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Newsletter

Korea Tax Updates

Clarification of the New Enforcement Fine System for Failure to Submit Documents During Tax Audits

In March, the Framework Act on National Taxes("FANT") was amended to introduce a provision allowing for the imposition of enforcement fines (이행강제금) when taxpayers fail to submit books or other required documents during a tax audit without just cause (Article 85-7 of the FANT, etc.). Under this new provision, for tax audits commencing on or after September 15, 2025, if a taxpayer fails to submit lawfully required books and records without a valid reason during the audit process, the head of the relevant regional tax office may impose an enforcement fine upon deliberation by the Enforcement Fine Review Committee.

To impose an enforcement fine, the regional tax office must first provide the taxpayer with a reasonable compliance period of at least 30 days. If the taxpayer fails to submit the required documents within that period, a notice must be issued stating that an enforcement fine may be imposed. If the taxpayer still fails to comply after the deadline, the enforcement fine may be imposed starting from the day after the deadline at a rate of up to 0.3% per day of the taxpayer's average daily revenue, as prescribed by Presidential Decree. If the taxpayer has no average daily revenue or it is difficult to calculate, a daily fine of up to KRW 5 million may be imposed.

On June 2, a newly enacted Presidential Decree further detailed the enforcement fine system, with the key provisions as follows:

- If the taxpayer fails to submit the required documents even after 30 days have passed from the day after the compliance deadline, enforcement fines can be imposed every 30 days from that date.

- The period for which the fine is imposed begins the day after the compliance deadline and ends the day before the taxpayer submits all required documents. If the audit is suspended, the suspension period is excluded from the enforcement fine period.

- The criteria for calculating the fine consist of general and quantitative standards. Under the quantitative standards, the daily fine rate is tiered based on the taxpayer's average daily revenue, ranging from 0.1% to 0.2%.

- The taxpayer must pay the enforcement fine within 30 days of receiving the imposition notice. However, in cases of natural disasters or other unavoidable circumstances, the fine must be paid within 30 days from the date the cause no longer exists.

Unlike the current administrative fine system, which imposes a one-time fine of up to KRW 50 million and cannot be levied repeatedly, the newly introduced enforcement fine is proportional to the duration of non-compliance and can be imposed repeatedly. As such, the new system is expected to more effectively compel compliance with document submission requirements during tax audits.

However, since tax officials must limit requests for documents to only what is minimally necessary for the audit under the provisions of FANT, disputes may increasingly arise over whether document requests during tax audits are lawful and necessary.

Zero-Rating Denied for Domestic Portion of International Freight Service

The taxpayer has provided international freight forwarding services under a master agreement with overseas affiliates. For transactions under prepaid terms (where the consignor pays the freight), the taxpayer has applied zero-rating for VAT purpose to the domestic portion of the transport service.

Article 32(2)(i) of the Enforcement Decree of the Value-Added Tax Law ("VATL") stipulates that "international transportation services provided by a freight forwarder who, under an international multimodal transportation contract, receives cargo from a consignor, transports it using another party's means of transport such as a vessel or aircraft at its own risk and expense, and receives freight charges from the consignor" shall be subject to zero-rate VAT. However, the tax authority denied the application of the zero-rate to the domestic segment of the transportation service in question and imposed VAT at the standard rate of 10%, citing the following reasons:

(1) The taxpayer had no direct contractual relationship with the consignor (shipper), having contracted only with its affiliate;

(2) The taxpayer lacked the authority to determine final freight charges and bore only limited liability for the domestic portion;

(3) The taxpayer was paid by the affiliate rather than the shipper, meaning the domestic service was not performed "on its own name and responsibility" as required by law.

The taxpayer argued that, from the stage of accepting international multimodal transport service contracts, it and its affiliate jointly provided such services to the consignor by presenting transportation unit costs, sharing global liability insurance premiums, and

allocating profits from territorial segments, thereby jointly bearing the obligations and accounting of the contract. Based on these arguments, the taxpayer filed a tax appeal.

In this case, the Tax Tribunal strictly interpreted Article 32(2)(i) of the Enforcement Decree of the VATL and held that the taxpayer had not directly entered into a contract with the consignor, the contract in question could not be recognized as a joint contract, and the taxpayer had not received freight charges directly from the consignor. Therefore, the Tribunal concluded that the requirements for the zero-rated VAT treatment were not met and dismissed the taxpayer's appeal (Josim 2024Seo4286, 2025.5.13.).

Keynote: The Tax Tribunal upheld a strict interpretation of the zero-rating provision under the VATL and relevant regulations. Unless the taxpayer directly contracts with the shipper and assumes full responsibility and risk for the transportation service, zero-rating will not apply—even if the service is part of a broader international freight arrangement. Recent decisions of the Tax Tribunal reflect a trend toward tighter enforcement in this area (e.g., Josim 2023Seo7730, 2023.12.26.). As similar cases remain pending in court, the outcomes will be worth monitoring for any future developments.

Newly Issued Tax Interpretations

Court Denies Bypass of Pre-assessment Review (Review of Adequacy of Tax imposition) Due to Delay Attributable to the Tax Authority

Background

The taxpayer transferred land and a building located in Seocho-gu, Seoul on December 16, 2016, and filed and paid the capital gains tax, applying the capital gains tax exemption clause.

In 2021, the regional tax office conducted an internal audit of the district tax office and recommended that the taxpayer's capital gains tax return be reexamined for appropriateness. According to this recommendation, the district tax office received the relevant capital gains tax data from the Regional Tax Office on August 3, 2021.

Later, on May 2, 2022, the district tax office delivered a preliminary notice of tax imposition to the taxpayer and, just seven days later, on May 9, 2022, issued a notice of assessment for the capital gains tax to the taxpayer for the 2016 tax year.

Issue

Whether the tax authority may lawfully bypass the pre-assessment review (Review of Adequacy of Tax imposition) procedure under Article 81-15(3)(3) of the FANT solely because less than three months remained before the expiration of the statute of limitations—particularly when such timing was the result of the authority's own administrative delay.

Court Ruling

The Supreme Court held that the requirements for bypassing the pre-assessment review (Review of Adequacy of Tax imposition) under Article 81-15(3)(iii) of the FANT are not satisfied merely because the statute of limitations for tax imposition is set to expire within three months. In particular, the Court clearly ruled that if the imminent expiration of the statute of limitations was caused by delays in the tax assessment process attributable to the tax authority itself, the exception clause cannot be applied.

The Court has consistently held that the constitutional principle of due process must be observed when tax officials exercise their taxing power (e.g., Supreme Court Decision 2012Du911, 2014.06.26.). This case above is also viewed in the same context, emphasizing the substantive implementation of pre-assessment procedures to protect the taxpayer's right to defend. The Court made it clear that, if the tax authority intends to bypass the procedure on the grounds that the statute of limitations is about to expire, it must bear the burden of proving the rational basis for such bypassing.

Pharmaceutical Product Returns Not Considered Entertainment Expense, But Ordinary Business Expense

A pharmaceutical company regularly accepted returns of near-expiry finished drug products from its distributors in accordance with internal return policies and industry practices. The tax authority deemed the costs of returned products as entertainment expenses, asserting that the voluntary acceptance of returns constituted preferential treatment for specific clients..

In response, the taxpayer argued that the returns were uniformly applied to all customers based on objective criteria, were related to product quality management and inventory control, and did not involve any provision of monetary or in-kind benefits. Moreover, the taxpayer issued negative tax invoices for the returned goods.

The Tax Tribunal ruled in favor of the taxpayer, finding the corporate tax and VAT assessments imposed by the tax authority to be revoked. The Tax Tribunal acknowledged that the return transactions were not targeted at specific customers, but rather stemmed from the characteristics of distribution in the pharmaceutical industry and purposes of quality control. It further held that the taxpayer issued negative amended tax invoices for the actually returned products, thereby satisfying the requirements for sales returns under the Value-Added Tax Act(Josim 2024Seo5252, 2025.05.27.).

Keynote: Where product returns are conducted in line with uniform standard applicable to all distributors and are driven by factors such as expiration dates, quality control, or industry norms, they should not be treated as entertainment expenses. If the returned goods are physically recovered and disposed of, and negative tax invoices are properly issued, the VAT reversal may also be recognized. To support such treatment, it is advisable to document internal return policies, include relevant terms in contracts, and maintain evidence such as board resolutions, internal memos, or industry practice reports.

Validity of Tax Refund Claim Based on Errors in the Adjustment Ratio

The taxpayer, under a consignment purchase arrangement with large retailers whereby products could be returned if unsold, applied a statistical adjustment ratio (8.8%) in its tax filings to reconcile timing differences between accounting and tax revenue recognition.

However, the taxpayer later found out that the adjustment ratio (8.8%) was overstated based on actual sales data extracted from the retailers' EDI system and claimed that the error in the statistical input constituted a justifiable ground for a refund claim under the CITL.

The tax authority rejected the claim, stating that the adjustment ratio was established at the taxpayer's discretion and consistently applied in calculating the tax base, and that any defects in the underlying statistical assumptions did not, constitute grounds for a post hoc adjustments. In particular, the adjustment ratio is not explicitly regulated under tax law, and any variances inherent in statistical estimates do not constitute a tax reporting error.

The Tax Tribunal upheld the tax authority's position, stating that it was not clearly demonstrated that the data based on the retailer's EDI system was objective, and once an adjustment ratio is determined based on reasonable standards and consistently applied, post hoc adjustments based on the accuracy of the ratio do not justify an amended return (Josim 2023Seo7120, 2025.04.10.).

Keynote: Even if an adjustment ratio made by the taxpayer is found to be inaccurate, an amended return claim for tax refund will not be accepted unless the calculation of the tax base itself is erroneous, and the responsibility for any errors in statistical estimation is borne by the taxpayer.

Whether Real Property Transfer Constitutes Transfer of Business and Imposition of Aggravated Penalty

A taxpayer transferred leased commercial real estate and asserted that the transaction qualified as a "transfer of business" under the VATL, and therefore should be VAT-exempt. The claim was based on the continuity of business operations, including transfer of lease rights and contractual provisions indicating a comprehensive business transfer. The taxpayer further argued that not issuing a tax invoice did not constitute fraudulent behaviour for purposes of aggravated penalty.

The Tax Tribunal ruled that for a real estate transfer to qualify as a transfer of business, the transferee must continue the leasing business. However, the transferee in this case acquired the property for redevelopment purposes did not succeed existing leases, and immediately initiated trust registration and development-related services. Therefore, the transaction did not qualify as a business transfer and was subject to VAT.

However, the Tribunal held that the taxpayer's failure to issue a tax invoice did not rise to the level of "fraudulent behaviour" given the lack of clear intent to deceive (Josim 2025Joong0671, 2025.05.28.).

Keynote: In determining whether the transfer of business-use real estate constitutes a "transfer of business," for VAT purpose, it is necessary to consider not only the wording of the contract but also the actual succession of business operations, the transferee's intended use, and the post-transfer operational status in a comprehensive and substantive manner.

Furthermore, this case suggests that merely submitting certain documents or applying a specific tax treatment does not, in itself, constitute fraudulent behaviour.

Third-Party Reimbursed Discounts and Mileage in VAT Tax Base

The taxpayer operated department stores and offered customer discounts through gift certificates, mileage, and brand points, claiming that even if reimbursed by 3rd party, such discounts should be excluded from the VAT tax base. Based on Supreme Court Decision 2015Du58959, the taxpayer argued that customer discounts—regardless of whether the mileage was self-issued or provided by a third party—should be treated as sales discount.

However, the Tax Tribunal cited to the 2018 amendment to Article 61 of Enforcement Decree of VATL, which clearly stipulate that the reimbursed portion of third-party issued mileage (excluding self-issued mileage) must be included in the VAT tax base. Accordingly, the disputed discount amount was deemed subject to VAT.

In addition to that, with respect to discounts offered to VIP customers by tenants, the taxpayer claimed that such amounts effectively reduced rental income and should be treated as sales discounts, thereby excluded from the VAT base. However, the Tax Tribunal rejected this argument, noting that the lease agreements contained no provisions for offsetting rent based on these discounts, and the amounts had been recorded as promotional expenses, not as deductions from rent (Josim 2024Seo5252, 2025.05.27.).

Keynote: In this case, the taxpayer argued that, notwithstanding the 2018 amendment to the Enforcement Decree of the VATL, the mileage and discount amounts should be considered sales allowances deductible from the VAT taxable base, based on its interpretation of the sales allowance provision under the VAL and former Supreme Court decision, rather its Enforcement Decree. However, the Tax Tribunal did not accept this argument and instead interpreted the provision concerning third-party reimbursed mileage in strict accordance with the language of the 2018 amended Enforcement Decree of the VTAL.

Tax Treatment of Settlement Payments Arising from APA-Based Valuation Adjustments for Intangible Assets

Under a business transfer agreement that included a post-closing adjustment clause, the seller had previously applied for a unilateral Advance Pricing Agreement (“APA”). As a result of the APA, the value of goodwill and other intangible assets increased. Accordingly, the purchaser paid additional settlement amounts to the seller.

The National Tax Service (“NTS”) clarified that such additional payments should be viewed as part of the original consideration under the business transfer agreement. As such, the payments should be treated as deductible expenses for the purchaser and as taxable income for the seller and must be recognized in the fiscal year in which the settlement payment is made (Seomyeon-2024-Beopgyubeobin-4190, 2025.05.29.).

Keynote: This clarifies that, in a transfer transaction already completed, a subsequent price adjustment resulting from an APA should be reflected in the income of the fiscal year in

which the adjustment payment is made, rather than in the year when the original transaction was closed.

Interpretation of Conditions for Excluding Internal Service Transactions from the Application of the Arm's Length Rule Under the Consolidated Tax Regime

In 2021, the CITL was amended to provide that, in the case of intercompany service transactions among companies applying the consolidated tax filing system, "the denial of unfair acts rules" shall not apply if certain conditions are met. However, it was unclear whether the condition that "there must be no change in the amount of consolidated corporate tax" referred to the total tax liability of the entire consolidated group or that of individual entities. The NTS viewed that it refers to the total tax burden of the entire consolidated group, not of individual consolidated entities.

In addition, the NTS confirmed that "services" for purposes of the exclusion do not include loans or leases of assets (Seomyeon-2023-Beopgyubeobin-2133, 2025.05.26.).

Use of Bonded Storage and Blending Facilities by Foreign Corporation Does Not Constitute a Permanent Establishment in Korea

A foreign company purchases petroleum products in Korea and stores them in bonded oil tanks, where the products are later blended through a Korean storage company before being exported overseas.

The NTS interpreted that if the foreign company's key business activities—such as contract execution and payment collection—are conducted entirely overseas, and it does not maintain personnel or a fixed place in Korea, the use of bonded storage and blending facilities alone does not constitute a permanent establishment ("PE") in Korea (Seomyeon-2025-Gukjesewon-0819, 2025.05.22.).

Keynote: In a similar case (Sajeon-2024-Bubkyugukjo-0560, 2024.11.18.), the NTS determined that a foreign company did not constitute a permanent establishment in Korea, on the grounds that the company had no disposal rights over the domestic oil storage tanks.

Determination of a Special Relationship Based on Control over Business under the Law for the Coordination of International Tax Affairs

Article 2 of the Law for the Coordination of International Tax Affairs defines one type of special relationship as a situation where there is a common interest between the transacting parties—arising from capital investment, transactions of goods or services, monetary loans, or similar relationships—and one party is effectively able to determine the business policies of the other party. In addition, Article 2 of the Enforcement Decree enumerates five specific cases in which such a special relationship is deemed to exist.

The issue here is whether a special relationship can be established even in cases where one party is able to determine the business policy of the other party through means NOT enumerated in the Enforcement Decree.

The NTS interprets that, in determining the existence of a special relationship, such a relationship is established if one party is able to substantially determine the other party's

business policy through any one of the methods enumerated in the Enforcement Decree (Seomyun-2025-InteGookjesewon-0819, 2025.05.22.).

Keynote: This case is meaningful in that the NTS interprets the establishment of a special relationship based on the substantial determination of business policy under the Law for the Coordination of International Tax Affairs as being limited to the methods prescribed in the Enforcement Decree.

Upcoming Tax Reporting Reminder

- Submission obligation of transaction statements by foreign online platform service providers and payment gateway (PG) companies: to be submitted by October 15, 2025.
- 2025 2Q VAT Return and Payment Deadline: July 25, 2025
- Simplified Payment Statement for Employment Income for the First Half of 2025 (January to June) Submission Deadline: July 31, 2025
- Interim Corporate Income Tax Return for the 2025 Fiscal Year: For companies with a fiscal year ending on December 31, the interim corporate income tax return must be filed and paid by August 31, 2025

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