECD Model Tax Convention, the OECD established the Commentary of the previous OECD Model Tax Convention (amended as of July 11, 2014) and amends it periodically. The commentary defines place of effective management as the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are, in substance, made; moreover, it explains that all relevant facts and circumstances must be examined to determine the place of effective management—an entity may have more than one place of management but it can only have one place of effective management at any one time.⁴⁸⁾ According to the commentary, place of effective management is not a factor considered for determination of residency; rather, it is a concept discussed as a “tie-breaker rule,” which is a rule applied to determine which residency shall prevail in case more than two residencies exist. However, it also implies that by providing that a corporation may only have one place of effective management at one time, at other times, the place of effective management may be relocated.

It is worth noting that looking back, the concept of place of effective management was first introduced in relation to the types of business which inevitably require frequent relocation of place of business activities. The term place of effective management was first coined in a report published

48) Commentary on Article 4 of the OECD Model Tax Convention, Paragraph 24. However, the current OECD Model Tax Convention, which was amended as of November 21, 2017, has deleted such provision.

by the Organization for European Economic Cooperation (the “OEEC”) in 1958. According to the report, the concept of place of effective management was derived from the practical affairs of tax treaties relating to distribution of right to tax on income generated from marine, inland waterway, and air transport business purposed for the association of residency of a corporation with factors that are stable to a certain extent without frequent changes, even in the case where the corporation is subject to frequent relocation of place of business.⁴⁹⁾ Since place of effective management is a concept used to select one out of multiple places of business of a corporation, it functions as a basis for determination of residency of a dual resident corporation.

(b) Method of case-by-case determination of residency by mutual agreement

In this regard, as it is difficult to determine place of effective management due to the utilization of new communication technology and dual resident corporations rarely occur, some argue that place of effective management is more of a factor considered for the case-by-case determination method rather than a basis for determination of dual resident corporation. In 2017, the OECD concluded with regard to the dual residency issue of corporations (other than individuals) that it would be considered better to handle such issues on a case-by-case basis.⁵⁰⁾ Based on such a conclusion, the OECD Model Tax Convention Art. 4(3) provides that the competent authorities of the contracting states shall settle the issue of dual residence of a person, other than an individual, by mutual agreement. In case where the residence of a corporation under a tax treaty is determined by mutual agreement, the competent authorities would be expected to take into account various factors, such as ① where the meetings of its board of directors or equivalent body are usually held, ② where the chief executive officer and other senior executives usually carry on their activities, ③ where the daily management is conducted and where the head office is located, ④ where the corporation’s head office is located, ⑤ which country’s laws govern the legal status of the corporation, ⑥ where its accounting records are kept, ⑦ whether determining that the corporation is a resident of one of

49) Judgment of May 24, 2013, 2012Guhap10673, Seoul Administrative Court.

50) Commentary on Article 4 of the OECD Model Tax Convention, Paragraph 23.

the contracting states but not of the other for the purpose of the tax treaty would carry the risk of an improper use of the provisions of the tax treaty.⁵¹⁾

The seven factors mentioned above may be considered when the contracting states of a tax treaty intends to determine residence of a corporation by mutual agreement, and it is not a standard proposed for the direct application on judgment over the place of effective management. For example, as the factors of location of head office and country governing the legal status of the corporation are factors of “form,” they contradict the basis of place of effective management. Further, the factor of risk of an improper use of the tax treaty is also difficult to be adopted as a basis for determination of place of effective management.⁵²⁾

(3) Legislation examples of other countries

(a) Key management and control standard of the UK

While the UK defines a domestic corporation based on the governing law of incorporation in principle, a corporation may be deemed a UK corporation if its place of “key management and control” is in the UK, even if the governing law of its incorporation is not UK law. In the UK, the board of directors is responsible for key management and control; the contents of such management and control pertains to important policy decisions and the place refers to the place where the meeting of board of directors is held. Such tradition became a widely accepted basis by countries that apply common law. However, when a shareholder or a director substantially exercises the right of the board of directors as an exception, such a shareholder or director is deemed as the person in charge of management and control, and the residence of such a person is recognized as the place of management and control.⁵³⁾

(b) Place of management standard of Germany

Germany adopts place of management as a basis for determination of a domestic corporation. Place of management refers to the place where

51) Commentary on Article 4 of the OECD Model Tax Convention, Paragraph 24.1.

52) Chang Lee, *Ibid.*, p. 242.

53) Gwang-Jin Chung, *Study on Place of Effective Management of Corporations as a Fundamental Factor for Comprehensive Right to Tax on Corporations*, 2016 Judicial Training Advanced Course Journal, Judicial Research & Training Institute, 2016, pp. 107-108.

representatives of a corporation conduct business management activities.⁵⁴⁾ In principle, the representative director is deemed as the responsible body for management under the German law rather than the board of directors, and the contents of management include factual, contractual, and organizational activities with certain extent of significance with regard to the day-to-day management of a corporation.

Place of management is the place where the representative director carries out his/her duties.⁵⁵⁾ However, if a shareholder makes all of the substantially important management decisions, such a person may be regarded as the responsible person of management.

In Germany, place of management is the place where important business management decisions are actually conducted. In other words, it is the place where business management guidelines are prepared, not where they are put into effect. Based on the fact that the place of management under German law is also determined by comprehensively taking into account the factual background, it may be deemed as a concept similar to place of effective management.⁵⁶⁾

(4) Relationship with the place of effective management under the CITL

It is necessary to review whether the basis of place of effective management under the CITL is the same as or different from the basis of place of effective management under tax treaties.

Since the term place of effective management used under the CITL was adopted from the term used under tax treaties, the first possible argument would be that the term should be interpreted with the same meaning as the term used under tax treaties. Based on this argument, since the place of effective management under the CITL adopted the term from tax treaties, the provisions relating to the term thereunder should be considered to analyze the meaning of place of effective management under the CITL.

However, the place of effective management under tax treaties is a term

54) Min Park · Kyung-Bong Ahn, *The Standard of Judgment of ‘Place of Effective Management’ in Corporate Tax Law*, Journal of IFA Korea Vol. 29. No. 1, International Fiscal Association Korea, 2013. 2., p. 152.

55) Min Park · Kyung-Bong Ahn, *Ibid.*, p. 153.

56) Gwang-Jin Chung, *Ibid.*, p. 111.

provided for the determination of the residence of a dual resident of the contracting states of a tax treaty and is done in order to prevent double taxation. Meanwhile, the place of effective management under the CITL is a term introduced to increase flexibility of determination of domestic corporation in order to prevent tax evasion, which may occur in case of application of the basis of location of head office and expand tax base. It would be reasonable to deem that the place of effective management, which is a tool for determination of residence of a dual resident corporation under tax treaties and the place of effective management under the CITL, are two different concepts. Accordingly, while discussions under the tax treaties may be considered as a reference, the place of effective management under the CITL is a concept independent from the former, which takes into account a variety of circumstances.

As the Commentary of 2008 OECD Model Tax Convention provides that the residence of a dual resident shall be determined on a case-by-case basis by mutual agreement, taking into account various factors including place of effective management, place of head office, etc., rather than solely reviewing the place of effective management, the seven factors above provided under the case-by-case method may play a meaningful role in the determination of place of effective management under the CITL. In particular, the factor of whether there is a risk of the decision on residence resulting in an improper use of the tax treaty refers to the intention or purpose of tax evasion. Moreover, taking into account the fact that the basis of place of effective management under the CITL was introduced for the prevention of tax evasion, the existence of purpose for tax evasion proposed by the OECD may serve as an important factor for the determination of definition and applicable scope of place of effective management.

Since the basis of place of effective management is a comprehensive concept and the basis of location of head office is already in place, it is necessary to restrict the applicable scope to seek legal stability and predictability; in that sense, it would be safe to interpret that if there is no intent or purpose for tax evasion, the DC taxation is not applicable. However, in reality, there are many cases where inbound transaction of a foreign corporation is recognized to have purpose of tax evasion if the foreign corporation does not properly establish a PE and conducts

important business activities in Korea. However, in case of outbound transactions, if a domestic corporation holding shares in a foreign corporation gains income through the foreign corporation under certain conditions, regardless of the domestic management and control activities, such an act is subject to taxation in accordance with the CFC taxation. Therefore, it is difficult to recognize that there is a separate purpose of tax evasion in such a case. This is particularly true, as in the latter case, the tax benefit enjoyable by the domestic corporation is tax deferral at best.

3) *PE taxation and CFC taxation under domestic tax laws*

(2) Necessity of review

Domestic tax laws have the PE taxation and CFC taxation in place in order to prevent tax evasion and deferral resulting from inbound transactions of foreign corporations and outbound transactions of domestic corporations; the basis of place of effective management was introduced in 2005 through an amendment of the CITL. As all foreign corporations that have a place of effective management in Korea may be deemed as domestic corporations without the differentiation of inbound and outbound transactions based on the literal interpretation of the provision on the basis of place of effective management, the relationship with the existing PE taxation and CFC taxation is at issue. Applied with a broad sense of definition, the basis of place of effective management may result in reduced scope of application of the PE taxation and CFC taxation or overlapping application of the two taxations.

(2) Relationship between PE taxation and DC taxation

PE taxation is purposed for the taxation on domestic source business income incurred from inbound transaction of foreign corporations. If a foreign corporation establishes PE in Korea, Korean tax authorities may exercise the right to tax on the business income. However, if the residence of the foreign corporation has entered into a tax treaty with Korea, it is the general principle of international taxation that such a corporation may not be taxed in Korea as long as it does not have a PE in Korea, even if the corporation generates income through substantial business activities in Korea. Such a situation results in tax evasion on the domestic source income.

DC taxation and PE taxation are similar in terms of that the place of business serves as grounds for taxation. A typical form of PE is the location of management where business activities are conducted. The OECD Model Tax Convention and most of the tax treaties explicitly provide that place of management is included in PE.⁵⁷⁾ While a place of effective management may fall under PE, a PE may not always fall under place of effective management. A typical example of a permanent establishment would be the location of manufacturing or sales activities and place of effective management is a place where the fundamental decision-making of a corporation is conducted, including business management strategies, fundamental policies, essential income generating activities, etc. Further, PE includes locations where less important decisions are implemented.⁵⁸⁾ DC taxation and PE taxation are different in terms of the party in charge of the activities as well as contents of the activities. PE applies to all business activities, excluding secondary and supplemental activities, and does not have any particular limitation on the party in charge of the activities. DC taxations require the party in charge of the activities to be the representative director, board of directors, or other senior officers, and the contents must be important management activities. While a foreign corporation's income attributable to a PE is taxed under PE taxation, the worldwide income of a foreign corporation is taxed under DC taxation.

It is necessary to define the relationship between the two taxations and, more specifically, determine whether DC taxation is applicable to foreign corporations that are not taxed pursuant to the PE taxation. Some say that judgment on the application of the two taxations shall be made separately by taking into account different taxation requirements. In this case, a foreign corporation may be taxable under the DC taxation even when the PE taxation is not applicable.

However, DC taxation has the minimum requirement of meeting the tax requirements of a PE, due to which it appears to be unreasonable to apply

57) Commentary on Article 5 of the OECD Model Tax Convention, Paragraph 2, Korea-UK Tax Treaty, art. 5(2), Korea-Germany Tax Treaty, art. 5(2), Korea-Japan Tax Treaty, art. 5(2). (However, Korea-US Tax Treaty, art. 9(2) does not include place of management in the scope of permanent establishment.)

58) Hae-Ma-Joong Kim, *Ibid.*, p. 24.

DC taxation on a foreign corporation which is not subject to PE taxation. Based on the fact that a foreign corporation may pay taxes only on its income attributable to its PE if it has a PE, while the corporation may have to pay taxes on its worldwide income if the place is determined to be a place of effective management, the forgoing interpretation is rational and systemic. It is illogical to say that a foreign corporation not subject to lower taxation is subject to a higher taxation. Therefore, the requirements for a PE—that is, a place of business must exist, the place of business must be fixed, business should be conducted through the place of business, and the business should not be secondary or supplemental—are objective requirements that must be satisfied for the application of place of effective management.

(3) Relationship between CFC taxation and DC taxation

CFC taxation is purposed to tax overseas source income incurred from outbound transactions of domestic corporations. If a domestic corporation gains foreign source income from a foreign place of business, such income may be taxed as worldwide income, but if the corporation earns income through a foreign corporation, such foreign source income may not be taxed unless the income is distributed to the domestic corporation as dividends. In such a case, tax deferral of foreign source income occurs.

While control and management activities and the place of management of a domestic corporation are not requirements for the application of CFC taxation, as the control and management activities on CFC is likely to be conducted at the place of business of a domestic corporation which is its shareholder, it is similar to DC taxation. However, the party responsible for management and control activities is the domestic corporation, which is the shareholder of the foreign corporation under the CFC taxation, whereas such a party is the representative or the board of directors of the foreign corporation in the case of DC taxation. In case of the CFC taxation, the foreign corporation that gains passive-type income with application of low tax rate locally is subject to taxation on the income of deemed dividends of the domestic corporation, whereas in the case of DC taxation, the foreign corporation is directly subject to taxation on its worldwide income.

It is necessary to determine the relationship between the CFC taxation and DC taxation and understand whether DC taxation is applicable to a

foreign corporation not subject to the CFC taxation. Some argue that the two taxations are independent of each other as they have different requirements for taxation. In other words, the CFC taxation is applicable to a foreign corporation and yet if it is recognized that the place of effective management is in Korea, the corporation is deemed a domestic corporation that is not subject to CFC taxation.⁵⁹⁾ DC taxation is applicable without the consideration of the purpose of legislation of CFC taxation; according to this view, determination on application of DC taxation shall take place first and application of the CFC taxation shall follow. On this basis, taking into account the fact that CFC taxation typically applies to paper companies that do not conduct any local business activities and gain income in a passive manner, in case the application of CFC taxation is an issue, DC taxation may apply in advance and, depending on the case, it may also be applicable to a foreign corporation that is not subject to the CFC taxation.

However, it is unreasonable to apply the DC taxation in advance in a case where the CFC taxation is applicable or apply the DC taxation on a foreign corporation not subject to CFC taxation. In principle, under the domestic tax law, the domestic tax authority does not have the right to tax overseas source income and partial income, as passive income may be taxed in a restricted manner pursuant to the CFC taxation; such taxation is aimed not directly at the foreign corporation but at the domestic corporation, which is the shareholder of the foreign corporation. Therefore, it is logically unacceptable to tax the worldwide income of a foreign corporation, which is not subject to the CFC taxation, by deeming it as a domestic corporation. According to an opposing interpretation of the CFC taxation, it may be understood as an intention to not exercise its right to tax on foreign corporations that are not subject to the taxation. Taking this into account, unless there are any special circumstances, if the concept of DC taxation competes with CFC taxation, it would be reasonable to interpret that CFC taxation shall supersede and that DC taxation is not applicable to a foreign corporation if it is not subject to CFC taxation.

59) Sang-Woo Lee, *Problems in the Treatment of Taxation on Foreign Corporations*, Journal on Special Act Vol. 12, 2015, pp. 306-307.

4) Place of effective management as a supplemental basis of determination of domestic corporation

Since place of effective management is an indefinite concept, considering it as an independent basis of determination of domestic corporation under a circumstance where the basis of location of head office is already in place under the CITL may greatly infringe legal stability and predictability. Therefore, it is necessary to restrict the applicable scope in accordance with the systemic interpretation of tax laws and domestic tax laws.

First, the intent or purpose of tax evasion proposed as a basis of determination of residence on a case-by-case basis under tax treaties may be considered for the restriction of applicable scope of place of effective management for inbound or outbound transactions. Moreover, the tax requirements for PE taxation and CFC taxation shall be considered necessary conditions for the application of DC taxation. Therefore, if CFC taxation and PE taxation are not applicable, it should be deemed that DC taxation is also not applicable; moreover, application of PE taxation and CFC taxation shall supersede application of DC taxation, and DC taxation may only apply when there are additional circumstances to consider.

Taking into account the fact that an overly wide definition of a domestic corporation through the exaggerated interpretation of place of effective management may result in unnecessary conflict in the right to tax as foreign corporations may be classified as domestic corporations, it is necessary to restrict the applicable scope of place of effective management. While an expanded interpretation of the concept of place of effective management may contribute to increased tax revenue, in the long-term, it may not be beneficial to the national interest of Korea as it may result in significant infringement of legal stability and predictability of inbound investments of foreign corporations. Therefore, it is desirable to understand the basis of place of effective management as a basis for supplementing the basis of location of head office.

4. Basis of the Judgment on place of effective management under the CITL

1) Determination of the judgment standard

Under the CITL, a place of effective management indicates the place

where key management and commercial decisions that are necessary for the conduct of a corporation are made. A place of effective management as a concept must be limited in its applicable scope from the perspective of a supplementary basis of domestic corporations and, in this regard, must at least satisfy the requirements for PE taxation and CFC taxation. Further, it requires, as an additional basis of judgment, intent/purpose of tax avoidance and evasion, which is one of the factors in the tax treaty that determine the country of residence by issue.

The activities of a corporation are identified by several factors. To determine the activities that constitute a place where key management or commercial decisions necessary for conducting businesses of a corporation are made in substance, the subject of management, content of management, and place of management should be objectively reviewed, while the corporation's intents and objectives should be reviewed subjectively. While taking these overall circumstances into consideration, from the perspective of a supplementary basis, the specific basis of judgment for a place of effective management can be divided into an objective basis and a subjective basis. The objective basis of judgment includes a subject of management, content of management, and place of management, all of which, at minimum, need for the requirements for PE taxation and CFC taxation to be satisfied, while an intent/purpose of tax avoidance and evasion contemplated under the OECD Model Tax Convention is required as the subjective basis of judgment.

2) *Objective basis of judgment*

(1) Substantive judgment

Subject of management, place of management, and content of management, all of which are an objective basis of judgment on place of effective management, should be judged in substance. The objective of judging the subjective, place, and content of management in substance is to primarily consider the actual factual relations rather than the details of laws, articles of incorporations, agreements, and other documents.⁶⁰⁾ Should there be a person functioning as a representative in substance apart

60) Gwang-Jin Chung, *Ibid*, p. 112.

from one existing in name, he or she should be judged as the subject of management. A place of management does not mean a registered location, given that a place that is actually in use is where the importance lies.

(2) Subject of management

The place and content of management can be judged only after the subject of management or who the manager is, is determined. There are two views with regard to who should be deemed the subject of management: one that views the board of directors as the subject of management and another that views the representative director as the subject of management. Given that Korea adopts a board of directors-oriented corporate governance structure by setting forth the board of directors as the final decision-making body of a stock company (*Jusik Hoesa* in Korean) in principle,⁶¹⁾ the board of directors is the subject of management. However, where a corporation’s decision is in substance made by a person (i.e. representative director, controlling shareholder, etc.) other than its board of directors pursuant to articles of incorporation or substance of operations and its board of directors only confirms such decisions, then other considerations may be made as an exemption.⁶²⁾ The same applies where the representative director or the chief executive officer is deemed the subject of management. In other words, a subject of management can be determined based on who decides the content of management. Ultimately, a subject of management can only be determined by comprehensively taking into account the corporation’s articles of incorporation, decision-making process, content of management, etc.

In the case of PEs, not only the board of directors or the representative director, but all officers and employees of a foreign corporation are the subjects of acts that constitute a PE. Depending on the case, not only officers and employees of a foreign corporation but also the employees of other affiliates and transaction counterparties can be such subjects as well. For CFC taxation, the subject of acts would mostly be the officers and employees of a domestic corporation holding shares in a foreign corporation. In cases where CFC taxation applies, the domestic corporation,

61) KCC, art. 393.

62) Gwang-Jin Chung, *Ibid*, p. 113.

being the subject, is subject to taxation on the deemed dividend and is required to hold a certain percentage of shares.

(3) Content of management

The content of management refers to the key management and commercial decisions that are necessary for the conduct of a corporation's business. The National Tax Service considers the content of management at its highest level, deeming it necessary to comprehensively take into account relevant facts and overall circumstances such as the location where the meetings of the board of directors are held, the location where the corporation's final decisions are made, and the objectives of the investment structure.⁶³⁾ This is comparable with PEs, in that the activities of PEs are key and material activities and those that are preliminary or supplemental do not constitute PEs. For CFC taxation, such activities would be considered the management activities of a domestic corporation that is a shareholder.

In terms of theory, it is not easy to judge what activities constitute content of management which is an objective basis of judgment. The issue is to determine the point up to which should be viewed as key management, when a corporation's content of management varies in form, ranging from the highest level of decision-making to normal management duties.

Common law countries such as the UK, which view important management and control as content of management, prioritize the highest level of decisions in business, including business strategies and fundamental policies. On the other hand, continental law countries, such as Germany, assume a different position and focus more on normal management rather than strategy and policy decisions. However, given that the UK reportedly heavily weighs not only on business strategies but also on the sales and lease of real estate,⁶⁴⁾ and continental law countries deem management activities to include material, normal management activities that are accompanied by risks,⁶⁵⁾ there is barely any substantial

63) *Seomyun2team-2316*, December, 20, 2007.

64) Robert Couzin, *Corporate Residence and International Taxation*, International Bureau of Fiscal Documentation, 2002, p. 59.

65) Min Park · Kyung-Bong Ahn, *Ibid.*, pp. 169-170.

difference.

Another view divides a corporation's level of management and control into three sub-categories of strategic management—actual management to implement strategic management, supervision of day-to-day sales activities, and from thereon provides actual management as *de lege ferenda* for basis of determination of residency.⁶⁶⁾ Yet, other than strategy and financial issues of a corporation, it is difficult to specifically list the important content of management. Furthermore, as key factors of the conduct of business differ on the basis of the nature of such business, they should be determined case by case.⁶⁷⁾

Considering all of the above, key management generally refers to the decisions relating to long-term company strategy, fundamental policies, corporate finance, and management and disposal of major properties, while commercial decisions refers to income generation.⁶⁸⁾

(4) Place of management

(a) Locational requirement of a PE and the meaning of place of management

A place of management means the location where a subject of management conducts management. Examples would be a place where board of directors' meetings are held or the office of a controlling shareholder/representative director. A place of management must satisfy the required elements to constitute a PE. To be a PE, the place must be fixed and be where business is wholly or partly conducted. A place of business is a place for a foreign corporation to conduct business in Korea and such place does not necessarily need to be owned but must be occupied or used by the foreign corporation. Business means profit activities that are independently and continuously conducted at one's own risk and calculus. Non-profit activities, subordinate activities, and one-time activities do not

66) Robert Couzin, *Ibid*, p. 58.

67) Gwang-Jin Chung, *Ibid*, p. 114.

68) Robert Couzin, *Ibid*, p. 59; Jae-Ho Lee, *Basic Concept and Determining Factors of Place of Effective Management Under the Corporate Income Tax Act*, Journal of IFA Korea, Vol. 31, No. 1, International Fiscal Association Korea, 2015, p. 302.

constitute a business. The permanency of a business place is a time-based concept. A business place must have a certain level of continuity and where it is only temporary or maintained for a short period of time, the permanency requirement would not be satisfied.⁶⁹⁾ The permanency requirement should be deemed to apply to not the place itself but rather the use of such a business place.⁷⁰⁾ While the OECD sets out six months as the standard for the locational consistency of a PE, in practice, it has been shown that the period where such consistency is acknowledged differs on the basis of the business and country.⁷¹⁾ Furthermore, a foreign corporation's business must be wholly or partially operated at its business place. Business activities are not required to be operated by employees, and it makes no difference whether service is provided through various equipment.⁷²⁾ A place of management under the basis of the place of effective management must at least satisfy such requirements for the place of a PE.

Further, a place of effective management can be deemed as the location where meetings of the board of directors or any other meetings of an equivalent decision-making body is held, a location where the chief executive officer and other officers perform their normal daily duties, where senior managers perform their day-to-day management duties, where accounting records are normally recorded and kept, etc. The location where accounting records are recorded and kept can also be deemed as a place where key management and commercial decisions are made. Accounting records mean the records on income and expenditures or accounting books. Since these accounting records are prepared concomitant to business operations at the place where such business operations take place, it may also follow as an indirect fact that key management occurs at their keeping place.⁷³⁾ According to some, if the locations of recording and storage are different for accounting documents, it is difficult to presume a place of effective management solely by the circumstance of being the

69) Commentary on Article 5 of the OECD Model Tax Convention, Paragraph 28.

70) Arvid Aage Skaar, *Ibid.*, p. 190.

71) Commentary on Article 5 of the OECD Model Tax Convention, Paragraph 28.

72) Kyung-Geun Lee · Deok-Won Seo · Beom-Joon Kim, *Ibid.*, p. 490.

73) Chang Lee, *Ibid.*, p. 245.

keeping place.⁷⁴⁾ However, as past accounting materials can be of good use for management, the storage location of such materials can be a factor to judge the place of management.

Where a corporation's highest level of management function is operated at multiple domestic and foreign locations, it becomes an issue whether it is possible to acknowledge two or more places of effective management. In such cases, some say that it is reasonable to recognize the existence of a domestic corporation, as it is sufficient to judge the place of effective management by taking into account the domestic circumstances under the CITL, and if multiple places of effective management are recognized at domestic and foreign locations, the residence of dual resident shall be determined by mutual agreement; therefore, there is no need for Korea to limit the applicable scope of domestic corporation in advance.⁷⁵⁾ However, a place of effective management is grounds to accrue unlimited tax liability and, thus, even if a corporation were to carry on its management activities through multiple domestic and foreign locations, it would be inadvisable to acknowledge the domestic place of management as the place of effective management. When comparing the importance of managerial activities with those conducted through a place of management overseas, if such a place of management overseas conducted more material management activities, then a such place should be acknowledged as the place of effective management.

There may be difficulties in determining a place of management if the subject of management made decisions in writing or in electronic form. In such cases, the residence of the subject of management has to be determined as the place of management,⁷⁶⁾ but such residence of the subject of management is not required to be the residence prescribed in the tax laws.⁷⁷⁾ However, the residence of the subject of management has a strong nature as a basis of determining the individual's residence, and while the true intent of the subject of management is immaterial to a corporation's

74) Gwang-Jin Chung, *Ibid.*, p. 118.

75) Gwang-Jin Chung, *Ibid.*, p. 115.

76) Ekkehart Reimer ·Alexander Rust, Klaus Vogel on Double Taxation Conventions, 4th edition, Walters Kluwer, 2015, p. 262.

77) Gwang-Jin Chung, *Ibid.*, p. 117.

decision, certain formats and public announcements are required. Therefore, it is reasonable to judge a corporation's place of management to be where such intent is expressed in accordance with legal procedures, objectified and mailed, or kept in written or electronic form, rather than on the basis of an individual's residence.

(b) Consistency of place of management and transfer of place of management

A place of effective management is a concept that is founded upon the premise that, even if historically a place of business was frequently relocated, a location where management functions were performed is rarely moved. This means that management is normally conducted in a consistent manner at a particular location. For a place of business to be acknowledged as a PE, it is required to be "fixed" and, accordingly, DC taxation would also obviously require such consistency in management. The premise here is that the conduct of management activities fundamentally requires a durable relationship between the corporation's human resources and physical facilities. A location where some number of decisions was made by the chief executive officer cannot be deemed the place of effective management.

That is not to say a place of effective management is definitive; it can be transferred. The question then becomes what underlying facts are necessary to deem a place of effective management transferred. If a corporation's subject of management conducted business moving from one location to another, to the point of weakening the subject of management's relevance to the place where material decisions relating to the corporation's business were made, then the place of effective management should be deemed to have moved.

However, even if a subject of management temporarily relocates for personal reasons, a corporation's place of management cannot be deemed accordingly transferred. Other factors that constitute the corporation should be comprehensively taken into account for judgment. Given that a place of effective management is where material decisions related to the business of a corporation are made in a fairly consistent manner, the [location's] nature, as such place, must be at the point of not just being weakened but discontinued. It is in this regard that, once a place of effective management is established, special circumstances are subsequently

required to acknowledge the discontinuance of the place of effective management and, thereby, its transfer.

3) Subjective basis of judgment

An intent/purpose of tax avoidance and evasion is required to acknowledge a place of effective management. The reference made in the Commentaries on the OECD Model Tax Convention to possibility of raising risk of inappropriate utilization of tax treaties by determining a corporation under a tax treaty as a resident of one contracting state but not of the other is an indirect expression of whether the objective/purpose of tax avoidance and evasion exists. Here, an objective/purpose of tax avoidance and evasion refers to avoidance and evasion of Korean taxes. It would be difficult for domestic tax authorities to judge an avoidance and evasion of foreign taxes, and even if there were any, it would barely constitute grounds for applying DC taxation. In fact, it is difficult to bring forth any cases where there were avoidance and evasion of foreign tax in the acts of foreign corporations to evade DC taxation.

5. Whether the plaintiff's place of effective management is in Korea

1) Summary of issues

As a standard of place of effective management, a subject of management, content of management, place of management, and objective/purpose of tax avoidance and evasion are required. Where the board of directors or the representative director would be deemed as a subject of management, in this case, the board of directors made its resolutions in writing and the directors resided in different countries, such as Singapore, US, and Korea. Further, given that the size of the board of directors was not large and the company was more of a closely held corporation mainly operated by the majority shareholder A, it is difficult to deem the board of directors as actively functioning. Then, regardless of whether the subject of management is focused on the board of directors or the representative director, ultimately representative director A becomes the subject of management and the content and place of management are the main issues. The question is, how to understand the details of e-mails, reports, etc. of the plaintiff's employees who executed A's instructions in

the course of purchasing or collecting the CB or the CB collection activity.

Specifically, the discussion surrounds i) whether to include management and decisions of the CB collection activity in the content of management; ii) whether to deem Korea as the place of management activity when business instructions and reports were made and received through e-mails and other methods from Korea and overseas; and iii) whether the plaintiff has purposes of tax avoidance and evasion.

2) *Positive view*

Positive view is the viewpoint that, although incorporated in Singapore, the plaintiff has its place of effective management in Korea in light of the following circumstances. It is also what is argued by the tax authority.

(1) Content of management

Not only the purchasing activities but also the collection activities are fundamental and material to the plaintiff's investment business in the CB, and it was Korea where key management and commercial decisions were made in relation to the collection activities. In other words, the CB includes convertible bonds and bonds with warrants, which are not ordinary bonds. For such bonds, business decisions made in the course of their collection are extremely important because the bond collection outcomes differ on the basis of how share acquisition rights are exercised and disposed.

(2) Place of management

The place where purchase-related management activities, such as decision-making for the CB purchase activity, were conducted is in part abroad, but in whole, Korea. In other words, the plaintiff's representative director A is the plaintiff's final decision making body. In 2008 and 2009, A stayed in Korea for an extended period and made key management and commercial decisions that were necessary to the conduct of the plaintiff's CB investment business in Korea. The plaintiff's employee is the plaintiff's managing director in charge of finance, who stayed in Korea for an extended period in 2009 and executed the CB investment business, in substance.

In this case, a part of the material decisions regarding the CB investment were made overseas, and it is difficult to determine the plaintiff's place of

effective management on the basis of where A actually made decisions. Wholly considering the legislative intent underlying place of effective management, Korea should be deemed the place of effective management for this case, as it is the place where the plaintiff's material business was conducted and in which A regularly stayed in 2009. Furthermore, the place where A's Korean office was set up (i.e. the office of the Company D) should be deemed as the place of effective management in this case, unless there are special circumstances that indicate otherwise.

In 2009, the plaintiff did not perform any business other than the CB investment business, and the Singapore office was used only for living purposes by A's son. None of the plaintiff's officers and employees was permanently stationed in Singapore. As a result, in 2009, Singapore could no longer be considered the place of effective management, or it can be said that its nature as the plaintiff's place of effective management weakened.

(3) Objective/purpose of tax avoidance and evasion

The plaintiff did not pay any taxes to any country on the income accrued from the CB investment by reporting the profits accrued from the CB investment as one-time capital gains from transfer of bonds in Singapore, thereby being exempt from taxation while simultaneously being exempt from paying corporate tax on the interest gained on foreign currency denominated bonds as a foreign corporation in Korea.

3) *Negative view*

Negative view is the position that the plaintiff's place of effective management does not exist in Korea. It is the view of the court judgment. The following reasons are provided in this regard.

(1) Content of management

The bond-purchasing activities are fundamental and material to the CB investment business. That the HK branch obtained investment information that would allow for the said branch to acquire the CB put on the market for urgent sale to non-residents and then purchased the CB at a considerably low price is the part that is fundamental and material to the CB investment. The collection of the CB purchased by the plaintiff is a simple activity that is rather mechanical and repetitive.

(2) Place of management

It cannot be categorically stated that the place where the meeting of the plaintiff's board of directors or such equivalent organization convened was in Korea. Of the three people on the board of directors, the remaining two persons, excluding B, are not residents of Korea; moreover, throughout 2009, the plaintiff's board of directors never convened in Korea, being only held through e-mails exchanged among board members. Given that such e-mails were sent from in and out of Korea, the plaintiff's board of directors should be deemed to be held at home and abroad.

The place where the plaintiff's representative director normally performed activities is also not in Korea. A moved overseas several times, and in that process, gave instructions or received reports in relation to the purchase of the CB via e-mail. In or around September 2009, A's office was set up in the office of Company D, but by then most of the CB collection activities were closed.

The location where accounting documents are stored is not in Korea. Only materials related to the CB is stored at the office of Company D, and there is no evidence proving that any other accounting documents are stored in Korea.

It is difficult to deem solely from the purchase and collection activities of the CB that the plaintiff's place of effective management was moved to Korea from its previous place in Singapore. The purchase and collection activities of the CB were operated from January 2009 to around September 2009. It is difficult to deem this period as having the consistency of locations of a head office or a principal office. In 2009, the plaintiff operated a variety of businesses other than the CB investment business, such as an energy-related business in Kenya as well as real-estate investment businesses in the US and Singapore; therefore, it is difficult to deem its relevance to Singapore, due to the discontinuation of the operation of the CB business in Korea.

(3) Objective/purpose of tax avoidance and evasion

The plaintiff bore the securities transaction tax and interest income tax in Korea, and the plaintiff, not Company D, acquired the CB because the HK branch limited the qualification for bond acquisition to non-residents. Therefore, it is not acknowledged that the plaintiff had the objective/

purpose of tax avoidance and evasion.

6. The meaning and evaluation of the Judgment

The Judgment clarifies the meaning of a place of effective management, which separates domestic and foreign corporations, where key management and commercial decisions necessary to the business operation of a corporation is made. As the basis of such Judgment, the Court specifically ruled that the above key management and commercial decisions refers to the decisions and management related to a corporation’s long-term business management strategies, fundamental policies, corporate finance and investment, management and disposal of key properties, essential income-generating activities, etc. Furthermore, setting forth the place of effective management of a corporation to be the location where meeting of the board of directors or any other meeting of equivalent decision-making body is held, location where the chief executive officer and other officers perform their normal daily duties, location where high-level managers perform their normal management duties, and location where accounting documents are normally recorded and stored, the [Judgment] deemed as the subjects of management the board of directors, the chief executive officer, and other officers, and the location where such subjects of management perform their daily duties was deemed to be the place of management, and that the place of management requires a certain level of consistency in terms of time and location. With regard to transfer of place of effective management, the Judgment identified the limitation of such transfers by acknowledging them only in cases where there are special circumstances to deem that the corporation no longer relates to its previous place of effective management.

The Judgment is the first precedent to explicitly declare abstract legal principles and a basis of judgment for a corporation’s place of effective management. In other words, the Judgment provided specific requirements for the basis of judgment of a place of effective management (i.e. subject of management, place of management, and content of management), and further required that place and content of management be consistent in terms of time and location. The Judgment bears significant meaning in the sense that it deemed the strict standard of disconnection from a previous

place of management to be necessary in order to determine a foreign corporation that had a place of effective management in a foreign country to be a domestic corporation. In particular, the Judgment is reasonable in its ruling that maximum prudence is required in determining a corporation established in a foreign country as a domestic corporation on the grounds of place of effective management; as such determination infringes upon the tax payer's legal stability and predictability as well as result in disputes among countries for the right to tax.

However, the Judgment does not explicitly determine the more fundamental problem, that is, what would be a reasonable way to view the relationship with the place of effective management principle.⁷⁸⁾ As mentioned earlier, in light of the systematic interpretation of the PE taxation and CFC taxation under Korean tax laws, it is reasonable to deem the basis of place of effective management as falling under supplementary basis for determining the location of a head office. The supplementary nature of the place of effective management principle could be indirectly inferred from the Judgment, but where such legal nature added to the Judgment, the Judgment would have been more meaningful. Further, in light of the Judgment referring to circumstances such as the plaintiff's tax payments in Singapore, the Judgment appears to have taken the tax evasion intent as consideration; however, the ruling on the tax evasion purpose should be supplemented as it was not a specific basis.

IV. Conclusion

The place of effective management under the CITL is a general concept, the applicable scope of which has been an issue raised since its introduction. The discussion arises from the foreign corporation taxation system under Korean tax laws, that is, the comparison and analysis of PE taxation and CFC taxation. With regard to the interpretation of general

78) From the opinion that it is reasonable to prioritize on the basis of location of head office, excluding cases with an objective/purpose of tax avoidance and evasion and other special cases, Yeong-Jun Jeon and Soo-Hyeon Seong, *Basis of Judgment on Place of Effective Management and Offshore Services*, Taxnet, 2016.

taxation provisions, in cases where the respective issues were whether gains in futures trading of JPY denominated deposits fall under interest earnings under the income tax law, the Supreme Court limited the applicable scope of the general taxation provisions through relevant provisions and systematic interpretations. In such case, the Supreme Court deemed that the applicable scope of the “catch-all” taxation provision on interest earnings are generally defined, but inapplicable to foreign currency trading profit, given that trading profit from bonds or securities is listed as one of the interest earnings and cannot be deemed similar to trading profit from bonds or securities. Further research and analysis will accumulate and hopefully provide a specific basis of judgment that takes into account the legal meaning of a place of effective management and its relationship with the foreign corporation taxation system.

