



Korean Tax Update

Samil Commentary

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NTS Audit Direction for the Second Half of 2022

After the inauguration of the new Commissioner of the National Tax Service (NTS), the National Tax Administration Reform Committee held its first meeting on September 21 to discuss three key agenda items of national tax administration. They included operational plans for tax administration, directions of NTS audits and measures to enhance the transparency and accountability of tax assessments. Regarding the directions of NTS audits, the following points were discussed.

- Considering the complex economic situation and the resurgence of the COVID-19 pandemic, audits of taxpayers will be scaled back to 14,000 cases in 2022. The total number of tax audits decreased from 16,008 in 2019 to 14,190 in 2020 and 14,454 in 2021.
- To alleviate burdens on taxpayers and assist them stay more focused on their business activities, the predictability of tax audits will be improved. Under the plans, the proportion of periodic tax audits (vs non-periodic audits) will be increased to 63% in 2022, compared with an average of 62.8% for the years of 2020 and 2021 during the pandemic, and an average of 56.7% for the years of 2015-2019 prior to the pandemic. The proportion of simplified audits primarily conducted in the form of a desk audit will be raised to 20% of audits on individual and corporate taxpayers in 2022, compared with an average of 18.8% for the years of 2020 and 2021 during the

pandemic, and an average of 14.8% for the years of 2015-2019 prior to the pandemic. This seeks to lower the burden of audits undertaken for small and midsize taxpayers.

- For simplified audits, a new scheme will be introduced to allow small and midsize taxpayers to list three options of audit timing in order of preference. This will enable a taxpayer to select a preferred timing for a tax audit to be undertaken by tax auditors.
- In a bid to strengthen the transparency and accountability of tax assessments during the course of tax audit (from the start, proceeding through to completion), a task force will be formed to promote the due process and appropriate assessment.
- The NTS will focus its audit capabilities on and take firm actions regarding irregular tax evasion attempts through illegal means undermining fair taxation and threatening people's livelihood, offshore tax evasion, and new forms of tax evasion schemes based on online platforms.

NTS Investigation of 32 taxpayers suspected of evading taxes through unfair competition: According to the NTS, the latest investigations targeted 32 taxpayers suspected to have engaged in illegal acts by monopolizing property development gains, abusing a higher social status, or taking advantage of legal loopholes to hand down wealth to descendants. The NTS presents three major examples of such attempts where: 1) a construction company mobilized affiliates such as paper companies to increase the likelihood of successful bids for a public housing site and transferred the site to a company controlled by a descendant of the company's owner at a low price; 2) a company's owner swindled corporate profits and assets (such as a super car, luxury residences) by exploiting a scheme which grants shareholder voting rights in proportion to the respective share ownership; 3) a company's controlling share ownership was transferred to a descendant by way of irregular capital transactions such as business restructuring implemented without proper economic reasons.

Foreign Financial Account Reporting Marks a Record High since 2018

The National Tax Service (NTS) announced that 3,924 Korean residents (including domestic companies) reported a total balance of KRW64 trillion held in foreign banks and financial institutions during 2021 by the due date (i.e. June 30, 2022), marking a record high since 2018. The reporting this year grew from the levels in 2021 by 8.5% (KRW5 trillion) and 25.4% (794) in the amount of balance and the number of taxpayers, respectively. Of particular interest was a rapid increase in the number of reporting taxpayers and the amount of balances held in individual securities accounts reported in 2022, which have grown to 1,621 and KRW15.8 trillion, an increase of 644 and KRW12.9 trillion from the prior year, respectively. This is largely attributable to the increased valuation of stocks held, as well as equity shares acquired by exercising stock options (stock purchase rights), assisted by booming foreign stock markets in 2021. By country where foreign financial accounts were held, the US and Japan took up KRW26.8 trillion and KRW10.8 trillion in the balance amount reported, respectively, accounting for 58.8% of the total reported amount.

The NTS has identified non-reporting or under-reporting cases through post-reporting verifications and tax audits, and imposed sanctions in the forms of fines, criminal charges, disclosure of personal information, etc. For non-compliance with the reporting requirements by the due date, a fine will be imposed up to 20% of the amount not reported. In case where a reasonable cause for non-reporting is not provided, an additional charge of 20% of such an amount shall be assessed.

Korea Customs Service Announced Measures to Boost the Growth of Duty Free Retail Business

The Korea Customs Service (KCS) announced on September 14, 2022 a series of measures to foster the growth of duty free retailers. They include 15 tasks in three sectors aimed at: i) enhancing the convenience of travellers; ii) supporting the business stability of duty free shops, and iii) promoting regulatory innovation to improve the competitiveness of duty free logistics.

Measures to enhance the convenience of travellers will: i) allow online purchases at duty free shops in departure and arrival halls; ii) create a delivery area to pick up duty free goods in arrival halls; iii) allow online purchases of duty free alcoholic beverages (subject to consultation with the NTS); iv) permit the purchase of duty-free goods through mobile authentication without passports presented at downtown duty-free shops; and v) ensure improved convenience for travellers when they declare and pay duties by enabling automatic calculation and mobile declaration of duties payable, if they make declaration of luggage via a mobile device.

To support stable business operations by duty free shops, the KCS will expand sales channels for duty free goods, such as open markets and virtual spaces (like metaverse), lower annual license fees paid by duty free shops and adjust the fees that duty free operators excessively pay to travel agents to attract tourists. Also, the KCS will extend the valid period for the existing policy of authorizing the sales of duty free goods in stock to domestic markets, while alleviating duties payable on domestic duty free sales.

Measures to strengthen the competitiveness of duty free logistics will: i) introduce a preliminary patent scheme where a duty free shop with a new patent can display duty free goods in the shop prior to the issuance of letters patent; ii) allow all duty free goods to be sold before being brought into duty free warehouses in order to help reduce inventory burdens on duty free retailers; iii) permit pre-departure shipment from an integrated logistics warehouse for foreigners buying in bulk; iv) establish a one-stop logistics and declaration system for duty free shops; v) allow small & midsize and mid-scale duty-free business to operate a single integrated warehouse rather than separate ones for duty free shops operated both in arrival and departure halls, and vi) allow returned duty free goods to be directly brought into an integrated logistics warehouse.

Rulings Update

Whether the denial of unfair transaction rules would apply in case of the delayed collection of construction receivable by the subcontractor from the contractor

In this case, a Korean construction company engaged in housing construction business, etc. carried out new apartment construction work subcontracted by a real estate developer ('contractor') which was its local related party. The company did not receive consideration for the construction work from the contractor within 60 days from the invoice date pursuant to the Fair Transactions in Subcontracting Act although it had completed the subcontracted construction work. A regional NTS office challenged that the construction receivable (i.e. consideration for construction work) which was not collected within 60 days should be treated as a deemed loan between the local related parties, subject to a deemed interest income calculation. As such, the regional NTS office assessed corporate income tax on the deemed interest income in the hands of the company based on the denial of unfair transaction rules. The company made a tax appeal to the NTS.

Regarding this, the NTS found that: i) it appeared that there were unavoidable circumstances behind the delayed collection of the consideration receivable, including the unexpected financial distress of the contractor caused by a large number of unsold new apartments and the cancellation of contracts due to poor quality construction; ii) even though the delayed collection of the receivable could fall under one of the events subject to the denial of unfair transaction rules (e.g. profit shifting to a related party) (as prescribed in Article 88(1)(6) or (9) of the Presidential Decree of the Corporate Income Tax Law (CITL)), it should be considered that the company as a subcontractor had to take into account the contractor's business difficulties and payment incapability in delaying the collection of the construction receivable; and iii) it would be economically reasonable for the company to strengthen the recovery of overdue receivables after the contractors' financial status improved so as to achieve the company's construction revenue increase through the efficient management of the contractors (*refer to Daebeop 89nu8095, 1990. 5. 11.*). Consequently, the NTS decided in favor of the company that it would be difficult to apply the denial of unfair transaction rules in the concerned case since the company's delayed collection of construction receivables from the contractor falls within justifiable acts in light of sound business norms and commercial transaction practice as well as reasonable economic reasons. (*Simsa-Beobin-2021-0023, 2022. 2. 23.*)

This case indicates that the NTS found it difficult in view of the economic reasons to apply the denial of unfair transaction rules to the construction company's delayed collection of construction receivables from a contractor, its local related party. There is another case where the Tax Tribunal found it difficult to apply the denial of unfair transaction rules to a dispute similar to this case (*Joshim2020jeon7787, 2021.12.13.*). It is considered necessary to refer to the Tax Tribunal case together with the NTS decision when determining whether to apply the denial of unfair transaction rules in a particular situation where a Korean subcontractor is unexpectedly forced to delay the collection of

construction receivable from a local related party contractor due to the liquidity issues of the contractor caused by the large number of unsold new apartments, etc.

Whether capital gains from the sale of a company house offered to employees for less than 10 years would be subject to additional corporate income tax

As prescribed in Article 55-2(1)(2) of the CITL (i.e. Special Treatment for Capital Gains on Transfer of Land, Building, etc.), where a domestic company sells its own house specified in the Presidential Decree of the CITL, it shall be subject to additional corporate income tax at 20% of the capital gains from the sale of the house ('additional corporate income tax'). However, additional corporate income tax on capital gains shall not be imposed on the sale of company house offered to employees, other than shareholders, for at least 10 years under Article 92-2 (2)(2) of the Presidential Decree of the CITL, among others (i.e. Special Treatment for Capital Gains on Transfer of Land, Building, etc.).

This case concerns a taxpayer which had sold its own house offered to its employee for less than four years in August 2019 after acquiring the house in January 2016 and failed to pay additional corporate income tax on the capital gains from the sale of the house in 2019. In this case, the taxpayer argued that although it sold the company house which had been provided to the employee for less than four years, the sale of the house was made not for the purpose of taking capital gains therefrom but for providing the employee with a larger company house being purchased with the proceeds from the sale of the smaller house for employee housing benefits. The taxpayer therefore argued that it would be unreasonable to impose the additional corporate income tax on the capital gains from the sale of the concerned house.

Regarding this, however, the Tax Tribunal ruled that a company house shall be excluded from the scope subject to the additional corporate income tax only in the case where all of the following conditions prescribed under the CITL are met: i) a company house should be provided to employees other than shareholders; ii) it should be a company-owned house or residence provided to employees for consideration or free; and iii) the period of providing the company house to employees should be at least ten years. In this context, the Tribunal decided that gains from the sale of the company house which was provided to the employee for less than four years in this case cannot be excluded from the scope subject to the additional corporate income tax. (*Joshim2022seo6035, 2022. 8. 31.*)

This case indicates that unless there is a special rule under the CITL for the exclusion of a company house provided for less than 10 years from the additional corporate income tax, capital gains on the sale of the company house provided for less than 10 years cannot be exempt from the additional corporate income tax, regardless of whether there are any justifiable reasons for the sale of a smaller house to replace it with a larger house for employee housing benefits per the taxpayer's argument. Accordingly, it should be noted that the imposition of the additional corporate income tax would depend on whether the period for providing a company house to employees is at least 10 years or not, regardless of any justifiable reason for the sale.

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