Samil Commentary

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National Tax Administration Policy for 2022

The National Tax Service (NTS) announced on January 26, 2022 its tax administration policy for 2022 that includes enhanced digital-based tax services for taxpayers and diverse services to meet the needs to support taxpayer welfare. The policy also calls for improving the basis of tax fairness through cracking down on wilful attempts to evade or not paying taxes. To this end, the NTS announced its major aims that it is committed to implementing that include:

- Improving convenience for taxpayers by expanding pre-populated or fully-populated tax forms and providing useful guidance aided by big data analytics to make it easier to file taxable items including tax incentives;
- Establishing an intelligent tax compliance environment using digital technologies including the enhancement of existing systems such as 'Hometax 2.0', mobile Hometax, etc.;
- Reinforcing the responsibilities and authority of the Taxpayer Advocate Committee and the functions of taxpayer advocate officers in regional NTS offices and district tax offices to ensure that they perform more supervision and checking functions in tax audit processes;
- Simplifying documents required for pre-screening of R&D tax credit eligibility and

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improving the existing consulting services for small and midsize enterprises (SMEs) to ensure that an increasing scope of SMEs may access the NTS consulting services to identify and resolve in advance uncertainties before being subject to tax verification or audit sometime in the future;

- Actively responding to the OECD discussions on the introduction of digital services tax which is aimed to be implemented in 2023;
- Preparing measures to facilitate the utilization of national tax information in line with the data openness and digital transformation policy; and
- Establishing a sophisticated infrastructure to help the NTS effectively cope with tax fraud and evasion, including the standard forensic investigation system.

Regional Comprehensive Economic Partnership Agreement enters into force in Korea on February 1, 2022

The Ministry of Trade, Industry and Energy announced that the Regional Comprehensive Economic Partnership (RCEP) agreement concluded in November 2020 entered into force in Korea on February 1, 2022. Compared with the Korea-ASEAN Free Trade Agreement (FTA) and other existing FTAs, the Ministry expects the RCEP agreement to expand the markets for major Korean export goods such as motors, parts and steel products, and the service markets in the fields like online games, animations, films and music. In particular, the Ministry anticipates that Korean companies' administrative burden associated with the application of FTAs would be reduced due to certain advantages of the latest FTA. They include the application of single unified standards for origin certification among countries in the region, the expanded scope of cumulative origin(*), and diversified ways of origin certification including certificates of origin self-issued by certified exporters meeting prescribed requirements. (*The Cumulative Rules of Origin provides that any raw material procured in any of the 15 member countries and used for finished goods manufactured in another country shall be regarded as being originated from the country where the final production takes place.)

In this regard, the Korea Customs Service held a RCEP briefing session on January 18, 2022 to provide domestic companies with information concerning the latest FTA agreement and how they can best utilize the agreement to support their new profit model. In the briefing, three strategic approaches have been addressed to focus on expanding: 1) exports based on the relaxed criteria for determining country of origin; 2) the scope of origin certification based on the Cumulative Rules of Origin; and 3) exports of regionally competitive industries by taking advantage of differences in tariff rates among member states.

* The RCEP is an FTA among ten member states of the Association of Southeast Asian Nations (ASEAN) and five non-ASEAN member states (Australia, China, Japan, Korea and New Zealand). The 15 member countries account for about 30% of global trade, GDP and population, thereby making the agreement concluded among them the world's largest FTA.

NTS Announces List of Virtual Asset Service Providers for Virtual Asset Valuation

On December 28, 2021, the National Tax Service (NTS) announced the list of qualifying virtual asset service providers (VASPs) for the valuation of virtual assets in accordance with the Inheritance and Gift Tax Law ("IGTL"). Effective from January 1, 2022, gifted or inherited virtual assets shall be subject to gift tax or inheritance tax for the value of the virtual assets determined pursuant to the valuation method as stipulated in the recently amended IGTL. (The gift and inheritance taxation is separate from the taxation on other income arising from the sale, exchange or lease of virtual assets for income tax purposes which is to be effective on or after January 1, 2023.) The qualifying VASPs announced by the NTS are: Dunamu, Bithumb Korea, Korbit and Coinone which have been registered with the Korea Financial Intelligence Unit.

The table below presents the valuation method to be newly applied to virtual assets under the IGTL beginning from January 1, 2022, compared with the valuation method applied through December 31, 2021.

Through December 31, 2021	From January 1, 2022	
	Virtual assets traded on the cryptocurrency exchange of the VASPs announced by the NTS	Virtual assets traded on other exchanges
Based on the market price as of the base date for valuation* * Value that is reasonably recognized, such as the market price at closing on the trading day, the price at the time of trading, etc.	Based on the average value of daily average prices for the period one month before and after the base date for valuation (*)	Based on the value that is reasonably recognized, such as the daily average price or the closing price of the trading day.

(*) For the valuation of virtual assets traded on multiple cryptocurrency exchanges of the VASPs announced by the NTS, it shall be based on the average of daily average prices disclosed by the VASPs for one month before and after the base date for valuation.

NTS Simplifies Documents Required for R&D Tax Credit Pre-screening

From January 2022, the National Tax Service (NTS) has simplified documents required to apply for pre-screening of the eligibility for research and development (R&D) tax credits. It also published the pre-screening guidelines at the end of January 2022. Introduced in 2020, the pre-screening program requires the NTS to validate in advance the eligibility of R&D tax credits for companies that plan to claim R&D tax credits. The program is intended to help avoid uncertainties possibly experienced by companies planning to make R&D investment, and to reduce potential disagreements between the tax authorities and taxpayers claiming tax credits. It aims to ultimately promote tax compliance in good faith as regards to R&D tax credits. Applications for the pre-screening is not compulsory and taxpayers may opt to claim R&D tax credits in filing tax returns at their discretion. However, if companies file tax returns in accordance with the results of pre-screening, they would have certain benefits, such as exemption from the post-filing verification of tax credit items, as well as constant supervision of whether the eligibility requirements continue to be satisfied after the tax

credits are claimed. Also, they will not be subject to penalties on under-reporting or underpayment even if the actual tax assessment on the tax credit is different from the pre-screening results. In order to expedite the pre-screening process (within about two weeks), the NTS clarified 10 necessary documents including payroll books to be submitted for the pre-screening process. Further, useful information is available on the NTS website for public perusal, including several examples of how to prepare research notes and cases accepted or rejected based on the results of pre-screening.

The pre-screening program involves the examination of two aspects of R&D tax credits claimed, specifically, whether certain R&D activities carried out by a claimant would meet the criteria in terms of technology under Article 2 (1) of the Special Tax Treatment Control Law ("STTCL") and whether R&D expenditure incurred by the claimant falls within qualifying expenditure for R&D tax credits under Article 10 of the STTCL. The NTS and the Korea Institute for Advancement of Technology (KIAT) shall be responsible for the pre-screening in terms of technological and expenditure aspects.

<table>
<tr><th rowspan="2">Category</th><th rowspan="2">Qualifying Expenditure</th><th rowspan="2">Tax Credit</th><th colspan="2">Pre-screening by</th></tr>
<tr><th>Techno-ology</th><th>Expend-iture</th></tr>
<tr><td>New growth · source technologies</td><td>R&D expenditure for technologies listed in Schedule 7 of the Presidential Decree of the STTCL</td><td>Up to 40% of qualifying expenditure incurred in the current year</td><td rowspan="2">KIAT</td><td>NTS</td></tr>
<tr><td>National strategic technologies</td><td>R&D expenditure for technologies listed in Schedule 7-2 of the Presidential Decree of the STTCL</td><td>Up to 50% of qualifying expenditure incurred in the current year</td><td>NTS</td></tr>
<tr><td>General R&D activities</td><td>Research and human resources development expenditure other than R&D expenditures above</td><td>May claim tax credit for either 1) or 2): 1) up to 25% of qualifying expenditure incurred in the current year; or 2) up to 50% of an increase of R&D expenditure in the current year from the previous year</td><td>NTS</td><td>NTS</td></tr>
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Rulings Update

Whether the value of an unfinished building recorded in the inventory of a company would be excluded from the deemed acquisition tax base of its controlling shareholder

According to Article 7(5) of the Local Tax Law (LTL), where a person becomes a controlling shareholder (i.e., a shareholder, together with its related parties, owning more than 50% of shares) by acquiring shares in a Korean company, in general, the controlling shareholder shall be 'deemed to have acquired certain types of properties (real estate, etc.) owned by the company' (the 'deemed acquisition') and be subject to deemed acquisition tax on the

real estate, etc. in proportion to its shareholding ratio. In this case, the deemed acquisition tax base of the controlling shareholder shall be determined based on the total value of such real estate, etc. of the company. However, where there is no value reported by a controlling shareholder, or the reported value is lower than the tax base, the tax base shall be calculated based on the total value of the real estate, etc., subject to acquisition tax, recorded in the book of the company (Article 10(4) of the LTL, effective prior to the amendment on December 28, 2021).

This case concerns a taxpayer which became a controlling shareholder in a real estate development and sale company (the ‘property developer’ or the ‘company’) by acquiring shares in the company. At the time of share acquisition, the property developer was constructing a new building on the land it owned, and the land as well as the building under construction were recorded as inventory assets on its books. The issue in this case was whether the value of the unfinished building of the property developer would be excluded from the deemed acquisition tax base of its controlling shareholder.

The Tax Tribunal stated that a controlling shareholder would be deemed to have acquired the real estate, etc., subject to acquisition tax, owned by the company on the date it became the controlling shareholder of the company by acquiring more than 50% of the shares, and as such, it would be difficult to impose deemed acquisition tax on an unfinished building by treating the controlling shareholder as having acquired the unfinished building on which the acquisition tax liability did not arise at a time of deemed acquisition. The Tax Tribunal further ruled that the deemed acquisition tax base for the controlling shareholder should be calculated based on the book value of the real estate, etc. at the time of deemed acquisition, but it should exclude the value of the unfinished building on which the acquisition tax liability did not arise at the time of deemed acquisition. The Tax Tribunal finally decided that in this case it would be reasonable to exclude the amount of expenditure incurred for the construction of the unfinished building and for the change of the land category from the value of inventory assets per the property developer’s books in determining the deemed acquisition tax base for the controlling shareholder. (*Joshim2021ji0885, 2021.11.23*)

This case is considered important in that it has made clear that out of the book value of a company, the value of an asset on which the acquisition tax liability has not arisen at the time of deemed acquisition must be excluded from the deemed acquisition tax imposed to its controlling shareholder. Also, although there was no issue raised in this case as to the time of acquisition for an unfinished building, in other similar cases it may be necessary to consider that the time of acquisition for a newly built building should be determined on the earliest of the date a notification for an approval for use of the building is issued, the date its temporary use is approved or the date the building becomes in actual use, as stipulated in Article 20 (6) of the Presidential Decree of the LTL.

Whether the provision for estimated profits could apply to gains or losses on disposal of tangible assets classified as gains or losses from a discontinued business

Where the shares in an unlisted company is valued according to the supplementary valuation method under the Inheritance and Gift Tax Law (IGTL), generally, the net income

value per share should be calculated based on the weighted average of adjusted net income per share for the most recent three years. Under Article 56(2) of the Presidential Decree of the IGTL, however, the net income value per share may be calculated based on the average of the estimated profits per share computed according to Article 17-3(1)(4) of the Enforcement Rules of the IGTL if all of the requirements are met. One of the requirements is that a company should fall under any of the cases prescribed in Article 17-3(1)(6) of the Enforcement Rules of the IGTL, such as the case where the net income of the company has increased during the recent three years due to a temporary and accidental event, etc., specifically including: the case where the total amount of 'gains and losses on the disposal of tangible assets and securities according to the generally accepted accounting principles (GAAP)' exceeds 50% of the weighted average of net income before tax for the recent three years.

In this ruling, the taxpayer inquired as to whether gains or losses on the disposal of tangible assets being classified as gains or losses from the discontinued business according to the GAAP could fall within the meaning of 'gains or losses on the disposal of tangible assets' according to the GAAP under Article 17-3(1)(6) of the Enforcement Rules of the IGTL.

Regarding this, the NTS interpreted that even where gains or losses on the disposal of tangible assets were classified as gains or losses from the discontinued business per the books according to the GAAP, the concerned gains or losses from the discontinued business should fall within the meaning of gains or losses on the disposal of tangible assets according to the GAAP prescribed in Article 17-3(1)(6) of the foregoing Enforcement Rules. (*Seomyeon-2021-capital transaction-5221,2021.12.15*)

The NTS recent interpretation concerns only the gains or losses on the disposal of tangible assets which are included in gains or losses from the discontinued business in conjunction with the application of the above provision on the estimated profits for the supplementary valuation of unlisted shares. Additionally, however, it could be reasonably expected that such interpretation might be applicable to other items such as gains or losses on the disposal of securities which are included in gains or losses from discontinued business.

A short YouTube video on one of the topics in the latest issue is available on the Samil PwC YouTube Channel link. →PwC Korea YouTube Channel

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