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NEWSLETTER

TAX Group

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Reporting Obligations for Foreign Financial Accounts and the Tie-Breaker Rule under Tax Treaties

••• Recent Legislative and Judicial Developments

As tax transparency initiatives gain momentum and tax authorities enhance their oversight of offshore assets, the obligation to report foreign financial accounts has become a key compliance requirement that taxpayers must understand and adhere to.

This newsletter provides an overview of the reporting obligation for foreign financial accounts, its interaction with the tie-breaker rule used to determine residency under tax treaties in cases of dual residency, and key takeaways from a recent Supreme Court decision on the matter.

1. Reporting Obligation for Foreign Financial Accounts and the Tie-Breaker Rule under Tax Treaties

1) Overview of the Reporting Obligation for Foreign Financial Accounts

The obligation to report foreign financial accounts requires Korean residents and domestic corporations to report their account information to the district tax office if they hold foreign financial accounts exceeding a certain threshold. This reporting regime was introduced to broaden the tax base and enhance revenue collection (Supreme Court Decision 2019Do11381, March 12, 2020). As this obligation requires taxpayers to provide relevant information to the tax authority, it is regarded as a duty of tax cooperation, distinct from the obligation to pay taxes. Particularly under Korean tax law, which imposes tax on the worldwide income of residents and domestic corporations, the foreign financial account reporting obligation serves as a critical tool in identifying and verifying global income.

Under the Law for the Coordination of International Tax Affairs (**LCITA**), taxpayers are required to report the details of their foreign financial accounts to the National Tax Service (**NTS**) by the end of June of the following year, if the total balance of such accounts exceeds KRW 500 million on any last day of a given month during the relevant year. A foreign financial account refers to an account opened with a foreign financial institution for purposes such as banking, securities transactions, derivatives trading, or virtual asset transactions. Notably, in the case of jointly held accounts (e.g., with a spouse), each account holder is individually obligated to report.

2) Legislative Developments

Since its initial implementation in 2011, the foreign financial account reporting obligation has undergone several revisions to address interpretive uncertainties and administrative challenges. Notable amendments include the lowering of the reporting threshold from KRW 1 billion to KRW 500 million starting with the 2019 reporting year, thereby expanding the reporting scope. Beginning with the 2020 reporting year, individuals who directly or indirectly own 100% of a foreign corporation are required to report accounts held in the name of that corporation. From 2021, a cap on penalties was introduced, limiting them to KRW 2 billion per year, whereas previously there was no limit. Most recently, the scope of exemptions from the foreign financial account reporting obligation was expanded to include individuals or entities "recognized as residents of the other contracting state under a tax treaty" (Article 54(7) of the LCITA). This exemption, newly enacted on December 31, 2024, applies to accounts held during tax years or fiscal years beginning on or after January 1, 2025. In effect, even if a taxpayer is classified as a resident or domestic corporation under Korean domestic law, they will be exempt from the reporting obligation if they are determined to be a resident of the other contracting state under the relevant tax treaty. The following section provides a more detailed explanation of the scope and meaning of this new rule.

3) "Persons Recognized as Residents of the Other Contracting State under a Tax Treaty"

The residency determination standard for dual residents — referred to as the 'tie-breaker rule'—or entity qualifies as a resident under the domestic laws of bothapplies when an individual contracting states. For example, an individual may have a permanent address in one country while staying in another country for 183 or more days, or a corporation may be incorporated in one country but have its place of effective management in another. In such cases, the individual or entity may be considered a dual resident and potentially subject to double taxation on the same income. To mitigate this, tax treaties include tie-breaker provisions that assign residency to one country for treaty purposes.

Most of Korea's tax treaties follow the OECD Model Tax Convention's Article 4(2) for individuals, which determines residency using the following hierarchy: (i) permanent home, (ii) center of vital interests, (iii) habitual abode, (iv) nationality, and (v) mutual agreement between the two states if none of the above apply. For entities, most of Korea's tax treaties deem the residence to be the state in which the place of effective management is located. In cases of uncertainty, residency is determined through mutual agreement between the contracting states.

A longstanding issue has been whether the tie-breaker rule under tax treaties can be applied to the obligation to report foreign financial accounts. Proponents argue that since the reporting obligation is imposed on residents, the tie-breaker rule should apply to dual residents when determining reporting obligations. Opponents counter that the purpose of tax treaties is to avoid double taxation on income, and since the foreign financial account reporting obligation is not directly related to income taxation, the tie-breaker rule should not apply, even in cases of dual residency.

2. The Position of the Recent Supreme Court Decision (Supreme Court Decision 2024Ma6881, April 17, 2025)

In a recent decision, the Korean Supreme Court addressed the relationship between the tie-breaker rule under tax treaties and the domestic obligation to report foreign financial accounts. The case involved a Korean national, Mr. K, who was a dual resident of Korea and Singapore, but was ultimately determined to be a resident of Singapore under the Korea–Singapore tax treaty's tie-breaker rule. Based on this treaty-based residency determination, Mr. K did not report his foreign financial accounts held during the years 2015 through 2019 to the Korean tax authorities. The NTS imposed penalties for non-compliance with the reporting obligation. The first instance court ruled in favor of the taxpayer, holding that where an individual is recognized as a resident of the other contracting state under a tax treaty, it is appropriate to exempt that individual from the reporting obligation under Korean domestic law (Seoul Central District Court Decision 2022Ra759, June 24, 2024). In other words, individuals such as Mr. K, who are considered residents of the other contracting state under a tax treaty, do not fall within the scope of "residents" subject to the reporting obligation, and thus cannot be penalized for non-compliance.

However, the Supreme Court reversed the lower court's decision and held that the imposition of the penalties for violating the foreign financial account reporting obligation was valid (Supreme Court Decision 2024 Ma6881, April 17, 2025). The Court reasoned as follows:

(i) Under the LCITA, the reporting obligation applies to individuals who qualify as residents under the Individual Income Tax Law. Unless the LCITA expressly provides otherwise, individuals recognized as residents of the other contracting state under a tax treaty are not automatically exempt from the reporting obligation if they also meet the definition of a resident under domestic law;

(ii) The tie-breaker rule under the Korea–Singapore tax treaty is intended to resolve cases of double taxation relating to income taxes. Its application is therefore limited to such cases and does not extend to reporting obligations that are unrelated to the taxation of income; and

(iii) Although Article 54(7) of the LCITA–newly enacted on December 31, 2024–provides that "a person recognized as a resident of the other contracting state under a tax treaty" shall be exempt from the reporting obligation, this provision applies only to foreign financial accounts held during tax years beginning on or after January 1, 2025. The Court viewed this as a newly established (i.e., constitutive) rule without retroactive effect.

Based on these grounds, the Supreme Court overturned the lower court's ruling and remanded the case for further proceedings.

3. Takeaways

The recent Supreme Court decision (Supreme Court Decision 2024Ma 6881, April 17, 2025) clarified that the tie-breaker rule under tax treaties, which is used to determine residency in dual-residency cases, cannot, on its own, serve as a legal basis for exemption from Korea's domestic tax compliance obligations. This decision offers important guidance for future cases involving similar issues.

As discussed above, the current LCITA includes a newly enacted provision–effective as of December 31, 2024–that exempts individuals recognized as residents of the other contracting state under a tax treaty from the obligation to report foreign financial accounts. However, this exemption applies only to accounts held during tax years beginning on or after January 1, 2025, and will therefore apply for the first time to reports due in 2026. Accordingly, for prior reporting years–including those for which reports are due in 2025 – the Supreme Court's interpretation remains valid.

In light of the Supreme Court's decision, it is now clear that a mere assertion of treaty residency under the tie-breaker rule does not exempt taxpayers from Korea's reporting obligations for foreign financial accounts held in pre-2025 years. Taxpayers who omitted such reports based on dual residency claims may now face legal exposure, including penalties. It is therefore critical to promptly assess any potential risks and take appropriate corrective action. The LCITA provides penalty mitigation mechanisms designed to encourage voluntary compliance. Depending on the circumstances–such as whether a taxpayer files a corrected return or voluntarily discloses the omission later–penalties may be reduced by up to 90%.

Given the rapidly evolving legal landscape, continued monitoring remains essential. Since its inception, the foreign financial account reporting regime has been amended multiple times, with changes affecting reporting thresholds, asset scope, and penalty limits. Most recently, the regime has been updated to reflect treaty-based considerations. Further changes are possible, especially in light of global trends toward increased tax transparency. Taxpayers holding foreign financial assets are strongly advised to stay abreast of relevant developments and take proactive measures.

The Tax Group at Lee & Ko has extensive experiences advising clients on regulatory developments and associated risks. We provide comprehensive services, including former compliance reviews and legal risk assessments for clients with offshore assets. We encourage you to take this opportunity to review your compliance status and, where necessary, take proactive steps to avoid unnecessary penalties or legal disputes.

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