

Under the post-Covid 19 situation, research on ways to establish appropriate tax audit scale and improve verification to minimize tax verification burden

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I . Introduction

- The National Tax Service of the Republic of Korea (NTS) has maintained the total number of tax investigations at more than 16,000 per year until 2019, but under the recent Covid-19 situation, it significantly reduced the number of cases to about 14,000 to overcome the national crisis and received good reviews.
- The number of annual tax investigations has been continuously decreasing from 16,306 in 2018 to 16,008 in 2019, 14,190 in 2020, 14,454 in 2021, and 14,174 in 2022, which is the lowest level in the past 10 years.
- However, considering that the number of taxpayers is increasing every year, the tax audit rate is estimated to be continuously decreasing, and concerns are being raised whether the tax verification function, which is the core of fair taxation, is being weakened.

※ [reference-1] Trends in the number of corporate tax and personal income tax reports (source : NTS Tax Statistics Information Service, TASIS)

1) Corporate tax returns

Tax year	2018	2019	2020	2021	2022
Corporate tax returns	740,215	787,438	838,008	906,325	982,456

2) Individual income tax returns

연 도	2018	2019	2020	2021	2022
Individual income tax returns	6,911,088	7,469,635	7,850,913	9,339,463	10,275,113

- It appears to be a common problem around the world that the authority of tax authorities is continuously being reduced or that concerns are increasing about insufficient resources such as manpower and budget. In particular, this problem has intensified due to the recent Covid-19 situation, and efforts are being made to recognize this and secure resources again. For example, the United States has recently been increasing its resources for tax verification, including increasing the number of IRS personnel, and considering the current trend, it is expected that personnel and budget will increase significantly in the future.

※ [reference-2] Concerns about weakening the tax investigation function of the National Tax Service of the Republic of Korea¹⁾

- The National Tax Service plans to continue its policy of reducing the total tax investigation volume in the second half of the year. According to the National Tax Service, the number of tax investigations was 16,008 in 2019, but it is planned to conduct about 13,600 tax investigations in 2023, the lowest level ever. This is confirmation that the National Tax Service is dramatically reducing tax investigations. According to the National Tax Service's announcement, the number of tax investigations increased from 16,008 in 2019 to 14,190 in 2020, 14,454 in 2021, and 14,174 in 2022, making it clear that they are cautious about tax investigations. However, if you actually look at it, the experts' argument is that the number of 16,008 cases in 2019 is not that many. This means that the National Tax Service's policy of reducing tax investigations is not the original stance of tax administration. In particular, it is serious enough to say that with too much emphasis on tax payment convenience, it feels like the highest goal of national tax administration, which is to raise tax revenue, is disappearing.

1) Is it right for the National Tax Service to reduce tax investigations?, Sejungilbo, Aug 16. 2023

- There is a clear reason why tax audits must be strengthened. This is because the presumption that all taxpayers are sincere is only a legal theory. In reality, all taxpayers are potential tax evaders. No one is free from the temptation of tax evasion. Especially if you get advice from an expert, you can't help but be intrigued. Tax audits are the core of national tax administration. In particular, our national tax administration, which adopts a reporting and payment system, should view tax audits as an absolute weapon to ensure the sincerity of reporting. The most important thing in the reporting and payment system is reporting sincerity. If the sincerity of reporting falls apart, the foundation of fair taxation is shaken. This is a collapse of the basics of national tax administration. Therefore, tax audits that ensure the sincerity of reporting are inevitably the core of national tax administration. Nevertheless, it is questionable whether reducing tax investigations is truly the right direction for the development of national tax administration.

- It is known that the IRS has been experiencing a serious manpower shortage, and although efforts have been made to supplement this through the development of investigation techniques, it is currently understood to have reached its limit. The number of employees, which remained at over 100,000 in the 2010s, has also decreased by more than 20%, currently down to 80,000. Accordingly, the IRS is expected to increase its budget by \$80 billion over the next 10 years to fight tax evasion by the wealthy, which it has not been able to properly deal with due to lack of manpower, aging of the system, and response to Covid-19. Of the \$80 billion, It is said that more than half of the budget is planned to be invested in tax audits. ²⁾

2) IRS strengthens tax audits for high-income earners. "War on tax evasion by the wealthy", The Koreatimes, Aug 8. 2022

※ [reference-3] U.S. IRS plans to increase personnel³⁾

- IRS invests \$80 billion to improve tax collection system. This is the largest single case in IRS history. The key is to eradicate tax evasion by the wealthy and large corporations and improve customer service that taxpayers find inconvenient. On the 6th, the IRS announced a plan to “expand tax collection by investing \$80 billion.” (omitted) More than half of the \$80 billion is expected to be used to thoroughly monitor the wealthy and large corporations to ensure they cannot avoid taxes. It plans to focus enforcement resources on hiring lawyers and data scientists to better track increasingly complex corporate and partnership returns, as well as hiring additional accountants to track large corporations and high-income individuals. As of 2023, the number of regular IRS employees is approximately 80,000, a decrease of approximately 20% compared to 2010. The population has increased over the past 10 years and the tax system has become more complex, but the IRS is having difficulty collecting taxes due to a lack of manpower. Previously, the IRS announced that it would hire 20,000 new employees by the 2023-2024 fiscal year.

○ NTS has also been reducing the number of tax investigations to minimize the burden on taxpayers amid the recent difficult economic situation and global pandemic. I think that the requested aspect also exists to some extent.

- Most of the research on tax investigations in Korea so far has been about the need to further improve tax audit procedures or the need to better protect the rights and interests of taxpayers being investigated. As a result, the level of legalization of tax audit procedures and guidance on taxpayer rights has been significantly raised, and in-depth discussions were held on ways to improve national tax administration, including tax audits,

3) IRS takes action to eradicate tax evasion, The Korean Daily, April. 7. 2022

jointly between the public and private sectors through the 'National Tax Administration Reform TF(NTAR' in 2017 and 2018. As a result, a higher level of improvement has been achieved. Accordingly, this report focuses on the aspects of enhancing tax fairness and encouraging faithful reporting, which are the original functions of tax audits.

- Accordingly, we will first briefly look at Korea's tax audit system and ratio, learn about the appropriateness of the current investigation scale, and then consider whether there is room for improvement in the investigation method based on cases of improvement in foreign tax audits.

※ [reference-3] 2018 NTAR TF Tax audit improvements⁴⁾

Enhancing the neutrality and fairness of tax audits	1	▪ Establishment of measures to strengthen checks and supervision of tax investigation operations
	2	▪ Promoting legislation to prohibit the exercise of undue influence on tax audits
	3	▪ Establishment of measures to ensure procedural fairness for cross-tax investigations
Strengthening compliance with tax audit procedures and legality management	4	▪ Reasonably improve the performance evaluation system of investigation staff to enhance the legitimacy and objectivity of tax investigations.
	5	▪ Strengthening prior legality review of tax assessment
	6	▪ Establishment of measures to improve systematic tax audit records and document management
	7	▪ Describe tax audit procedures in detail in the investigation work manual and prepare measures to strengthen procedure training.
Securing transparency and relieving burden in tax audit operations	8	▪ Establishment of a plan for taxpayers to easily understand the tax audit progress through hometax services, etc.
	9	▪ Upon completion of a tax audit, a plan is provided to explain the results of the investigation to the taxpayer in detail and guide them in filing a revised return.
	10	▪ Reviewing measures to improve the system to resolve the issue of overlapping tax investigations between the National Tax Service and local governments

4) NTS press release, NTARTF prepares and issues a total of 50 reform recommendations, Jan 29, 2018

Strengthening the function and role of the Taxpayer Advocate Committee centered on external members	11	<ul style="list-style-type: none"> ▪ Establishment of a plan to further strengthen the check and supervision function for tax investigations, etc. through the Taxpayer Advocate Committee of the head office
	12	<ul style="list-style-type: none"> ▪ Expand the scope of deliberation by the Taxpayer Advocate Committee centered on external members
	13	<ul style="list-style-type: none"> ▪ Strengthening the professionalism and fairness of committee deliberations, such as appointing competent outsiders as Taxpayer Advocate Committee members.
Strengthening control of reporting verification procedures such as tax return verification and on-site verification	14	<ul style="list-style-type: none"> ▪ Reorganize related regulations so that report verification procedures, such as tax return verification and planning inspection, are clearly distinguished from tax audits
	15	<ul style="list-style-type: none"> ▪ Establish strict procedural control measures tailored to the taxpayer's perspective regarding the reporting verification process to ensure that taxpayer rights are not violated.

II. tax audit system of South Korea

1. Tax audit system, laws and regulations

- South Korea's tax audit procedures have been covered several times in other previous studies, so rather than explaining the entire article, we will briefly summarize the procedures below and focus on the parts related to the report's issues.

[Refence-4] tax audit procedures of South Korea

Phase	Precedure
taxpayer selection	<ul style="list-style-type: none"> • Review of reasons for Selection* of Persons Subject to Tax Investigation (Framework Act On National Taxes Article 81-6) * periodic selection and non-periodic selection
↓	
Planning	<ul style="list-style-type: none"> • Prohibition of re-investigating the same item of taxes and for the same taxable period (Framework Act On National Taxes Article 81-4) • Review of Jurisdiction and Period over Tax Investigation (Framework Act On National Taxes Article 81-6 & 81-8)
↓	
Notice to taxpayer	<ul style="list-style-type: none"> • Notice of Tax Investigation and Requests for Postponement (Framework Act On National Taxes Article 81-7)
↓	
Initiate	<ul style="list-style-type: none"> • Delivery of Taxpayers' Right Charter (Framework Act On National Taxes Article 81-2)
↓	
In Progress	<ul style="list-style-type: none"> • Prohibition of Abuse of Authority to Investigate Tax-Related Matters (Framework Act On National Taxes Article 81-4) • Tax official may suspend the tax investigation (Framework Act On National Taxes Article 81-8) • Prohibition of Keeping Account Books, etc. (Framework Act On National Taxes Article 81-10) • Prohibition of extension of the tax investigation period (Framework Act On National Taxes Article 81-8)
↓	
Notice on Result	<ul style="list-style-type: none"> • When a tax official completes a tax investigation, he or she shall explain to the taxpayer, the results of investigation (Framework Act On National Taxes Article 81-12)

○ 1-1. Tax audit provisions and definition of tax audit⁵⁾

- tax audit procedures of South Korea are legislated at the highest level among OECD countries, with 17 articles and 65 provisions in the Framework Act on National Taxes.
- Initially, the term 'tax audit' was first defined in 1996 when norms for taxpayer protection were included in the Framework Act on National Taxes in order to join the OECD. Tax audit was not defined separately, but in 2011, it was one of the cases in which the Charter for the Protection of Taxpayers' Rights was required. It was first defined in Chapter 7, Part 2, Taxpayer's Rights, listing tax audits. Since it was appropriate for important concepts in the legal system to be included in the definition provisions of Article 2, they were transferred to Article 2, Paragraph 21.

〈Framework Act on National Taxes amended in Dec. 31. 2018 - Article 2〉

21. The term “tax investigation” means any activity involving inquiries to determine or correct the national tax base and an amount of such tax and inspection or investigation of relevant books, documents, or other articles (hereinafter referred to as “book, etc.”) or issuance of an order for submission thereof.

- For reference, each tax law, such as the Income Tax Act and the Corporate Tax Act, also stipulates the right to question and investigate based thereon. For example, the right to question and investigate under the Income Tax Act is a power that has been included since the enactment of the Income Tax Act in 1949. At that time, the Income Tax Act stipulated the requirement for the right to question and investigate as 'when

5) 'Tax audit' and 'Tax investigation' are somewhat different terms, but in most foreign countries, the two words are used interchangeably. Therefore, hereinafter, the two terms will be used interchangeably, and term 'tax audit' will be mainly used.

necessary for an investigation', but with the comprehensive revision of the Act in 1975, it was changed to 'the right to question and investigate'. It was revised to 'when necessary for the performance of duties'. The position of the Supreme Court precedent is that the right to inquiry and investigation under each tax law that existed before is also a type of tax investigation, and that the procedural control provisions in Chapter 7-2 of the Framework Act on National Taxes should be viewed as a means of controlling this.

<Income tax law, enacted in 1949 - Article 58>

When necessary for an investigation, public officials engaged in tax affairs ask questions to taxpayers, persons recognized as liable for tax payment, or persons obligated to submit payment records under Article 53 (1) and invoices under Article 53 (2), and regarding the payment or calculation of income. You can inspect related ledgers and items.

<Income tax law - Article 170>

(1) If a public official who performs administrative affairs for income tax deems necessary for performing his/her duties, he/she may inquire of any of the following persons or investigate relevant books of accounts, documents, or other things, or order him/her to submit them: Provided, That a public official may investigate only the part related to religious persons' income in books of accounts, documents, or other things of a religious organization with regard to religious persons' income under Article 21 (1) 26 (including cases falling under Article 21 (3)) or may order a religious organization to submit only the part related to religious persons' income in books of accounts, documents, or other things of the religious organization: <Amended by Act No. 11146, Jan. 1, 2012; Act No. 13558, Dec. 15, 2015; Act No. 16104, Dec. 31, 2018>

- However, the National Tax Service, through its own directives such as 'Investigation Processing Regulations' and 'Corporate Tax Processing Regulations', operates an 'on-site verification' or 'tax returns verification' system for simple fact-checking that does not lead to a tax investigation, and provides the basis for this. It contains each of the above tax law regulations. Although the directive defines on-site verification and clearly distinguishes it internally by including the phrase 'not based on tax audit,' the Supreme Court's precedent is that it must be judged practically.⁶⁾

<Investigation Processing Regulations - Article 3>

2. "On-site verification" refers to the taxpayer or the taxpayer in order to process the tasks exemplified in any of the following items, such as tax management, taxation data processing, or collection of tax audit evidence, pursuant to the right to inquiry or inspection prescribed in each tax law. This refers to the act of confirming the facts by visiting a person who is recognized as having a transaction, etc., according to an on-site confirmation plan, without conducting a tax audit.

<Corporate Tax Processing Regulations - Article 2>

11. 'On-site verification' means that in cases where indirect confirmation method is not suitable for carrying out work in accordance with these regulations, an employee directly visits the relevant taxpayer or workplace to confirm the facts, such as specific matters or business reality within the scope of the original purpose of the business trip. refers to the act of confirming.

6) Supreme Court of Korea, March 16, 2017, Decision No. 2014두8360, etc.

13. 'tax return verification' refers to reviewing the corporate tax report contents, including whether they are reflected in the reporting guidance materials, to encourage taxpayers to voluntarily and faithfully report, and selecting corporations suspected of errors or omissions in specific items or types as those subject to verification. This refers to the task of checking whether the reported details are appropriate by providing written explanations and guidance on corrected reports.

- A certain inquiry activity is ① an act to determine or correct the tax base and tax amount, and ② an investigative official contacts the taxpayer directly at the office, workplace, factory, or address of the person being investigated and asks questions over a considerable period of time or records books for a certain period of time. When investigating documents, etc., this is considered a tax investigation and is differentiated from other simple fact-checking procedures.
- On the contrary, in order to recognize on-site verification, ① the tax official's investigation must be simple factual confirmation, such as on-site confirmation of the workplace, simple confirmation of bookkeeping, confirmation of specific sales facts, confirmation through issuance of civil documents, or receipt of data voluntarily submitted by the taxpayer. However, it will be limited to the simple questionnaire survey that usually accompanies this. ② It is presented based on the expectation that taxpayers will be able to respond easily or that it will not have a significant impact on the taxpayer's freedom to do business.
- This is because the Supreme Court also recognizes internal procedures such as simple factual confirmation that does not affect the freedom of taxpayers to do business, that is, internal

procedures such as on-site confirmation or confirmation of reported contents based on the right to inquiry under each tax law, but takes the position that the distinction must be judged in practice. show.

○ 1-2. Tax audit period

- Unlike most OECD countries, Korea's National Tax Service (NTS) limits the tax audit period and has legislated this.

<Framework Act On National Taxes - Article 81-8>

(1) A tax official shall endeavor to shorten the tax investigation period to the minimum possible, in consideration of the taxable items of investigation, the category and scale of business, complexity of investigation, etc.: Provided, That the tax investigation period may be extended in any of the following cases: <Amended on Jan. 1, 2010; Dec. 31, 2011; Jan. 1, 2014; Dec. 31, 2018>

1. Where it is evident that a taxpayer has evaded investigation, by hiding books or documents, etc. or delaying or refusing the submission thereof;
2. Where it is necessary to investigate a place of transaction and conduct the on-the-spot confirmation of the transaction place or financial transactions;
3. Where a suspected case of tax evasion is detected or where, in the course of conducting a tax investigation, an investigation into tax offense under the Procedure for the Punishment of Tax Offenses Act is conducted;
4. Where the investigation is suspended due to a natural disaster or a labor dispute;
5. Where an official for taxpayer advocacy service or an official in charge under Article 81-16 (2) (hereinafter in this Article, referred to as "official for taxpayer advocacy service, etc.") acknowledges that additional fact-checking is required in relation to the suspicion of tax evasion;
6. Where a person subject to tax investigation applies for the extension of the tax investigation period to clarify the suspicion of tax evasion, etc. and the official for taxpayer advocacy service, etc. accepts such application.

- (2) Where a tax official sets a tax investigation period pursuant to paragraph (1), the tax investigation period shall not exceed 20 days for the taxpayers whose annual income or transfer amount is less than ten billion won in the taxable period with the largest annual income or transfer amount of the entire taxable periods subject to tax investigation. <Newly Inserted on Jan. 1, 2010>
- (3) Where the tax investigation period set under paragraph (2) is extended pursuant to the proviso of paragraph (1), approval is required from the head of a competent tax office for the first extension of the period; while, after the first extension, approval is required from the head of a higher tax office, and the extension period shall be extended by up to 20 days, respectively: Provided, That restriction on the tax investigation period under paragraph (2) and restriction on the extended tax investigation period under the main clause of this paragraph, shall not apply in any of the following cases: <Newly Inserted on Jan. 1, 2010; Jan. 1, 2014; Dec. 23, 2014; Dec. 31, 2019>
1. Where investigation of the details of the actual transaction is required due to suspicion of untruthful description of transaction, such as undocumented transaction and disguised or fabricated transaction;
 2. Where investigation is conducted on suspicion of tax evasion using cross-border trade or suspicion of irregular expatriation of the earnings from tax evasion accrued in the Republic of Korea;
 3. Where investigation is conducted on suspicion of tax evasion through the use of fake names, double-entry book-keeping, use of borrowed accounts, omission of cash transactions, etc.;
 4. Where investigation is conducted on suspicion of tax evasion through property speculation using false contracts, unregistered transfer of property, etc.;
 5. Where investigation is conducted on an inheritance tax or gift tax case, stake transfer, or tax offense, or simultaneous investigation is conducted for persons in an investment or trade relationship.

- (4) Where it is impracticable to continue a tax investigation due to grounds prescribed by Presidential Decree, such as delay in the submission of data by a taxpayer, a tax official may suspend the tax investigation. In such cases, the suspended period shall not be counted in the tax investigation period and the extended period of tax investigation under paragraphs (1) through (3). <Newly Inserted on Jan. 1, 2010>
- (5) During the period of suspending a tax investigation provided for in paragraph (4), a tax official shall not ask questions to the taxpayer to determine or correct the tax base and tax amount of national taxes; nor inspect or investigate account books, etc. or request the submission thereof. <Newly Inserted on Dec. 19, 2017>
- (6) When a tax official suspends a tax investigation under paragraph (4), he or she shall immediately resume the tax investigation when the grounds for suspension are eliminated: Provided, That the tax investigation may resume when it is necessary to do so urgently, such as securing tax claims, etc. <Newly Inserted on Jan. 1, 2010; Dec. 19, 2017>

- However, in the reality that tax evasion laws are becoming increasingly sophisticated, if the investigation period is limited, it becomes difficult to weed out insincere tax evaders through investigation, and in fact, the investigation period continues to increase every year. The National Tax Service's corporate tax audit period was 34.8 days in 2012, but it recorded 37.5 days in 2016, 40.4 days in 2018, exceeding 40 days for the first time, and 43.5 days in 2021, the longest period in the past 10 years. Provided by Rep. Yoo Dong-soo's office

○ 1-3. Principle of Integrated Investigation

- Integrated investigation and partial investigation are methods of tax investigation, and Korea stipulates the 'integrated investigation principle'. An integrated investigation is a tax investigation in which all tax items related to a specific taxpayer are subject to investigation. Unless an exception is

specifically stipulated, if the tax authority decides to conduct a tax investigation, it is interpreted as having an obligation to conduct an integrated investigation under the law.

- When a investigation is conducted only on specific items, it is called a 'specific items investigation' and is distinguished from an integrated investigation. A partial investigation, which can be seen as a contrast to an integrated investigation, is a investigation to confirm some specific items. However, The term 'full investigation' is also used as a counterpart to a partial investigation, but as it is used with a similar meaning to a certain extent, the term integrated investigation will be used below.

<Framework Act On National Taxes - Article 81-11>

- (1) In principle, a tax investigation shall be conducted, integrating the items of tax subject to the duty to return and pay in accordance with tax-related statutes with respect to the business of a taxpayer. <Amended on Dec. 19, 2017>
- (2) Notwithstanding paragraph (1), in any of the following cases, only specific tax items may be investigated: <Newly Inserted on Dec. 19, 2017>
 1. Where it is necessary to investigate specific tax items in consideration of the characteristics of tax items, taxpayer's type of return, business scale or suspicion of tax evasion, etc.;
 2. Where it is necessary to investigate specific tax items urgently for the security of tax claims, etc.;
 3. Other cases prescribed by Presidential Decree, where it is necessary to investigate only specific tax items in consideration of the efficiency of tax investigation, taxpayers' convenience, etc.
- (3) In any of the following cases, notwithstanding paragraphs (1) and (2), a limited investigation may be conducted for parts necessary to verify the matters in the relevant case (hereinafter referred to as "partial investigation"): <Newly Inserted on Dec. 19, 2017; Dec. 31, 2018>

1. Where it is necessary to verify whether requests for correction, etc. under Article 45-2 (3); 156-2 (5) or 156-6 (5) of the Income Tax Act; or 98-4 (5) or 98-6 (5) of the Corporate Tax Act are processed; or national tax refunds under Article 51 (1) are determined;
 2. Where it is necessary to verify the facts, etc. in accordance with the determination of re-investigation provided for in the proviso of Article 65 (1) 3 (including cases Article 66 (6) and Article 81) or in the proviso of Article 81-15 (5) 2;
 3. Where it is necessary to verify part of a transaction in the middle of tax investigation for the other party to the transaction;
 4. Where the tax evasion of a taxpayer is informed in detail and it is necessary to verify the suspicion of the relevant tax evasion;
 5. Where it is necessary to verify the suspicion of tax evasion by means of the use of fake names and the use of borrowed accounts;
 6. Other cases prescribed by Presidential Decree, where it is necessary to verify specific places of business, specific items or specific transactions in consideration of the efficiency of tax investigation, taxpayers' convenience, etc.
- (4) No partial investigation on grounds falling under paragraph (3) 3 through 6, shall be conducted more than twice for the same tax item and for the same taxable period. <Newly Inserted on Dec. 19, 2017>

[This Article Newly Inserted on Jan. 1, 2010]

- The reason for distinguishing between integrated and partial investigations is to reduce the discretion of tax authorities and protect taxpayers' rights and interests. This is because the burden on taxpayers increases if tax audits are conducted multiple times by abusing discretion in a situation where it is possible to verify all tax details through a single tax audit. However, from the perspective of the taxing authority, if a tax investigation is conducted in a situation where it is necessary to verify relatively simple items, an integrated investigation must be conducted for all tax items and the entire tax period, unless it falls under an exception, or an integrated investigation must be conducted for all tax items and the entire tax period.

Because the items are small, the burden on taxpayers may be judged to be excessive, which may put them in a dilemma of having to give up the tax audit.

- 1-4. prohibition Re-investigating the same item of taxes and for the same taxable period
 - Tax authorities are prohibited from reinvestigating the same tax items and the same taxation period, that is, duplicate tax audits. However, in cases where the ban on reinvestigation is deemed to be contrary to fairness, exceptions are permitted, and the reasons are limited.

〈Framework Act On National Taxes - Article 81-4〉

(2) No tax officials shall re-investigate the same item of taxes and for the same taxable period, except in any of the following cases: 〈Amended on Jan. 1, 2013; Dec. 23, 2014; Dec. 15, 2015; Dec. 20, 2016; Dec. 19, 2017; Dec. 31, 2018〉

1. Where obvious evidence exists to admit a suspicion of tax evasion;
2. Where it is necessary to investigate a party to a transaction;
3. Where faults are found in connection with at least two taxable periods;
4. Where an investigation is conducted in accordance with a decision on re-investigation under the proviso of Article 65 (1) 3 (including cases applied mutatis mutandis in Articles 66 (6) and 81) or under the proviso of Article 81-15 (5) 2 (limited to investigations within the scope as stated in the text of a decision);
5. Where a taxpayer provides a tax official with money and other valuables or helps a person provide a tax official with money and other valuables in relation to the duties of the tax official.
6. Where an investigation is conducted into a part not included in the relevant investigation, after a partial investigation provided for in Article 81-11 (3) is conducted;
7. Other cases prescribed by Presidential Decree, which are similar to subparagraphs 1 through 6.

- If we look at the main reasons for each exception, we can first mention cases where there is clear data to support the suspicion of tax evasion. The precedent interprets this as ‘a case where a significant degree of probability that tax evasion will be confirmed is recognized by data supported by objectivity and rationality.’⁷⁾
- In addition, the case of investigating parts not included in the investigation after a partial investigation can also be seen as a major reason. In the Supreme Court ruling (2014두12062, sentenced on February 26, 2015), parts not included in the investigation after conducting a partial investigation can also be considered a major reason. Even in the case of an investigation into the same tax item and the same tax period, it was ruled that this is a prohibited reinvestigation, and a new investigation was established in response to this.⁸⁾

○ 1-5. Sanctions for failure to cooperate with tax audit

- During the tax investigation process, many taxpayers are responding faithfully to the investigation staff's exercise of their right to question and inquiry, but some taxpayers are failing to fulfill their obligation to cooperate during the investigation process, such as intentionally delaying the submission of data. Some examples are as follows:

[Reference-6] Example of taxpayer’s non-cooperation with tax audit

- ❶ Refusal to submit data or only partial submission during the investigation process (especially in the case of overseas data, it is more difficult to submit data)

7) Supreme Court 2010.12.23. Sentence 2008Du10461 judgment, etc.

8) Re-thinking of the Prohibition of Duplicate Tax Audits Principle, Hongik Law Review, Vol. 22, No. 1, Aug 25. 2020

- A tax investigation was initiated on the charge that a resident of Korea didn't report overseas (Country A) income, and during the process, a request was made to submit the business status and financial statements of Country A. However, the data was continuously collected by exploiting the fact that there is no agreement on data submission between countries. By refusing to submit, it makes it difficult for investigators to determine overseas income.
- While conducting a tax audit on corporations that received tax deductions for research and human resource development expenses, they were requested to submit contracts to confirm expenditure details, but they refused to submit the data until the end because they had technology currently under development.
- Refusal to submit data on the grounds that various supporting documents were lost during the recent office relocation process.
- An irregular investigation was conducted based on the analysis that corporate employees who received a tax reduction for local transfers mainly went to work at the Seoul branch, but they refused to submit the data, saying that all computerized attendance records were destroyed.

② Delay in submitting data or evidence during the investigation process

- When a foreign investment corporation requested the submission of data that it obviously possessed, the submission was delayed until the end of the investigation on the grounds that head office approval was required to submit the data.
- When a rental company was being investigated for allegedly missing income amounts and was asked to submit related documents and other documents, it responded by saying that it could not find the documents due to physical discomfort due to the stress of the tax audit and delayed submission until the end of the investigation period.

③ Submitting false or fabricated data during the investigation process

- When submitting data, intentionally deleting the summary column containing the contents from the Excel ledger and manipulating it to make computer verification difficult.
- Submission was intentionally delayed due to the large amount of documents stored at the local factory making transportation difficult, and then additional manipulation was made when submitting the data.
- Cash and card payment amounts were automatically recorded through a program that manages business sales electronically, but these are periodically deleted.

④ Refusal to submit data during investigation, but submitting data during litigation, etc.

- In a fairly frequent case, an omission in the amount of income is recognized during the investigation and a tax penalty is imposed, but later, during the appeal process or in a criminal trial under the Tax Offenders Punishment Act, additional data such as necessary expenses are submitted and this is acknowledged.
- In a case similar to the above, during the investigation of the data (a company that issues and distributes false tax invoices and other data for commercial purposes), some transactions were considered fabricated transactions and a tax notice was notified, but the data was not submitted at the time of the investigation. In the pre-tax adequacy review process, various materials were submitted to prove that some actual transactions occurred, leading to the conclusion that it is difficult to view them as fictitious transactions.

- Fines under Article 88 of the Framework Act on National Taxes appear to be the only means of sanctioning unfaithful behavior during the tax audit process.

- Initially, the fine was 5 million won per case, but with the revision in 2014, the upper limit of the fine was raised to 20 million won, and in 2022, it was revised again and raised to 50 million won. However, it does not act as an effective sanction for companies with large sales such as large corporations. It's true. In light of the fact that more than hundreds of millions of won in additional tax may be incurred if a taxpayer faithfully submits data, the reality is that the current fine level is insufficient to guarantee fulfillment of obligations.
- As seen in the above cases, if the taxpayer does not submit data during the investigation process, there is no choice but to respond firstly with a fine and secondly with estimated taxation. However, if the taxpayer submits the data during the appeal process, the taxation is eventually canceled. There is also a view that certain improvements are necessary in order for tax audits to play their role in ensuring fair taxation, as cases have arisen.

<Framework Act On National Taxes - Article 88 (Administrative Fines for Refusal to Perform Duties)>

- (1) The head of the competent tax office shall impose an administrative fine not exceeding 20 million won on a person who has made a false statement in response to a question by a tax official under regulations governing right to inquiry and investigation under tax-related statutes or a person who has refused or evaded the performance of duties.
<Amended on Dec. 21, 2021>

- For reference, if a taxpayer violates the obligation to submit data stipulated by law in an international transaction, a fine of up to 100 million won may be initially imposed, and if the taxpayer fails to submit data again, an additional fine of up to 200 million won may be imposed. Because this is possible, the level of sanctions has been raised for international transactions compared to domestic transactions.

<Adjustment Of International Taxes Act - Article 87

(Administrative Fines for Noncompliance with Obligation to Submit Data on International Transactions)>

- (1) Any of the following persons who fails to submit data by the deadline without any unavoidable cause prescribed by Presidential Decree or submits false data shall be subject to an administrative fine not exceeding 100 million won: <Amended on Dec. 31, 2022>
 1. A person obligated to submit a consolidated report on international transaction information under Article 16 (1) or a statement of international transactions under paragraph (2) 1 of that Article;
 2. A person in receipt of a request to submit data under Article 16 (4);
 3. A local constituent entity obligated to file a global anti-base erosion information return under Article 83 (1) or a local constituent entity obligated to file a return under paragraph (4) of that Article.
- (2) The tax authority may require a person on whom an administrative fine is imposed pursuant to paragraph (1) to submit data or correct false data within a specified period for compliance of 30 days; and where the person fails to submit data or to comply with the request for correction within such period, the authority may additionally impose an administrative fine not exceeding 200 million won in proportion to the period of delay.

- In addition, through a recent revision, a clause was added stating that after a fine for negligence is imposed, a 30-day performance period can be set again to request submission of data or correction of false data, and if the request is not fulfilled within the period, a fine of up to 200 million won can be imposed again.

2. Annual number and rate of tax audits

- In fact, in terms of the size of the tax audit, compared to the tax audit rate in the United States or Japan, the personal income tax investigation rate in Korea is 0.08% as of 2017, while the rate in the United States is 0.14% and Japan is 0.23%, which is significantly lower. In addition, the corporate tax investigation rate is 0.71% as of 2017, which is considerably lower than the 0.94% in the United States and 3.38% in Japan, and this investigation rate will be discussed in more detail in the relevant section below.
- Despite the low rate of tax audits, the rate of ‘no additional tax due from tax audit(No change)’ is generally around 5% in Korea, while in the United States it exceeds 10% for both individuals and corporations, and has recently approached 40% in the case of corporate audit in particular. In other words, Korea’s tax administration capabilities are excellent.

[the rate of no change due from NTS tax investigation]⁹⁾

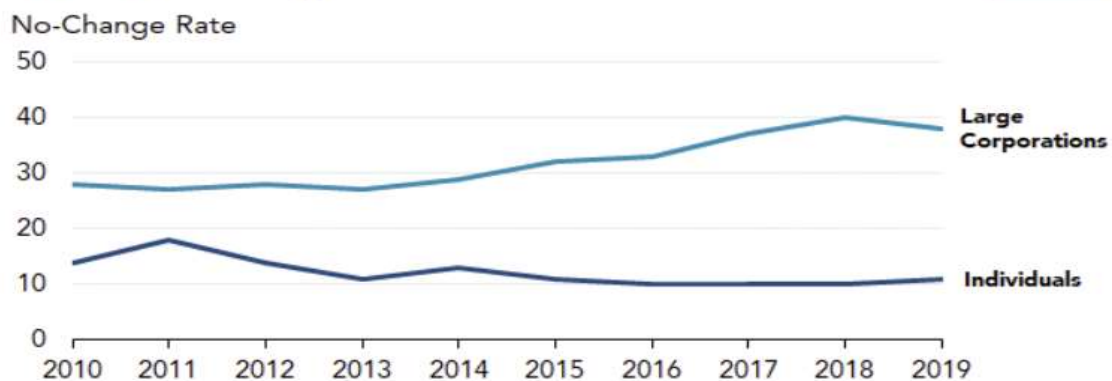
- As a result of analyzing the business investigation results conducted by the National Tax Service in the first half of 2009, it was found that there were 76 cases, or 5.1% of the total number of investigations, of 1,485 cases, in which there was no levied or additional tax amount. In the case of corporate business investigations, 57 out of 900 (6.3%) cases showed that there was no tax levied even though tax audits were conducted, and among the individual business investigations, there were 19 out of 585 (3.2%) investigations in which there was no levied tax amount.
- Of these, 67 cases were found to have no original omission, accounting for the majority. This result shows that some claims that ‘tax investigations are carried out unreasonably with the goal of collecting money’ are a misunderstanding.

9) This is different from the fact that ‘investigation is carried out until taxes are collected’, Newswire, Oct 21. 2009

[the rate of no change due from IRS tax investigation]¹⁰⁾

- In the 2019 tax audit of all large companies (with assets of \$10 million or more), the rate of no change was found to be very high at 38%, and for large companies with assets of \$20 billion or more, the rate was also very high at 16%. The no change rate of personal income tax was also high at 11%, but this phenomenon appeared to be noticeable in the investigation of large companies.
- There are various hypotheses as to why the no change rate in large companies is increasing, and an internal survey was conducted on employees, but the answers appeared to be unclear. Some experts believe that the biggest reason is that limited budgets and personnel reductions make it difficult for the IRS to compete with accounting firms and law firms with sophisticated strategies and highly paid tax experts.

Percentage of Income Tax Returns Audited With No Change



- Japan's National Tax Service also discloses tax investigation results in a very limited manner, but it discloses the number of underreporting cases among the number of investigations, so if the number of underreporting cases is subtracted from the number of investigation cases, it can be used in the same way as the no-performance statistics in Korea and the United States. To estimate the tax audit no change rate through this, as of 2017, income tax was 17.81% and corporate tax was 25.51%, which is very high compared to Korea. ¹¹⁾

10) Too Many IRS Audits of Big Businesses Result In No Change In Tax Liability, Janet Holtzblatt, Apr 19, 2021

11) The Operating State and the Reform Measures for the Tax Audit, An, Sook Chan, Jun 16, 2020

- The appropriate tax audit rate or probability will vary depending on each country's tax compliance and the form or characteristics of the tax audit system, but some, like Hyun Jin-kwon/Park Chang-gyun (2001) and Ahn Sook-chan (2020), point out that there is a need to increase the investigation rate to prevent tax evasion.

[Evaluation of Korea's tax investigation ratio]¹²⁾

- Although it is difficult to clearly assess the appropriateness of the level because the investigation ratio may vary depending on each country's tax compliance or other circumstances, it is suggested that Korea's investigation ratio is lower than that of the United States or Japan, and there is a need to maintain the investigation ratio appropriately.
- 'First, it is necessary to maintain the annual tax audit rate appropriately to ensure the effectiveness of the system. The scale of the tax investigation will be limited due to the size of the tax office's organization and investigation personnel, but it must be conducted at a level that can guarantee faithful tax payment by taxpayers. Although the income extraction ratio of individual business owners is quite high at 35.67%, the tax audit rate is only 0.10%, and the income extraction ratio of corporate businesses with income of 10 billion won or less is also close to 50%, but the investigation ratio is only 0.22%, currently. This raises questions about whether the very small number of tax audits is effective in realizing fair taxation. The investigation rate may vary depending on the socio-economic environment of each country or the taxpayer's tax awareness, but overall, the investigation rate in Korea is not high compared to the United States or Japan. According to Shim Hae-rin and two others (2019), corporate tax avoidance decreases as the tax audit rate increases.'

- However, since it is realistically difficult to increase the current manpower or budget in a short period of time, we will examine below whether there is a more efficient improvement plan within the scope of not significantly increasing the current scale.

12) The Operating State and the Reform Measures for the Tax Audit, An, Sook Chan, Jun 16. 2020

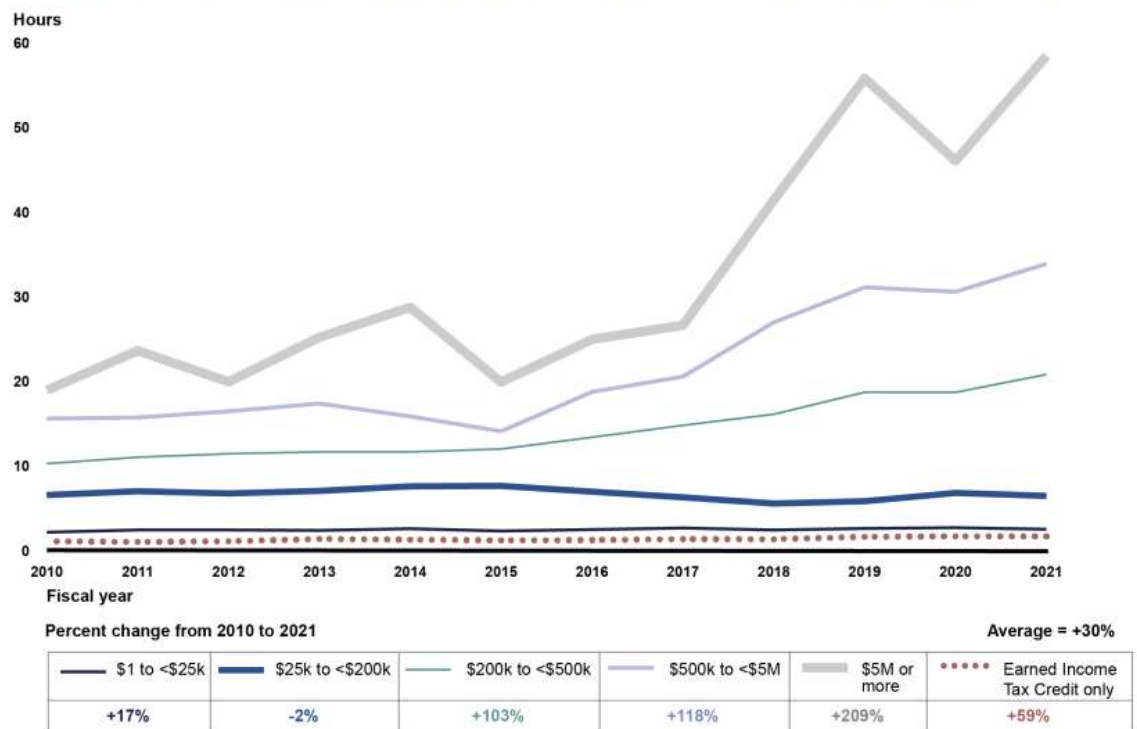
III. How to improve tax audit system efficiency

1. Changes in the tax environment: Global synchronization - focusing on the United States

○ In the United States, the tax audit period has also increased significantly recently. In the United States, there is no limit to the tax audit period, so statistics on the time required for the actual investigation can be seen as an indicator that best reflects the time required to invest in the tax audit. However, it is difficult to find this because thorough security is maintained for corporate businesses. , the time spent on researching individual businesses with income of \$5 million or more has recently shown a sharp increase of more than 200%, from approximately 20 hours in 2015 to close to 60 hours in 2021.

[Rapid Increase in Average U.S. Tax Audit Duration]¹³⁾

Figure 5: Average Hours per Audit, By Total Positive Income and Earned Income Tax Credit (EITC), Fiscal Years 2010 to 2021



13) GAO, TAX COMPLIANCE : Trends of IRS Audit Rates and Results for Individual Taxpayers by Income, May, 2022

- The main reasons are the recent high retirement rate of investigators, the lack of business continuity due to many factors hindering the working environment such as COVID-19, and frequent tax law revisions.
- The U.S. Center on Budget and Policy Priorities (CBPP) estimates that by 2022, when the COVID-19 situation is almost over, the IRS budget has been cut dramatically over the past decade, reducing the agency's ability to perform its basic duties of enforcing the nation's tax laws and helping taxpayers achieve voluntary compliance. It was pointed out that it was seriously damaged. Noting that the National Tax Service's workforce is rapidly decreasing and the audit rate for large corporations and high-income taxpayers has also plummeted, the tax gap is also growing, and stated that the IRS needs to be rebuilt.¹⁴⁾
- CBPP suggested that the current situation of the IRS is very poor and that there is a need to improve it. First, it is mentioned that the IRS's staff and budget (expressed as resources) are still 20% lower than in 2010.
- In particular, noting that funds related to tax verification and operational functions, which are essential elements for fair and efficient enforcement of tax laws, have decreased, it was also noted that even the minimum number of people required to be assigned to tax audits was deployed to respond to Covid-19.
- Due to this decrease in funds, the number of employees in the IRS tax verification department has also sharply decreased. In particular, the number of revenue agents (auditors) who directly conduct tax investigations has decreased by nearly 40% compared to 2010, raising concerns that this can be seen as a serious problem. Considering the recent increase in the number of retirees, it was stated that resources are needed to actively hire and train new tax inspectors.

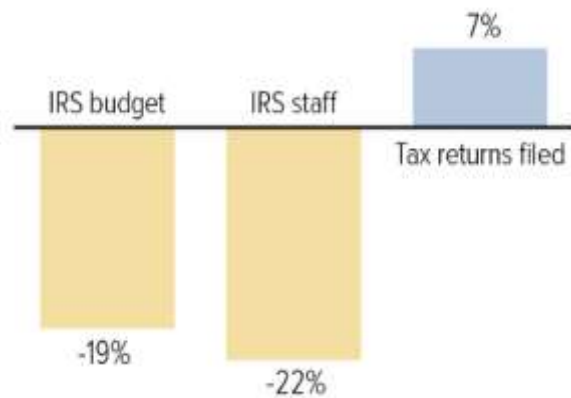
14) Center on Budget and Policy Priorities(CBPP), Chart Book: The Need to Rebuild the Depleted IRS, Dec. 2022

※ [The workload is rapidly increasing due to a decrease in IRS resources]

- While tax returns have increased by 7%, the budget has decreased by 19% and the number of employees has decreased by 22% compared to 2010.

Internal Revenue Service Faces Increased Workload with Fewer Resources

Percent change from 2010 to 2021 (funding adjusted for inflation)



Note: Figures compare 2010 to latest available (2015 for staff levels, 2017 for all else).

Source: Social Security Administration

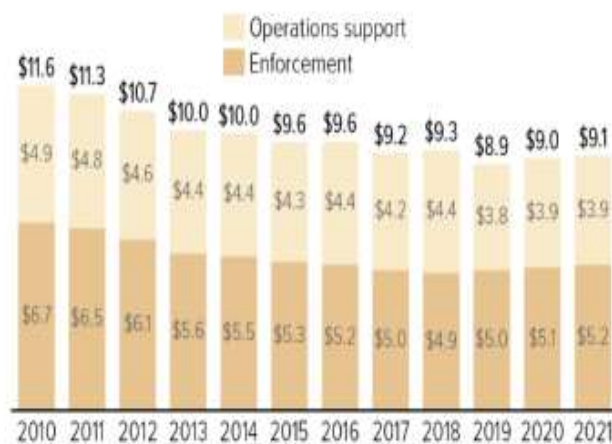
CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

※ [Decrease in funding for IRS tax verification and operational support department]

- Tax verification department cut by more than 30%

Funding for Enforcement and Operations Support Has Eroded

In billions of 2021 dollars



Note: Totals may not add due to rounding. Does not include funding from coronavirus relief legislation enacted in April and December of 2020. Operations support includes office space, information services, and other functions that support the enforcement division.

Source: CBPP analysis based on Office of Management and Budget and Congressional Budget Office data

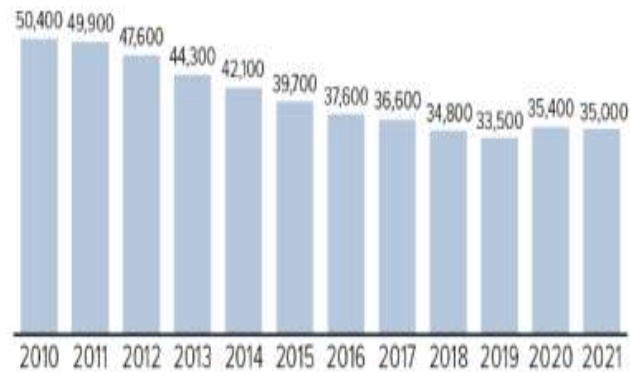
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※ [Impact of IRS budget reduction on the number of tax verification department staff]

- Compared to 2010, the number of employees is also more than 30% lower.

Budget Cuts Have Reduced Enforcement Staff by 31 Percent Since 2010

IRS full-time-equivalent enforcement staff funded through appropriations, by fiscal year



Source: Government Accountability Office through 2015; IRS Congressional Budget Justifications for 2016-2021.

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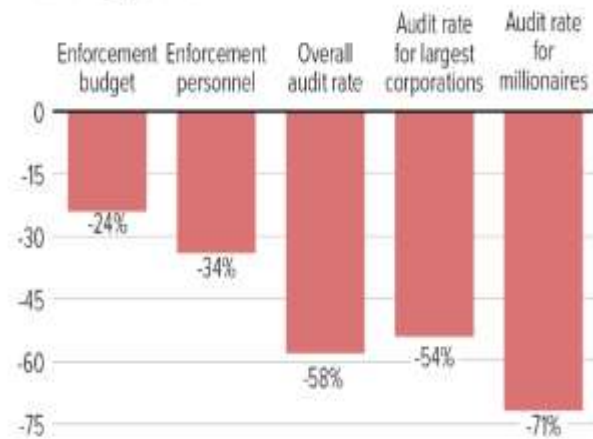
- What is receiving the most serious evaluation is the sharp decline in the number of tax verification cases, and the proportion of tax audits that require a direct verification process by highly trained staff using their know-how such as experience and education has decreased by 58% since 2010. There is great concern.
- During the same period, the tax audit rate for large corporations decreased by 54%, and the tax audit rate for high-income individuals with income of more than \$1 million decreased by 71%.
- American society is taking the IRS' resource depletion quite seriously. The IRS estimates the "Gross Tax Gap," the amount of tax that taxpayers voluntarily do not pay on time, was \$441 billion annually for the 2011-2013 period, with the most recent estimate being \$441 billion per year for the 2011-2013 period. and subsequent collections from late fees, the "Net Tax Gap" was \$381 billion annually during this period.

※ [Severe depletion of IRS tax verification functions from 2010 to 2019]

- In particular, the annual tax audit rate plummeted by 58% compared to 2010.

IRS Enforcement Severely Depleted

Percent change, 2010-2019*



*The decline in the enforcement budget is as of 2020, adjusted for inflation.

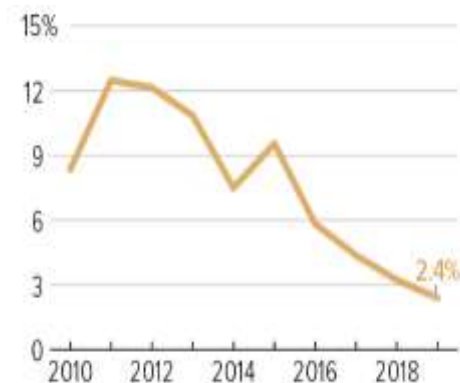
Note: Largest corporations refers to corporations with \$1 billion or more in assets. Millionaires are those with total positive annual income above \$1 million. Audit rates are calculated by comparing the number of audits closed in a given fiscal year with the number of returns filed in the preceding calendar year. The IRS changed its method of calculating audit rates for the 2020 Data Book and all future Data Books. The agency now calculates rates by comparing the number of in-process and closed audit rates in a given tax year with the number of returns filed in that same tax year.

Source: CBPP calculations of IRS and Department of Treasury data

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Audits on Millionaires Have Fallen 71 Percent Since 2010

Audit rate, by fiscal year



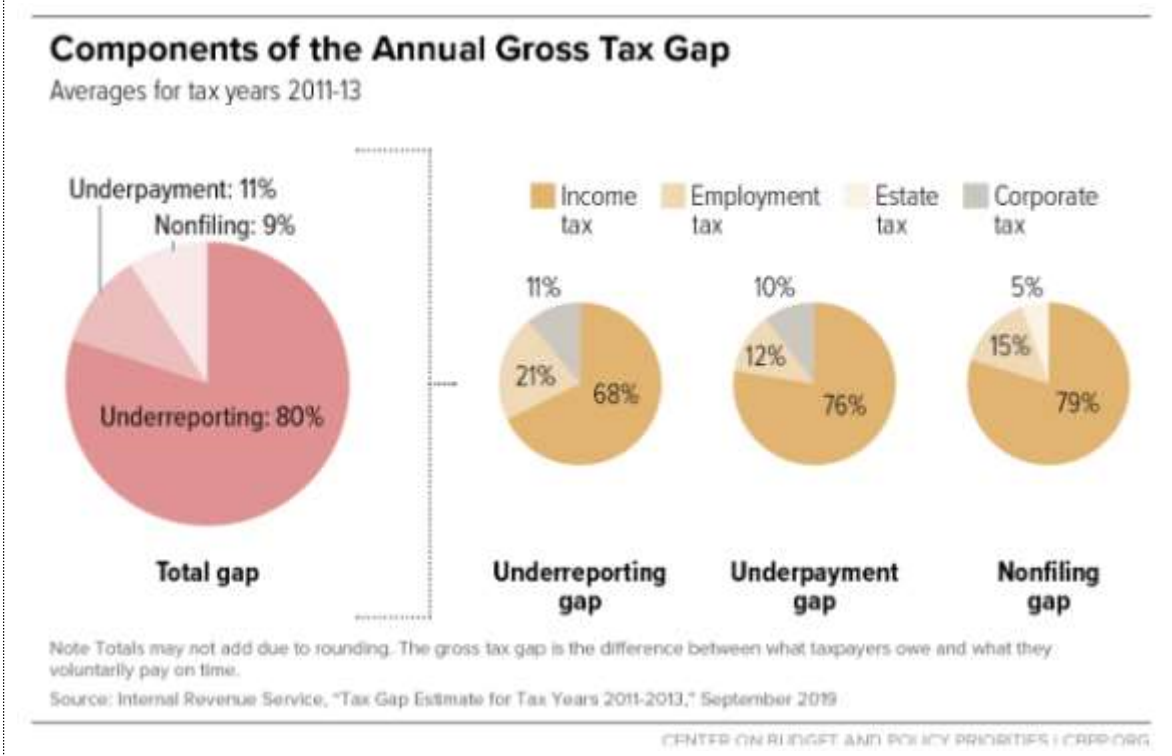
Note: Millionaires = filers with incomes greater than \$1 million. Audit rates are calculated by comparing the number of audits closed in a given fiscal year with the number of returns filed in the preceding calendar year. The IRS changed its method of calculating audit rates for the 2020 Data Book and all future Data Books. The agency now calculates rates by comparing the number of in-process and closed audit rates in a given tax year with the number of returns filed in that same tax year.

Source: IRS Data Books, 2010-2019

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- According to current Treasury Department estimates, the 'net tax gap' in 2019, which is depleting IRS resources, is approximately \$548 billion and is estimated to reach approximately \$7 trillion over the next 10 years. IRS Commissioner Charles Rettig said the Treasury Department's estimates were somewhat underestimates and predicted the net tax gap could reach \$1 trillion in 2019 due to the rise in hard-to-trace income from digital currencies and offshore accounts.
- In addition, as will be explained later, the degree of tax evasion by wealthy households is estimated to be much greater than the existing IRS estimates, and its impact on the net tax gap is also significant, which is reflected in the current IRS policy direction and targeting.

※ [Total annual tax gap measured over the period 2011-2013]



- Accordingly, the United States is struggling to prepare a long-term plan to significantly increase manpower in accordance with the 'Inflation Reduction Act', and tax authorities in countries outside of COVID-19, such as the UK, are also making efforts to normalize tax audits. This is discussed below. Decided to take a look

2. Measures to improve tax verification efficiency in major countries

1) United States

○ i. Strengthening qualitative factors

- In the case of the United States, the most notable change was the introduction of the so-called 'Campaign Approach'.
- Since 2016, the IRS has reorganized the tax investigation method for large corporations, changing from a taxpayer - focused to an issue-focused campaign approach and changing the tax investigation paradigm to a risk-focused approach.
- First, it is necessary to look at the background of the reform. As of 2023, the IRS is still experiencing difficulties due to lack of manpower and budget, but it appears that the beginning began about 10 years ago. The IRS's budget in 2016, when the campaign-style tax audit was introduced, was \$11.7 billion, the lowest since 2008, and when inflation is taken into account, it was the lowest in 20 years since 1998.
- The workforce was approximately 76,000 in 2017, a decrease of 19% compared to 95,000 in 2010. In particular, the tax investigation and collection workforce decreased even more significantly, decreasing by nearly 30% compared to 2010.
- The annual tax audit rate and Recommended Additional Tax for large businesses also fell significantly, reaching only one-third of the level in 2010 in 2015 and half of the level in 2010 in 2016. Recommended Additional Tax per tax audit is also trending downward.
- The number of tax audits for large corporations at the time of the reorganization also decreased to about 6,450 in 2016, which is only 63% of the 10,200 pending in 2010. The tax audit rate also fell to less than 10%, below 60% compared to 16.6% in 2010.

- In other words, in a situation where resource depletion such as budget and manpower is accelerating, it has become difficult to secure tax payment faithfulness by maintaining an appropriate tax audit rate using traditional tax audit methods.

※ [At the time of introduction of the system, Recommended additional tax from the IRS tax audit of large corporations, etc.]

tax year	Recommended additional tax (1,000\$)	number of tax audits	Recommended additional tax per tax audit (1,000\$)
2010	25,280,520	10,207	2,477
2011	24,843,737	10,459	2,375
2012	17,024,825	10,752	1,583
2013	15,517,249	9,876	1,571
2014	16,297,035	7,858	2,074
2015	9,014,876	7,410	1,217
2016	13,192,852	6,453	2,044

※ [At the time of introduction of the system, the number and rate of tax audits of large corporations by the IRS, etc.]

tax year	number of returns	number of tax audits	ratio
2010	61,570	10,207	16.6%
2011	59,291	10,459	17.6%
2012	60,489	10,752	17.8%
2013	62,347	9,876	15.8%
2014	64,261	7,858	12.2%
2015	66,484	7,410	11.1%
2016	67,701	6,453	9.5%

- First, in 2016, the IRS preemptively determined that investigations of large corporations and international transactions were causing a serious loss of tax revenue and carried out reorganization. In other words, the existing Large and Medium-Size Business Division (LMSB) was reorganized into the Large Business and International (LB&I).
- In other words, the organization was reorganized from an industry-specific organization to a practice-specific organization to concentrate resources (staff and budget) on areas with a higher risk of tax evasion.¹⁵⁾
- Accordingly, at that time, the IRS analyzed tax evasion risks, selected issues or issues on which to focus its capabilities, and introduced campaign-style tax investigations to build consensus by preemptively announcing them to the public.
- The existing method of having each investigation team review reports and tax issues was changed to a method where the central department conducts actual tax investigations on issues that have been analyzed. In other words, the headquarters selected the campaign target through an analysis of the risk of evasion using internal and external data.
- Before the initial announcement in January 2017, we analyzed a large amount of data and conducted and analyzed hundreds of internal proposals to select issues and maintain an appropriate level of tension for taxpayers by not excluding selection due to the small number of applicable subjects.

15) However, from 2024 onwards, due to the influence of the 'Inflation Reduction Act' and the 'Taxpayer First Act', the organization for each type of taxpayer will be reorganized into an organization by function, and the existing large corporate international tax bureau will be investigated. It is said that functions will be separated and a dedicated investigation organization will be operated.

※ [Organizational reorganization before and after campaign approach]

- Reorganized from an industry-specific organization to a practice-specific organization.

Before (LMSB)	After (LB&I)
(6 Domestic Industries)	(5 Substantive Practices)
<ul style="list-style-type: none"> ▪ Financial Services ▪ Retailers, Food, Transportation and Healthcare ▪ Communications, Technology, and Media ▪ Heavy Manufacturing and Pharmaceutical ▪ Natural Resources and Construction 	<ul style="list-style-type: none"> ▪ Pass-through entities, ▪ Enterprise activities ▪ Treaty and transfer pricing ▪ Withholding and international individual ▪ Cross-border activities
(4 International Functions)	(4 Geographic Practices)
<ul style="list-style-type: none"> ▪ International Individual Compliance ▪ International Business Compliance ▪ Global High Wealth ▪ Transfer Pricing Operations 	<ul style="list-style-type: none"> ▪ Northeast(New York) ▪ East(Illinois), ▪ Central(Houston), ▪ West(Oakland)

- In addition, by providing clear guidelines on the work to be performed during the actual field investigation process and providing prior training through the preparation of standard questionnaires, the autonomy of each tax inspector was limited to a certain extent and allowed them to focus on the campaign. However, if there were other major issues discovered during the course of conducting the investigation, it was of course possible to investigate them.
- In particular, while trying to encourage voluntary and honest tax payment through active promotion and internal reporting, we have improved sincerity through various methods such as soft-letter, outreach, Develop published guidance, Forms changes, etc. in addition to tax audits. When announcing the campaign, we have promoted the general manager and the department in charge. By listing them together, transparency and policy accountability have been strengthened.

- The general manager did his best to promote the campaign by holding a seminar jointly with private professional organizations such as EY or KPMG to provide information on the background and details of the campaign selection.
- If the announced campaign is judged to have achieved its intended purpose, the campaign will be terminated, and campaigns currently active in 2023 will continue to be posted on the website.
- Looking at the operation method of the campaign, we look at not only the tax investigation method, but also encouraging voluntary reporting by sending soft letters, face-to-face publicity (Outreach), developing published guidance and even format revisions. It is possible to use methods that can efficiently reduce the risk of the campaign topic, such as using available methods, and the IRS has great discretion to select and verify the most 'appropriate' method for the purpose of the investigation.
- For reference, it is known that taxpayers under investigation do not know whether the tax investigation they are receiving is an issue extracted through the 'campaign' method or some other selection method was used, and the investigation staff also does not disclose this separately. Known. This is a reasonable measure for research efficiency.

※ [Active campaign(as of April 2023)]¹⁶⁾

* listed in alphabetical order under 'the subject matter' and/or 'geographic practice area' with jurisdiction over each campaign.

** The date each campaign was launched is shown next to the campaign.

○ **Cross-Border Activities Practice Area**

- Corporate Direct (Section 901) Foreign Tax Credit (11/03/17)
- Financial Service Entities Engaged in a US Trade or Business (06/07/21)
- Foreign Base Company Sales Income: Manufacturing Branch Rules (09/10/18)
- Form 1120-F Delinquent Returns (10/30/18)
- Form 1120-F Interest Expense/Home Office Expense (09/10/18)
- Form 1120-F Non-Filer & Protective Return US Business Activity (01/31/17)
- IRC 965 - Treatment of Deferred Foreign Income Upon Transition to Participation Exemption System of Taxation (11/04/19)

○ **Enterprise Activities Practice Area**

- Allocation of Success-Based Fees Without Rev. Proc 2011-29 (09/14/20)
- Costs that Facilitate an IRC 355 Transaction (03/13/18)
- IRC 199 - Claims Risk Review (09/10/18)
- IRC Section 807(d) - Computation of Life Insurance Reserves (09/14/20)
- IRC Section 807(d) - Re-Computation of Life Insurance Reserves (09/14/20)
- Limitations on Consolidated Net Operating Loss Carryovers (09/28/20)
- Micro-Captive Insurance (01/31/17)
- Research Issues (02/27/20)
- Syndicated Conservation Easement Transactions (09/10/18)
- Tax Cuts and Jobs Act (TCJA) (05/01/20)

16) IRS, LB&I Active campaigns, 2023. 5. 8.

※ [Active campaign(as of April 2023, continued)]¹⁷⁾

○ **Pass-Through Entities Practice Area**

- Distribution in Excess of Partner' s Basis (02/07/22)
- Partnership Losses in Excess of Partner's Basis (02/07/22)
- S Corporation Distributions (07/02/18)
- S Corporation Losses Claimed in Excess of Basis (01/31/17)
- S Corporations Built in Gains Tax (07/19/19)
- Sale of Partnership Interest (03/13/18)
- Self-Employment Contributions Act (SECA) Tax (03/13/18)

○ **Treaty and Transfer Pricing Operations Practice Area**

- Captive Services Provider (04/16/19)

○ **Withholding & International Individual Compliance Practice Area**

- Expatriation of Individuals (07/19/19)
- FATCA Filing Accuracy (10/30/18)
- Financial Service Entities Engaged in a US Trade or Business (06/07/21)
- FIRPTA Reporting Compliance for NRAs (09/14/20)
- Foreign Earned Income Exclusion (11/03/17)
- Forms 1042/1042-S Compliance (05/21/18)
- Form 1120-F Chapter 3 and Chapter 4 Withholding (11/03/17)
- High Income Non-filer (07/19/19)
- Individuals Employed by Foreign Governments & International Organizations (09/10/18)
- Individual Foreign Tax Credit Phase II (10/30/18)
- IRC Section 965 for Individuals (07/06/20)
- Loose Filed Forms 5471 (04/16/19)
- Nonresident Alien Individual Tax Credits (05/21/18)

¹⁷⁾ IRS, LB&I Active campaigns, 2023. 5. 8.

※ [Active campaign(as of April 2023, continued)]¹⁸⁾

- Distribution in Excess of Partner' s Basis (02/07/22)
- Nonresident Alien Schedule A and Other Deductions (05/21/18)
- Nonresident Alien Tax Treaty Exemptions (05/21/18)
- Offshore Private Banking (04/16/19)
- Offshore Service Providers (10/30/18)
- Post Offshore Voluntary Disclosure Program Compliance (07/19/19)
- Swiss Bank Program Campaign (11/03/17)
- US Territories – Erroneous Refundable Credits (07/19/19)
- US Territories Self Employment Tax (07/19/19)
- Verification of Form 1042-S Credit Claimed on Form 1040NR (11/03/17)
- Virtual Currency (07/02/18)

- **Withholding, Exchange & International Individual Compliance Practice Area**
 - Nonresident Alien Rental Income from US Real Property (10/05/20)
 - Puerto Rico Act 22, Individual Investors Act (01/27/21)

- **Eastern Compliance Practice Area**
 - Research Issues (02/27/20)
 - Syndicated Conservation Easement Transactions (09/10/18)

- **Northeastern Compliance Practice Area**
 - Limitations on Consolidated Net Operating Loss Carryovers (09/28/20)
 - SECA Tax (03/13/18)

- **Western Compliance Practice Area**
 - Individual Foreign Tax Credit (Form 1116) (11/03/17)
 - Taxable Asset Transactions – Matching Buyers and Sellers (01/27/21)

18) IRS, LB&I Active campaigns, 2023. 5. 8.

※ [Treatment streams commonly used or used in conjunction with tax investigations during the tax verification process for campaign topics are as follows]

- As shown in the example below, verification is focused on issue-base tax examination, but other methods are also used in parallel to achieve the purpose.

Campaign Title	Treatment Streams
1. IRC 48C Energy Credit Campaign	Soft letters and <u>issue-focused examinations</u>
2. OVDP Declines – Withdrawals Campaign	Variety of treatment streams <u>including examination</u>
3. Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (MVPDs) and TV Broadcasters	Development of an externally published practice unit, potential published guidance and <u>issue-based exams</u> , when warranted
4. Micro-Captive Insurance Campaign	<u>Issue-based examinations</u>
5. Related Party Transactions Campaign (for taxpayers in “mid-market segment”)	<u>Issue-based examinations</u>
6. Deferred Variable Annuity Reserves & Life Insurance Reserves IIR Campaign	Develop published guidance
7. Basket Transactions Campaign	<u>Issue-based examinations</u> , soft letters to material advisers and practitioner outreach
8. Land Developers-Completed Contract Method (CCM) Campaign	Development of a practice unit, issuance of soft letters and follow-up with <u>issue-based examinations</u> when warranted
9. TEFRA Linkage Plan Strategy Campaign	Developing new procedures and technology to work collaboratively with the revenue agent conducting the TEFRA partnership examination (this is not specifically identified as a treatment stream, though it appears to be the driving output of the campaign approach)

※ [Treatment streams commonly used or used in conjunction with tax investigations during the tax verification process for campaign topics are as follows, continued]

Campaign Title	Treatment Streams
10. S Corporation Losses Claimed in Excess of Basis Campaign	<u>Issue-based examinations</u> , soft letters encouraging voluntary self-correction, conducting stakeholder outreach and creating a new form for shareholders to assist in properly computing their basis
11. Repatriation Campaign (focus on “mid-market population”)	Improve issue selection filters while conducting examinations on identified, high-risk repatriation issues (this is not specifically identified as a treatment stream, though it appears to be the driving output of the campaign approach)
12. Form 1120-F Non-Filer Campaign	Soft-letter outreach – if companies do not take appropriate action, LB&I will conduct <u>examinations</u>
13. Inbound Distributor Campaign	<u>Issue-based examinations</u>

- However, Treasury Inspector General for Tax Administration (TIGTA) has pointed out the following points regarding campaign-based tax audits, which need to be considered when considering their introduction in Korea in the future.¹⁹⁾
- At the beginning of the campaign's introduction, various proposals were received, and about 730 proposals were received before the public announcement, but the number of campaign submissions received has decreased sharply since then. There was a continuous decline, with 194 submissions in 2017, 51 in 2018, and 2 in February 2019.
- In 2019, only 15% of the total LB&I inventory was created through campaigns, and the remaining 85% were generated through traditional methods such as CAP (Compliance Assurance Process), CIC (the Coordinated Industry Case

19) Treasury Inspector General for Tax Administration(TIGTA), “Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection”, 2019. 9월

program), and DAS(Discriminant Analysis System). It is known that targets are selected using methods such as scoring of the Discriminant Analysis System. Although the campaign is classified as one of the seven compliance criteria for selecting investigation targets, some have pointed out that it falls somewhat short of initial expectations.

- In addition, the initially selected 13 campaigns were criticized for the fact that they were selected simply through a 'first in, first out' method and did not select the areas with the greatest tax evasion risk. This is something that must be considered when considering its introduction in Korea in the future, as similar criticism has been received against campaigns developed later.

※ Tigta has evaluated returns closed, Agreed %, Unagreed %, No change %, Recommended Dollars, etc. for 18 of the 24 campaign topics announced until September 2018 (ex. Micro-Captive Insurance, Baske Transaction, etc.).

- For some topics (ex. Micro-Captive Insurance), questions were expressed about the selection of topics because they were areas that had been intensively verified by existing research methods. However, regardless of this, the campaign research itself is still actively operated and actual evaluations are positive.



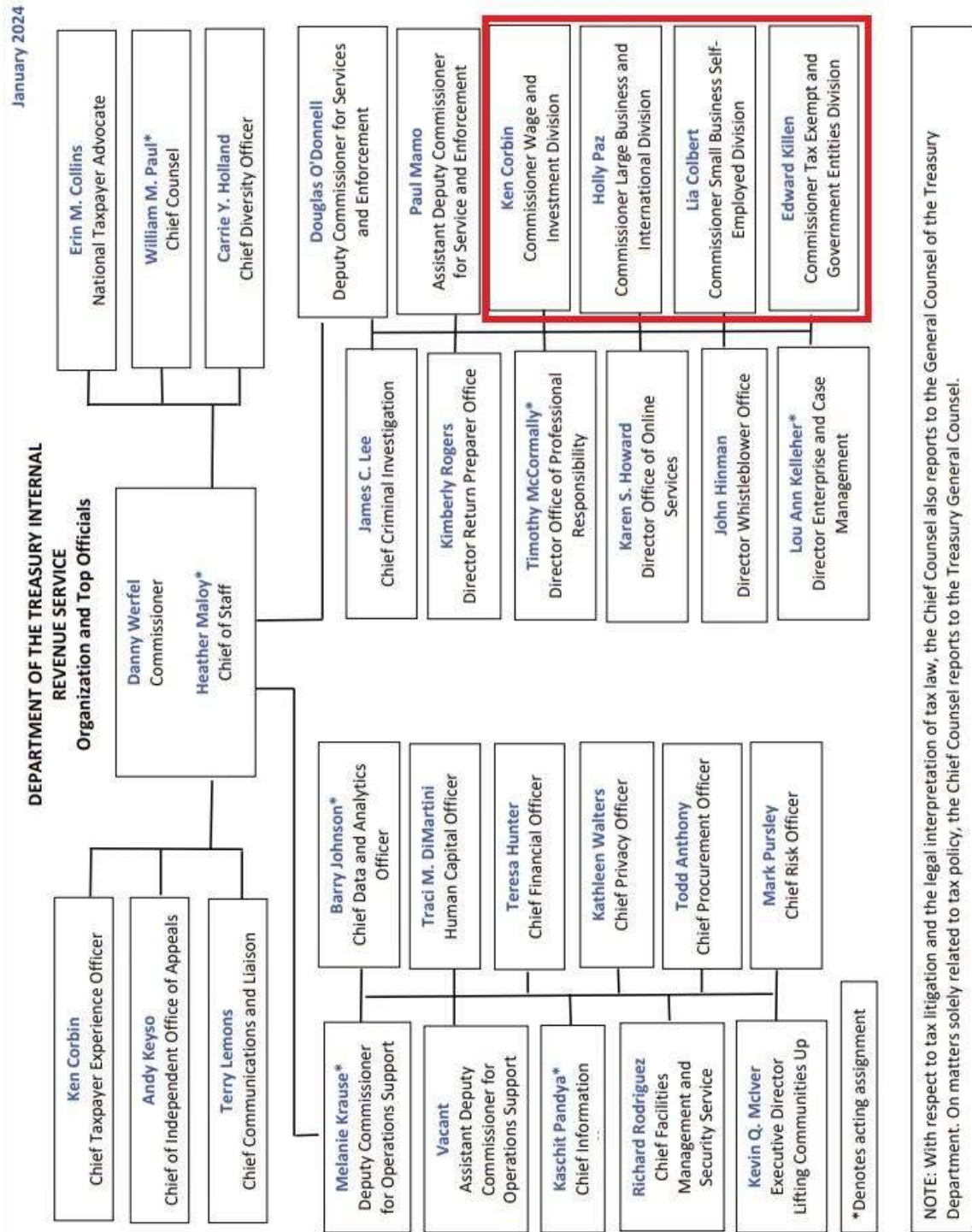
Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection

The measures above reflect the cumulative results for each campaign since the campaign was announced. However, these results may also include results of work performed while a particular campaign was previously a compliance project or CIP. For example, the Micro-Captive Insurance Campaign was previously a promoter examination and was converted to a campaign in September 2017.

The campaign program may incorporate multiple treatment streams in addition to issue-based examinations. These can include administrative guidance, outreach, new legislation, published guidance, soft-letters/notices, and tax forms or publications. The results above are related to issue-based examinations which are the result of the IRS's identification, selection, and development of these issues into campaigns.

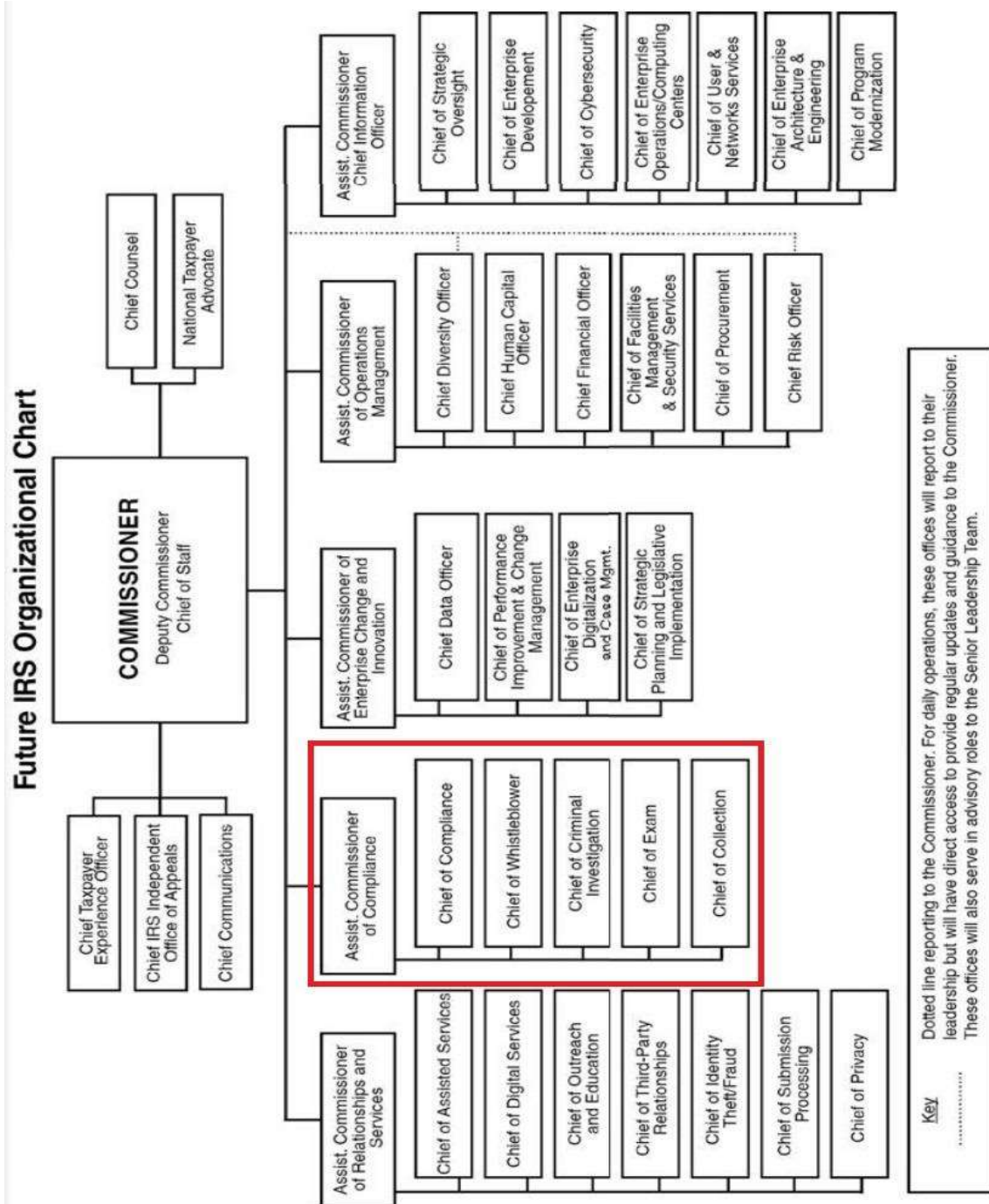
※ [Reference ❶] IRS current organization chart (see IRS website as of January 2024)

- Rather than having a separate investigation organization, the organization and work are divided by taxpayer type, and as a result, LB&I or SB/SE are responsible for everything from report verification to tax investigation.



※ [Reference ②] IRS organizational chart to be changed in the future (announced in December 2023)

- Due to the influence of the Taxpayer First Act, etc., the organization will be reorganized by function and a Chief of Examination will be appointed, and Criminal Investigation will also be assisted. Scheduled to be incorporated under Commissioner of Compliance



○ ii. Strengthening quantitative factors

- In the United States, the campaign method was well received, but as mentioned above, many people agreed with the need to reorganize the organization after the Covid-19 pandemic. The latest report in 2023 also emphasized the need to focus on areas with a high risk of tax evasion, such as partnership audits, taking a 'selection and concentration' strategy, while also emphasizing that strengthening quantitative factors by increasing manpower and budget must be supported.²⁰⁾
- A new study by the IRS and economists shows that the extent of tax evasion by wealthy households is much greater than previous IRS estimates. The latest research suggests that it is necessary to focus on high-income tax evasion in order to realize a fair economy after the COVID-19 pandemic as a policy direction, and that it is urgent to provide greater financial support to the IRS for this purpose.²¹⁾
- The IRS estimates the tax gap through random audits to be approximately 16% of total taxes, but although this may be accurate for 99% of taxpayers, it hardly reflects the tax gap for the top 1%.
- In other words, according to IRS estimates, it appears that high-income earners rarely evade taxes when reporting taxes, but in reality, this is not the case, and when considering concealment of overseas assets and relay income, the proportion appears to rise significantly.
- Following the IRS's efforts to crack down on offshore tax evasion, including the enactment of the Foreign Accounts Tax Compliance Act in 2010, the first reports of hidden foreign bank accounts were made between 2009 and 2011, with hundreds of these taxpayers just before being made public. They underwent

20) GAO-23-106020, Tax Enforcement : IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships, 2023

21) John Guyton, Patrick Langetieg, Daniel Reck, Max Risch, Gabriel Zucman 등, TAX EVASION AT THE TOP OF THE INCOME DISTRIBUTION: THEORY AND EVIDENCE, 2023

random tax audits, and most of them say that offshore tax evasion was not detected during the random audit process, and in particular, the percentage appears to be concentrated in the top 1%. In other words, it was assessed that the tax gap cannot be properly estimated through random audits.

❖ The IRS announced that it will focus on verification from working-class taxpayers to the wealthy, and will use artificial intelligence and improved technology to respond to tax avoidance, revealing key management areas.²²⁾

Major expansion in high-income/high wealth and partnership compliance work

Prioritization of high-income cases. In the High Wealth, High Balance Due Taxpayer Field Initiative, the IRS will intensify work on taxpayers with total positive income above \$1 million that have more than \$250,000 in recognized tax debt. Building off earlier successes that collected \$38 million from more than 175 high-income earners, the IRS will have dozens of Revenue Officers focusing on these high-end collection cases in FY 2024. The IRS is working to expand this effort, contacting about 1,600 taxpayers in this category that owe hundreds of millions of dollars in taxes.

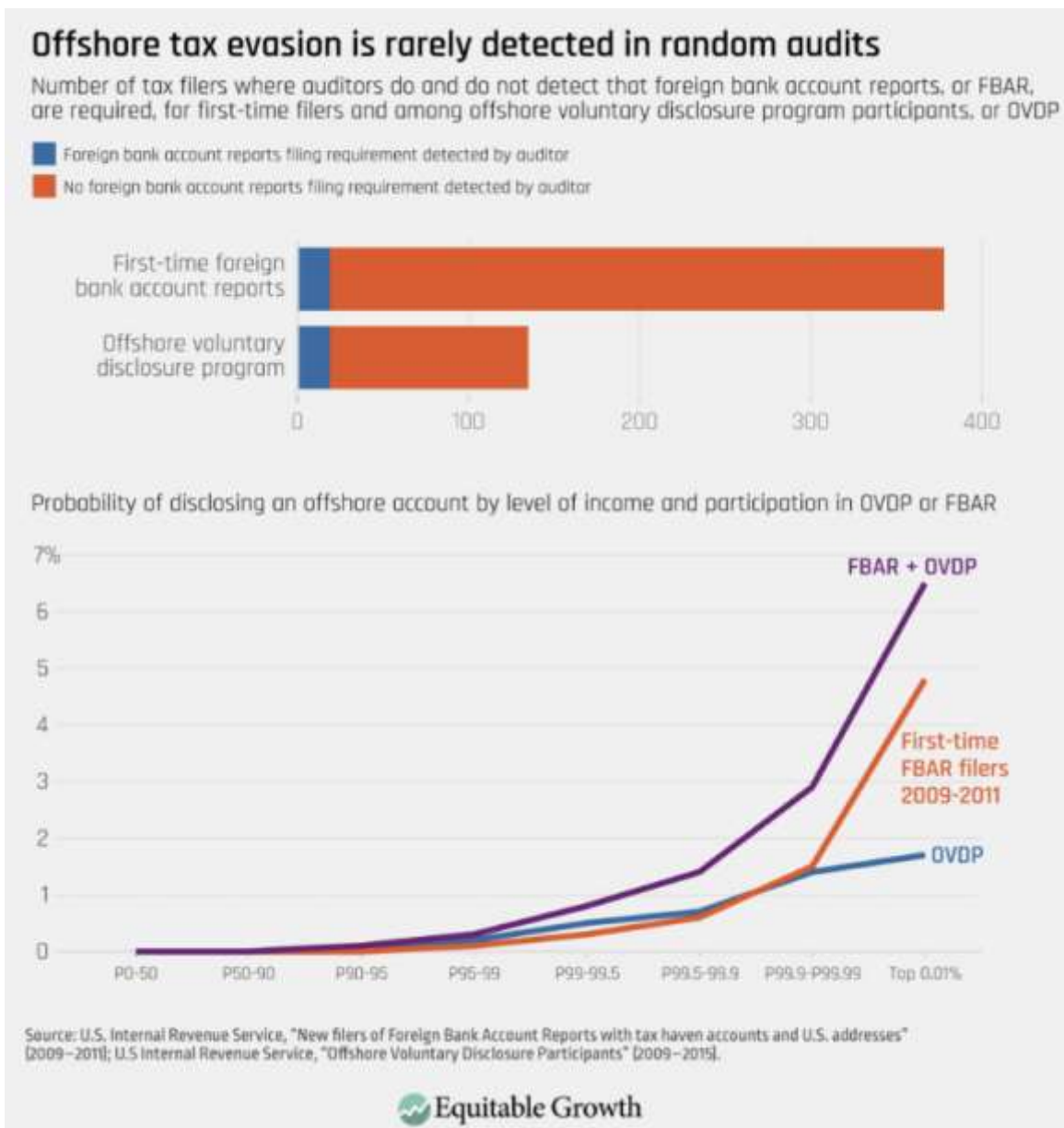
Expansion of pilot focused on largest partnerships leveraging Artificial Intelligence (AI). The complex structures and tax issues present in large partnerships require a focused approach to best identify the highest risk issues and apply resources accordingly. In 2021, the IRS launched the first stage of its Large Partnership Compliance (LPC) program with examinations of some of the largest and most complex partnership returns in the filing population. The IRS is now expanding the LPC program to additional large partnerships. With the help of AI, the selection of these returns is the result of groundbreaking collaboration among experts in data science and tax enforcement, who have been working side-by-side to apply cutting-edge machine learning technology to identify potential compliance risk in the areas of partnership tax, general income tax and accounting, and international tax in a taxpayer segment that historically has been subject to limited examination coverage. By the end of the month, the IRS will open examinations of 75 of the largest partnerships in the U.S. that represent a cross section of industries including hedge funds, real estate investment partnerships, publicly traded partnerships, large law firms and other industries. On average, these partnerships each have more than \$10 billion in assets.

Greater focus on partnership issues through compliance letters. The IRS has identified ongoing discrepancies on balance sheets involving partnerships with over \$10 million in assets, which is an indicator of potential non-compliance. Taxpayers filing partnership returns are showing discrepancies in the millions of dollars between end-of-year balances compared to the beginning balances the following year. The number of such discrepancies has been increasing over the years. Many of these taxpayers are not attaching required statements explaining the difference. This effort will focus on high-risk large partnerships to quickly address the balance sheet discrepancy. Prior to the IRA, the IRS did not have the resources needed to follow up and engage with all the large partnerships with such discrepancies. However, the IRS will soon have the resources and plan in place to ramp up this effort. It will begin in early October when the IRS will start mailing around 500 partnerships. Depending on the response, the IRS will add these to the audit stream for additional work.

22) IRS, "IRS announces sweeping effort to restore fairness to tax system with Inflation Reduction Act funding; new compliance efforts focused on increasing scrutiny on high-income, partnerships, corporations and promoters abusing tax rules on the books", 2023. 9월

- The IRS will prevent an increase in audit rates for people making less than \$400,000 per year and add new fairness safeguards for people claiming the Earned Income Tax Credit
- In particular, we plan to focus on high-income earners of \$1 million or more and large-scale partnerships.

✧ Disadvantages of Random audits



- A factor that was not considered in the random audit was so-called 'pass-through income.' In the United States, research shows that the income from partnerships and S corporations generates more than half of corporate income and accounts for a significant portion of the increase in the income share of the top 1% since 1980. In other words, diesel income is much more concentrated in high-income earners than traditional business income, ownership is unclear, and the average federal income tax rate is 19%, which is lower than the average tax rate for existing companies.²³⁾
- Even if diesel income is discovered during the IRS's random investigation, less than 5% of cases lead to an audit of the company itself, and as a result, cases of corporate tax evasion are rarely found. This is a factor that may worsen the tax gap.
- There are three reasons why tax evasion is concentrated among high-income earners. First, it requires high costs and considerable sophistication to conceal tax evasion from tax audit enforcement personnel. Second, high-income earners can save a large amount of tax while taking little risk by developing a sophisticated strategy, resulting in high utility-to-cost ratio. Lastly, because the investigation rate at the top is relatively high, if the audit is 'not thorough enough to correct sophisticated tax evasion,' the frequent investigation itself is a factor in concealing tax evasion.
- In particular, the third reason has significant implications for Korea. That is, the original purpose of the investigation, which is to encourage voluntary and faithful reporting, can be achieved only when a more thorough verification of evaded income, such as offshore tax evasion or source companies of transit income, is conducted, and random audits are required. 'Frequent audits' of low-intensity investigations without

23) Business in the United States: Who Owns It, and How Much Tax Do They Pay?, The University of Chicago Press Journals

knowledge of specific allegations can be seen as having the same effect as granting immunity.

※ Some research results show that frequent tax audits of weak intensity, such as random audits, can actually accelerate the concealment of tax evasion.²⁴⁾

Proposition 2. Incentivizing Concealment. *Holding all else fixed, increasing the probability of detection under $\alpha = 0$ will weakly increase concealment.*

Proposition 2 implies that if there is a concealment action that shields evasion against a particular type of enforcement, increasing that type of enforcement incentivizes adoption of that concealment strategy. Our results suggest that broad 1040 audits like NRP random audits (and the SBSE audits with similar procedures) do not detect some types of evasion. Increasing the frequency of these types of audits could therefore incentivize adoption of sophisticated types of evasion. It also implies that increasing more sophisticated types of audits could incentivize *even more sophisticated* types of concealment, if available. Under a slightly different interpretation of the model, the proposition implies that frequent audits could incentivize the adoption of gray-area avoidance strategies that would require protracted litigation to challenge. Altogether, the fact that audits overall are relatively common at the top of the income distribution (see Figure A6a) suggests that a variety of more sophisticated concealment and dubious avoidance activities should be more prevalent at the top, all else equal.

- (Conclusion and Implications) The IRS self-evaluated that its cleaning capabilities have decreased significantly compared to before due to the recent response to COVID-19. Accordingly, the ‘selection and concentration’ strategy was adopted to focus taxation capabilities on preventing tax evasion by high-income earners. However, what is more important is that it is also focusing on strengthening quantitative factors, such as planning to massively supplement the IRS workforce, which has suffered a serious decline over the past 10 years, and improve the capabilities of tax inspectors.

24) TAX EVASION AT THE TOP OF THE INCOME DISTRIBUTION: THEORY AND EVIDENCE

2) The United Kingdom

- The United Kingdom also appears to be focusing its capabilities on areas that need to be concentrated, such as making efforts to strengthen tax verification for individuals with 'high net worth' in 2016.
- The UK National Audit Office (NAO) also revealed that tax revenue losses due to tax avoidance and non-compliance during the pandemic amounted to 9 billion pounds (about 15 trillion won). It was mentioned that the main reason for this was the transfer of 1,350 tax verification employees to the Covid-19 response department.
- The UK is also improving 'qualitative factors', such as focusing on verification of the scale of tax evasion and high-risk groups such as high-income earners, while also striving to strengthen 'quantitative factors' such as reducing the number of tax investigations after experiencing COVID-19.

※ The UK's Her Majesty Revenue & Customs(HMRC) announced that its investigation capabilities were weakened and public finances were lost as tax verification staff were relocated to support departments during the COVID-19 process (approximately 12% of staff were redeployed).²⁵⁾

- Before the pandemic, tax revenue from tax verification, etc. averaged 5.2% of total tax revenue, but decreased to 4.2% between 2020 and 2022, resulting in a loss of 9 billion pounds.
- Criminal prosecutions for tax crime cases also plummeted from about 700 in the previous period to 163 in the 2020-2021 period, pointing out that there is a high possibility that the tax gap will continue to increase in the process of returning to normal levels in the future. To this end, it was argued that rapid work efficiency was needed.²⁶⁾

25) <https://www.theguardian.com/business/2022/dec/16/tax-dodging-and-non-compliance-during-pandemic-cost-uk-9bn-nao>, Dec. 16. 2022, The Guardian

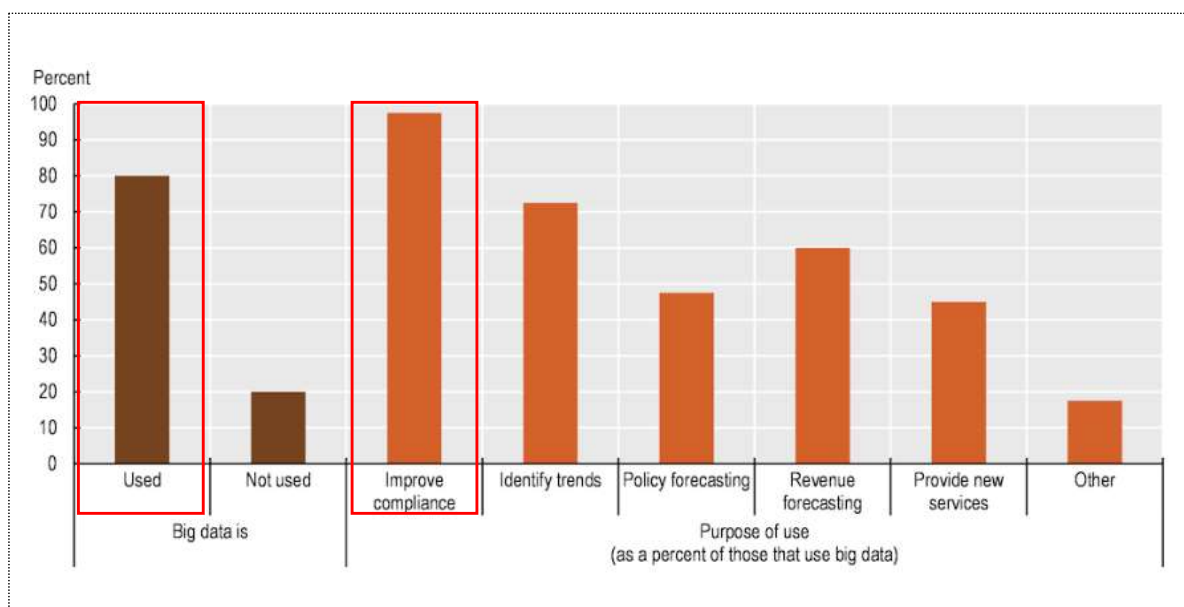
26) Managing tax compliance following the pandemic (<https://www.nao.org.uk/reports/managing-tax-compliance-following-the-pandemic/>)

3) Other recent cases of major OECD countries

○ Recently, major OECD countries are incorporating various cutting-edge technologies into tax verification. More and more diverse related data (electronic invoices, financial account information, etc.) can now be used not only by taxpayers but also by third parties, and more effective verification is possible through so-called unstructured data analysis. In addition, methods that combine not only tax analysis but also behavioral analysis are evolving. This can be categorized as follows:

○ **3-1. Utilizing data science such as machine learning techniques or the latest AI technology**

- (General information) As of 2022, 80% of OECD countries report using 'Big Data' in their work, and it is known that most countries are using it to improve compliance.



- Of the 58 tax authorities belonging to the OECD, 55 countries are using data science. In 2018, 8.8% of countries had not yet attempted to introduce it, but as of 2021, all 58 countries have already implemented or are attempting to implement it. Advanced cleaning is being done. The use of AI for risk management is also very high, with more than half of countries

not yet attempting to introduce it in 2018, but in 2021, 55% of countries are already using the technology and more than 80% including countries in the implementation stage. Cleaning technology is developing at a rapid pace.

Table 6.1. Evolution of the application of data science tools, artificial intelligence and robotic process automation between 2018 and 2021

Percent of administrations

Status of implementation and use	Data science / analytical tools			Artificial intelligence, including machine learning			Robotic process automation		
	2018	2021	Difference in percentage points (p.p.)	2018	2021	Difference in p.p.	2018	2021	Difference in p.p.
Technology implemented and used	71.9	94.8	+22.9	31.6	54.4	+22.8	22.8	50.0	+27.2
Technology in the implementation phase for future use	19.3	5.2	-14.1	15.8	28.1	+12.3	14.0	8.6	-5.4
Technology not used, incl. situations where implementation has not started	8.8	0.0	-8.8	52.6	17.5	-35.1	63.2	41.4	-21.8

- (Australia) The Australian Taxation Office (ATO) has developed a tool that can match all financial transaction data, regardless of its source or form. The accuracy was also found to be higher than manual work.
- There is also the ability to compare data sources and match each transaction based on small clues, allowing work to be performed without being greatly affected by abbreviations or typographical errors in the data.

- Receipts and payments in one group of bank statements to corresponding receipts and payments in another group of bank statements;
- Bank statement receipts/payments to their corresponding entries in accounting records;
- Debit entries in a set of accounting records to their corresponding credit entries within the same accounting records;
- Bank statements or accounting records to pay slips, invoices or inventory records.

- (Austria) In 2020, the Austrian tax authorities conducted a real-time review of the personal income tax (PIT) reports of salaried individuals, and scored them to select subjects for office audit. Although the number of selected cases was reduced by more than 40% compared to the past, the number of cases confirmed to require additional reporting and payment due to under-reporting has doubled compared to the past.
- Based on these achievements, the tax authorities initiated an important project to expand the real-time risk assessment target to all PIT reports, as well as VAT reports, corporate income tax (CIT) reports, and other various tax items.
- In addition, the Austrian tax authorities have been using supervised learning techniques to conduct case selection for business, salaried, and customs tax investigations since 2016, and have been shown to have a hit rate that is more than twice as high as manual selection.

※ Supervised Learning: A type of method (algorithm) by which a computer learns to achieve artificial intelligence. There are three types of Machine Learning, 'supervised learning', 'unsupervised learning', and 'reinforcement learning', and among them, supervised learning is the correct answer, i.e. , refers to a method of learning by giving labels.
(ex. Learn without any intermediate process by showing that the answers to $4*5$ and $20*20$ are 20 and 400, respectively, or by showing a picture of a dog and letting it know that the picture is a dog.)

- (Canada) An advanced analysis system including machine learning and deep learning is being tested to identify high-risk small and medium-sized businesses, and social network analysis is also integrated.

- In addition, digital forensic investigation tools are continuing to be advanced. The Canada Revenue Agency (CRA) is saving time and money through forensic tools that can access massive amounts of data collected through search warrants and other means.

- Graph database management systems and algorithms are used to automatically link all taxpayers by common ownerships and identify economic entities for population analysis, risk assessment, and workload selection.
- Social network analysis is incorporated to identify influential legal entities in the organisational structures and discover different patterns and characteristics of economic entities to enhance risk assessment.
- Ensemble anomaly detection (isolation forest, local outlier factor, mean shift clustering) and unsupervised learning (K-means, Gaussian mixture model, agglomerative clustering) methods are used to identify high-risk and anomalous segments in the small and medium enterprises population.
- Advanced techniques are used to generate powerful predictors, including incorporating artificial intelligence auto-encoder techniques to compress high dimensional data and a short-term memory neural network to extract information from longitudinal (sequence) financial and economic entity data, as well as economic entities' structure, which are used as predictors to enhance non-compliance prediction.
- Advanced analytics, including deep learning and graph neural networks, are used to identify high-risk small and medium enterprises taxpayers and their associated economic entities.

- For example, ❶ learning from investigators as they review relevant data or evidence to identify documents relevant to the investigation ❷ visual linkages, clusters, and patterns that help investigators focus on key areas of potential interest ❸ Defining and extracting key patterns for evidence useful in investigations, such as phone numbers, credit card numbers, social security numbers, etc. ❹ As well as 'fuzzy' searches that allow investigators to find the files they are supposedly looking for The tool is being developed with major functions such as searching metadata related to the file.

- (Israel) The Israeli tax authorities have developed the Analytics Center to support various analyses, through which 131 companies were selected for investigation in 2022, and the tax investigation of 43 companies was completed by the end of the

year, through which the amount of additional tax collected from the investigation was increased on average

- In addition, an AI model was developed to detect property owners who do not report rental income, and an accuracy of over 50% was achieved, with 425 suspects extracted and 227 of them incurring additional tax.

The Analytics Centre is a platform for maximising the yield per hour of any tax administration process by providing diverse supporting analytics products. It consists of two innovative core components:

- An analytics workshop for rapid production of a variety of analytics models such as AI models, graph analytics models, rule-based engines, statistical report generators, etc.; and
- A model cloud for scalable implementation of these models.

Once a model is manufactured in the workshop and registered in the cloud, it is ready to simultaneously serve multiple users through dedicated applications regardless of the model's initiator. This holistic platform drives the continuous growth of analytics usage up to an enterprise-wide level which increases organisational overall productivity. This system has for example produced models for the selection of cases for company, individual or VAT tax audit.

- (Sweden) STA, the Swedish tax agency, is known to be using artificial intelligence to collect not only electronic documents but also hand-written paper forms and then digitize them. First, the handwritten text is interpreted and converted into digital text, and a deep learning model developed and trained by STA is used in the process.
- In addition, the text is classified into one of about 60 subject categories and used for analysis. It is known that few AI models can use Swedish or interpret millions of handwriting samples..

The ability to interpret handwritten text can also be useful for a variety of other applications for the STA, as well as for other public authorities, municipalities, etc.

Key benefits of automated interpretation and classification of handwritten text:

- The information reaches the right competence much faster than before
- Increased ability to quantify and analyse the content of free-text information
- Automation of specific cases

○ 3-2. Increasing variety of data availability cases

- Examples of data collection from developed countries that can be used as a reference in the future are as follows. However, in the case of Korea, data collection through electronic documents such as electronic tax invoices is active and related data is being used in various ways, so it is known to have already reached the highest level.

- Information collected from related devices: Data collection sources are increasing, such as using online cash registers, fare counters used in taxis, truck operation recorders, and gate entry registration devices.
- Collection through banks, merchants, payment brokers, etc.: Taxpayer's financial transaction details are used, and in some countries, transaction details or transaction totals are collected on a regular basis.
- Verification of customer data or data from suppliers: As already used in Korea, the number of cases where various electronic invoices or cash receipts are used for tax verification is increasing.
- Unstructured data of taxpayers: Linking transaction information with unstructured data, such as taking into account evasion charges, through the Internet or social media.
- Utilization of other government agencies or international data exchange: Data from other government agencies for licensing, regulation, or social security purposes or data exchange between countries (ex. Common Reporting Standard and Country-by-Country Reporting) are being used for tax verification. . For example, in Sweden, where timber is one of the main national resources, field data from the Cadastral and Land Registry (Lantmäteriet) or the Swedish National Forest List (Riksskogstaxeringen) are combined and used for property tax assessment. However, since it takes about 7 years to informatize and scan all forests in Sweden, we plan to continue developing it in the future.

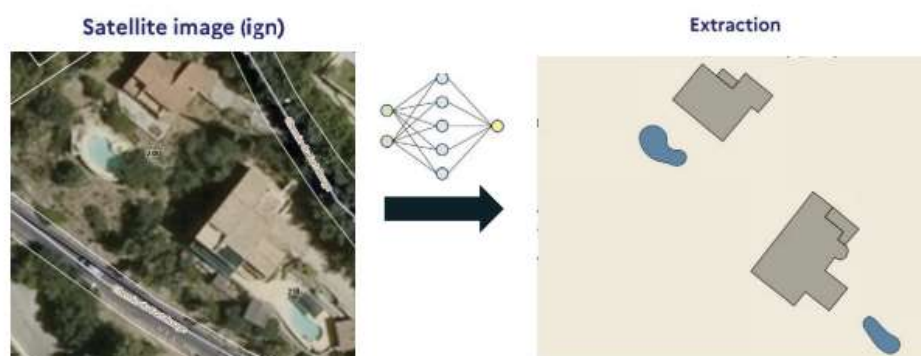
To address this, data is now derived from maps that provide a variety of information, including timber stocks. The maps are produced by combining data from the Swedish Mapping, Cadastral and Land Registration Authority ("Lantmäteriet") and field data from the Swedish National Forest Inventory ("Riksskogstaxeringen").

This new method will help to ensure more fair and equal assessment of forest properties, while improving the quality of the STA's registers. The analysis is carried out on an ongoing basis, as it takes about seven years to scan all of Sweden's forests. The STA believes this new method will help to ensure a better service to property owners through higher data quality.

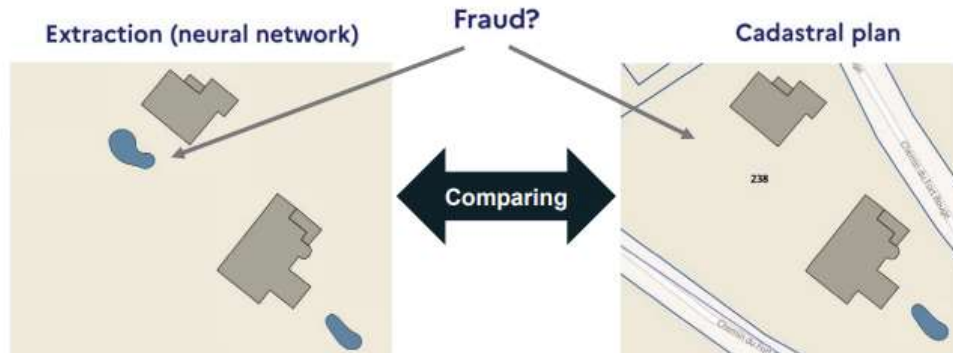
- For example, in Argentina, the automatic creation of electronic VAT returns is introduced as a major example of innovation, but in Korea, the 'pre-filled' service has been actively used not only for VAT reporting but also in various income reporting processes for several years.
- (France) As part of the 'Foncier innovant (land improvement)' initiative, the French tax authority (DGFiP) carried out a project to improve property tax reporting using AI based on aerial photography from the 'Institut national de l'information géographique et Forestière (IGN)'. Buildings and swimming pools were extracted through aerial images and matched with the information reported by the owners to the tax authorities to confirm correct taxation.

※ AI-based aerial photography and taxation linked data(DGFiP)

Physical entity extraction : Step 1



Fraud detection : Step 2



- (Lithuania) According to data from the Taxation Authority (STI), the level of tax evasion risk is the highest in the used car and related parts trading sector. According to a study in 2018, the VAT GAP arising from the used car trade sector was at a very high level of more than 38 million euros, and accordingly, tax authorities are making efforts to control this sector in particular.
- Due to the revision of the law, all vehicles are required to have vehicle owner reporting codes (SDKs) attached, so tax authorities have developed a system to track and manage these codes. Through this, 22 people suspected of omitting income amounts while running an illegal, unregistered trading business were identified, and they plan to continue to actively utilize the information to uncover charges of tax evasion, including uncovering 110,000 euros of unreported income.

※ All vehicles entering Lithuania must have a valid SDK. Without an SDK, vehicle registration and sale are impossible, and the SDK must be posted when advertising a vehicle. In fact, there have been cases where an entire area was investigated for missing SDKs.

- (Mexico) Changes in the digital environment and the development of artificial intelligence (AI) are demanding the capabilities required of tax inspectors, and Mexico accepted this and introduced electronic audit (e-audit) in September 2016, raising tax revenues without tax system reform or tax rate increases. Reported to have increased by 34%

※ [Refernce-1] IRS use of Big data

- “To utilize the data available to it, in 2011, the IRS created the Office of Compliance Analytics (OCA) to “both develop and accelerate strategic data-driven compliance initiatives as well as strengthen the Service’s analytic problem-solving capability.” In 2016, OCA was merged into the Research, Applied Analytics and Statistics Division (RAAS). Currently, four divisions of the IRS are engaged in data mining: IRS CI, the IRS Small Business/Self-Employed Division, the IRS Wage and Investment Division, and RAAS. These divisions have access to several data mining applications: Investigative Data Examination Application (IDEA) - formerly known as Investigative Data Analytics, Lead and Case Analytics (LCA), Return Review Program (RRP), Financial Crimes Enforcement Network (FinCEN) Query, and Compliance Data Warehouse (CDW). It should be anticipated that with the new robust contract with Palantir, these existing data mining operations will receive some new enhancements.”²⁷⁾

※ [Refernce-2] External evaluation of tax authority innovation²⁸⁾

- “While most authorities have started using advanced analytics, we see a range of sophistication in how research and analytics are used to segment taxpayers, prioritize examinations, and choose the appropriate examination approach, including the use of “light touch” approaches rather than full audits (Exhibit 3).“

27) The Impact of “Big Data” on IRS Civil and Criminal Tax Enforcement, July 19, 2019, Hochman Salkin Toscher Perez P.C.

28) Four innovations reshaping tax administration, Jan 29, 2018, McKinsey & Company

- “Several tax authorities have embraced analytics to transform how they conduct examinations and debt collections, using analytics to create early warning systems and practice extreme modeling, while others are still working to get beyond the basics.”

Early warning systems. Early warning systems can address taxpayer insolvency, a source of major tax revenue losses. By better understanding when taxpayers are at risk of insolvency, tax authorities can take actions to avoid increases in tax debt over time or reduce costs of debt collection efforts by focusing on debt with the best chance of recovery. A European tax authority that was losing a significant amount to insolvency cases implemented an advanced model using value-added tax (VAT), income tax, payroll, and other data sets to create a 360-degree view of taxpayers. This better understanding of taxpayers enabled the authority to robustly identify taxpayers at high risk of insolvency and proactively address these situations. As a result, the agency is on track to deliver targets of approximately \$8 million in operating cost reductions and \$800 million in reduced tax losses in debt collection.

Extreme modeling. In most countries, less than 5 percent of taxpayers are audited annually, so it is critical to maximize the value of these audits. By using an advanced model for case selection, tax authorities can deliver value by choosing the right cases and avoiding unproductive cases; for one authority, unproductive cases made up more than 50 percent of audits.

Some tax authorities now identify taxpayers for audit using extreme modeling, which involves using machine learning to build a sophisticated algorithm to identify the best predicting factors of a successful audit. One OECD country’s tax authority built such an algorithm integrating more than ten databases, using two independent modeling techniques, and automatically scanning more than 1,500 variables. The algorithm looks at changes in different ratios of expenses and revenues over time, opening up new insights compared with “static” features. The improved case selection avoided the more than 50 percent of unproductive audits and meant the cases selected returned up to two times more revenue than the baseline.

3. Conclusion and Implications

- Although consideration of quantitative factors is necessary, it is difficult to significantly increase the audit ratio or number of audit cases because the audit period takes longer and more people have to be invested in the same audit.
- According to the results of a study comparing the frequency of tax investigations by country for personal income tax, corporate tax, and value-added tax, that is, audit coverage and adjustment rate, Korea's tax audit frequency as of 2017 was 24th among 30 countries for personal income tax. recorded. In terms of corporate tax, it ranks 20th out of 32 countries. In the case of value-added tax, it ranked 31st out of 32 countries at a very low level. This is the result of calculating the corporate tax audit rate at 0.94%, and is expected to be lowered further assuming the corporate tax audit rate calculated in this report is 0.71%.²⁹⁾

[Comparison of the number of tax audits between OECD and Korea in 2017 - Number of tax audits per 100 taxpayers]

Countries	PIT	CIT	VAT
S. Korea	0.08	0.71	0.05
Average of surveyed countries	2.96 (30 countries)	5.13 (32 countries)	7.73 (32 countries)

- This is a fairly low figure even when simply compared with the United States or Japan as shown below (① Korea uses statistical yearbook figures, ② the United States uses field examination figures from IRS DATA BOOK, ③ Japan uses homepage general/special examination figures), and in the case of the United States, in addition to field examination, Considering that there is office examination and correspondence examination, the difference will be even greater.

²⁹⁾ Tax trends in major countries, Korea Institute of Public Finance

- Additionally, what is noteworthy is that the tax audit rate in Korea is gradually decreasing. Due to economic growth, the number of self-reported self-employed individuals has grown nearly three times from 2.01 million in 2003 and has steadily increased to 5.87 million in 2017. However, the number of people being investigated has remained at around 4,000, so the tax audit rate also decreased from 0.22% in 2003 to 2017. Decreased to 0.08%. In addition, corporations also showed nearly four-fold growth, increasing from about 200,000 in 2000 to about 730,000 in 2017, but the number of corporations audited remained at the 5,000 range in the 2010s without much change, so the audit rate also increased from 1.88% in 2000 to 2017. It continued to decrease by 0.71% per year.

[Comparison of personal income tax audit rates in 2016 ~ 2017]

Tax year	country	All returns filed for tax year (A)	Returns examined (B)	Ratio (B/A, %)
'17	S.Korea	5,874,671	4,911	0.08
	United States	149,919,416	214,582	0.14
	Japan	21,977,000	49,735	0.23
'16	S.Korea	5,482,678	4,985	0.09
	United States	147,967,324	243,722	0.16
	Japan	21,690,000	49,012	0.23

[Comparison of corporate income tax audit rates in 2016 ~ 2017]

Tax year	country	All returns filed for tax year (A)	Returns examined (B)	Ratio (B/A, %)
'17	S.Korea	726,701	5,147	0.71
	United States	1,906,645	17,962	0.94
	Japan	2,896,000	98,000	3.38
'16	S.Korea	673,374	5,445	0.81
	United States	1,887,078	19,377	1.03
	Japan	2,861,000	97,000	3.39

[Changes in personal income tax audit ratio]

- Tables were extracted from Korean notation data and written in Korean.
- A: All returns filed for tax year
- B: Returns examined

연도	조사인원(명, %)		
	확정 신고인원(A)	조사인원 (B)	조사비율(% (B/A))
2003	2,010,363	4,522	0.22
2004	2,114,527	4,370	0.21
2005	2,235,905	3,989	0.18
2006	2,279,497	4,049	0.18
2007	2,736,478	4,090	0.15
2008	3,074,419	3,335	0.11
2009	3,584,432	3,068	0.09
2010	3,570,816	3,624	0.10
2011	3,785,248	3,669	0.10
2012	3,956,702	4,563	0.12
2013	4,352,929	4,392	0.10
2014	4,564,682	4,264	0.09
2015	5,052,552	4,108	0.08
2016	5,482,678	4,985	0.09
2017	5,874,671	4,911	0.08

[Changes in corporate income tax audit ratio]

- Tables were extracted from Korean notation data and written in Korean.
- 신고법인수: All returns filed for tax year
- 조사법인수: Returns examined
- 조사비율: Ratio

연도	조사법인수		
	신고 법인수(개)	조사 법인수(개)	조사비율
2000	200,964	3,785	1.88
2001	240,352	4,280	1.78
2002	271,353	5,326	1.96
2003	303,462	4,536	1.49
2004	316,777	5,683	1.79
2005	333,313	6,343	1.9
2006	352,647	5,545	1.57
2007	372,141	4,174	1.12
2008	398,331	2,974	0.75
2009	419,420	3,867	0.92
2010	440,023	4,430	1.01
2011	460,614	4,689	1.02
2012	482,574	4,549	0.94
2013	538,134	5,128	0.99
2014	576,138	5,443	0.94
2015	623,411	5,577	0.89
2016	673,374	5,445	0.81
2017	726,701	5,147	0.71

- When a tax audit is conducted, the likelihood of detection of evasion by taxpayers increases, and as a result, taxpayers incur greater costs such as additional taxes, so it has the function of encouraging faithful tax payment. However, no clear conclusion has been made as to what the appropriate tax audit rate is. Research is difficult to find.
- If the investigation ratio compared to the total report is low, the possibility of detecting tax evasion is low, so taxpayers have less incentive to report faithfully. However, if the investigation ratio is excessively high, there is a possibility of restricting free business activities, so a cautious approach is necessary.
- However, considering the results of previous studies, it appears that the tax audit rate has a more positive effect on improving tax compliance. There are many studies on factors that affect tax compliance, and recent research has shown that fairness among taxpayers and tax ethics are also important, but one of the most important factors derived from various studies from past to present is 'probability of tax audit'. In other words, it is the tax audit rate.
- Some theoretical studies, such as Pencavel (1979), Cowell (1981), and Sandmo (1981), show that an increase in the probability of a tax audit actually lowers the real wages of taxpayers, increasing labor supply and earning more income, which leads to income evasion. There were also research results showing that there may be more incentives to do so.
- However, relatively recent studies such as Engel and Hines (1999) show that the probability of a tax audit increases tax compliance, and above all, in empirical studies, the results are similar to those predicted by the basic theoretical model of Allingham-Sandmo (1972), the most traditional model. It is analyzed that as the probability of a tax audit increases, reported income increases.³⁰⁾

30) An Analysis of Determinants of Taxpayer Compliance: An Experimental Approach, ,KiPF, Dec. 2011

※ [Other empirical studies and experimental methods, etc.]³¹⁾

- (Empirical research) A study by Witte and Woodbury (1985) used IRS statistical data to analyze the effect of tax authorities' policies, such as the probability of a tax audit, on tax compliance, and found that when the probability of a tax audit increases by 1%, tax compliance is between 0.18 and 1.95%. showed a significant increase. In addition, a study by Durbin, Graetz and Wilde (1990) also confirmed the significance that the average tax payment increases as the probability of a tax audit increases. (However, it has been confirmed that the number of taxpayers compared to the population actually decreases as the probability of tax audit increases)
- (experimental method) Friedland, Maitai, and Rutenberg (1978) demonstrated through experiments that the probability of a tax audit is effective in increasing tax compliance, and a study by Alm, Jackson, and McKee (1992b) also showed that tax compliance increases as the tax audit rate and penalty rate increase. This supports the statement that tax compliance decreases as the tax rate increases. In addition, a recent study by Park Myung-ho et al. (2011) again confirmed the results that as the probability of receiving a tax audit increases and the additional tax upon detection of tax evasion increases, taxpayers' tax compliance increases and evaded income decreases.
- Baek Woong-gi and Park Myeong-ho (2016) conducted an interview with 1,000 citizens and analyzed the determinants of tax compliance, and found that trust in the National Tax Service varies depending on the level of awareness of tax administration, such as the possibility of detection of tax evasion or the severity of tax evasion punishment.³²⁾

31) An Analysis of Determinants of Taxpayer Compliance: An Experimental Approach, KiPF, Dec. 2011

32) Measures to survey the level of taxpayer awareness in Korea and increase tax awareness, KiPF, Jun. 2016

- In other words, rather than increasing the severity of punishment for the few who are caught, it is important to raise awareness that national tax administration is fair by increasing the ‘possibility of detecting tax evasion’ through expanding the tax audit rate or expanding the tax net.
- When asked how much influence increasing the possibility of detecting tax evasion would have on the general public's awareness of faithful tax payment, 48.9% responded that it would have some influence and 44.0% responded that it would have a very great influence. In other words, more than 90% of respondents consider the possibility of tax evasion detection to be very important.
- In addition, the OECD's Tax Compliance Study (2010) also showed that many citizens consider deterrence factors such as strengthening tax evasion punishment and strengthening the fairness of the taxation process to be important among various factors that induce faithful tax payment.
- In order to block tax evasion, it is necessary to expand tax investigations beyond the current level. In the short term, it is essential to improve investigation efficiency and improve investigation techniques, and in the mid to long term, expand the size of investigation personnel.³³⁾

[Factors affecting the awareness of faithful tax payment (%)]

factor	very influential	somewhat influential	Sum
Strengthening punishment for tax evasion	47.5	46.3	93.8
Increased likelihood of detection of tax evasion	44.0	48.9	92.9
Social atmosphere regarding tax compliance	37.9	50.4	88.3
Providing faithful tax payment benefits	45.2	47.9	93.1
Strengthening tax education and promotion	24.7	53.6	78.3
Simplification and convenience of taxation procedures	27.6	55.4	83.0
Strengthening the fairness of the taxation process	45.3	47.0	92.3

33) Measures to survey the level of taxpayer awareness in Korea and increase tax awareness, KiPF, Jun. 2016

- In other words, maintaining a certain tax audit rate has a significant effect in preventing tax evasion and inducing tax compliance. Therefore, it is necessary to maintain the ratio of tax audits to taxpayers above a certain standard through recruiting personnel, etc.

※ There are also research results showing that Japan has a much higher anti-tax evasion policy than Korea, and that this is due to the high intensity of investigations, including the tax audit rate.³⁴⁾

- Although it is difficult to empirically compare and analyze the level of tax compliance in Korea and Japan, if compared indirectly through comparison of the size of the underground economy, research results show that the size of the underground economy is more than four times higher than that of Japan (Schneider and Enste, 2000)
- Comparing personal income tax audits, Korea selects around 0.3% of taxpayers subject to tax audits, while Japan shows an investigation rate more than three times higher at around 1%.
- In the case of corporate tax, Korea has a maximum of 1.8%, while Japan has a rate of 4%, which is more than twice as high. This can be seen as a result of Korea's clearly lower tax audit intensity than Japan.
- In order for Korea to more effectively prevent tax evasion, tax audits and related additional taxes need to be strengthened.

- In situations where manpower recruitment is limited, it is also a good idea to pay attention to improving qualitative factors. Many of the factors mentioned by the OECD and others have already been introduced or are being considered for introduction in Korea, and it is the duty of the tax authorities to immediately address them by upgrading investigation techniques.

34) Why is Japan's level of tax evasion lower than ours?, Hyun Jin-kwon, May 2006

- OECD (2006, 2017) defined tax audits as a tool to help taxpayers properly fulfill their obligations, dividing them into three major categories and stratifying them.³⁵⁾
- Korea's tax audit is based on the principle of an integrated investigation and excludes partial investigation. Therefore, it is necessary to consider subdividing the tax audit method as is being done by OECD countries.

- ◆ Comprehensive audits: This is the most common form of tax audit that people think of. It conducts an in-depth investigation of all information, activities, and transactions, and comprehensively examines various taxes, issues, and multiple tax years. It is a method that is usually conducted on major taxpayers, and it is an investigation that places a significant burden on relatively small businesses. It is also the most cost-prohibitive from the tax authorities' perspective, so it is difficult to extend the investigation indefinitely and focuses on taxpayers with higher risk.
- ◆ Limited scope audits: An investigation that selects and verifies only specific issues, specific tax items, or specific tax years, and is a method of verifying only 1 or 2 key items. Because it costs less than comprehensive audits, it is highly efficient and is sometimes conducted for the purpose of understanding taxpayers or changing behavior.
- ◆ Desk audit or review: A verification procedure conducted within the office of the tax authority rather than the office of the taxpayer or the taxpayer's agent, and the verification is mainly conducted on documents and records. Because it costs less to communicate with taxpayers by phone or email, it has the advantage of being able to efficiently screen for errors or omissions in multiple taxpayer reporting documents with limited manpower. If serious issues or problems are discovered during this process, limited scope audits or comprehensive audits mentioned above will be conducted.

35) OECD, The Changing Tax Compliance Environment and the Role of Audit, Sep. 2017

- To the above purpose, 1) it is possible to consider a plan to strengthen 'partial investigations', which are currently rarely used in Korea, by focusing on the US campaign-style tax audits or the OECD's limited scope audits. → See Table of Contents No. 4
- In addition, 2) At the selection stage, it is possible to differentiate the tax evasion risk analysis and apply a verification method suited to each person. This is something that is covered in considerable depth in the research of Seung-Chul Yoon (2014), but as discussions have continued to take place more recently, focusing on OECD countries, I would like to briefly introduce one related case before moving on.

[Example of response strategy to risk of tax evasion by major taxpayers]³⁶⁾

- The existing traditional tax investigation method used a strategy of individually responding to all tax evasion risks recognized by the tax authorities, which is still the most important role of the tax authorities. However, some countries recognize issues with greater tax evasion risks in real-time as much as possible. We are developing verification methods, and this is in line with the 'Cooperative compliance' systems actively operated in some OECD countries.
- In the case of Australia, the ACA (Annual Compliance Arrangement) system, which will be described later, has been introduced for large corporations, resolving tax issues in real time and allowing taxpayers to quickly provide information about uncertainty. Major taxpayers classified as 'key taxpayers' through tax evasion risk assessment are obligated to preemptively disclose tax issues, but are free from tax surprises such as tax audits.
- The United States also introduced the CAP (Compliance Assurance Process) system for major taxpayers in 2005 and converted it to a formal program in 2011. An IRS Account Coordinator is assigned to the company and the taxpayer works together to select and resolve issues.

36) Case study on differentiated tax investigation strategies according to the degree of tax evasion risk, Yoon Seung-chul, May. 2014

* For reference, the CAP system requires a large number of investigators, so no additional applications have been accepted since the second half of 2016, but new applications are being accepted for the 2019 fiscal year. It is said that CAP, which has received good reviews in terms of eliminating tax uncertainty in advance, will also be operated with a focus on issues.

[Additional recent examples of tax evasion risk differentiation to be introduced]

- In this report, I would like to introduce the case of the Genetal Taxpayer Classification System (the ADMIRAL) of the Hungarian National Tax and Customs Administration (NTCA).³⁷⁾
- Hungary first introduced the ADMIRAL system in 2016 to use limited manpower and budget more efficiently. For VAT verification purposes, ADMIRAL classifies companies and foreigners into three classes (reliable, neutral, unreliable) and shares the classification with the relevant taxpayers.
- NTCA treats each class differently. For example, reliable taxpayers are given a shorter VAT refund deadline, while unreliable taxpayers are subject to higher interest rates. Above all, there are differences in tax audits. In the case of reliable taxpayers, a shorter period is given for tax audits and the investigation is concluded within 180 days, while unreliable taxpayers are given an additional 60 days in addition to the general period.
- Classification criteria are determined by law and are updated every quarter and revised when necessary. The classification process is expected to be automated in the near future, but we are continuing to refine the system, including considering procedures to prevent taxpayers who want to benefit from ADMIRAL by acquiring reliable tax payment companies.

- 3) As I will discuss later, Germany's 'timely tax audit method' is similar to this, and introducing this method can also be fully considered.

37) OECD, The Changing Tax Compliance Environment and the Role of Audit, Sep. 2017

4. Possibility of using partial audit³⁸⁾

- In Korea, integrated investigations are the principle, and partial investigations are not actively utilized.
 - In the case of an integrated investigation, the tax investigation authorities may increase the inconvenience of the investigated person by dividing the investigation that could have been conducted once in a single session according to their convenience, thereby increasing the inconvenience of the investigated person, and the investigation technique is advanced through a screen for the entire company. There are clear advantages to improving .
 - However, as seen above, in order to respond to the increase in the number of business operators and the advancement of tax evasion laws such as offshore tax evasion amidst the global synchronization of the depletion of tax authorities' resources, including manpower, 'selection and concentration' of deploying manpower first in necessary areas is becoming increasingly necessary.
 - As will be explained later, in the United States, duplicate tax audits are not as strictly restricted as in Korea. Accordingly, the campaign-style tax investigation is being operated in parallel with LCC, a system similar to Korea's circular investigation, and precedent also states that 'IRS can conduct an investigation even when there is suspicion of illegality or further confirmation that it is not illegal. ', allowing the IRS considerable discretion in deciding which tax audit method to choose.
- However, in the case of Korea, the tax authorities have discretion as to whether or not to conduct a tax investigation itself, but if they do, they have no other option but to conduct

38) Summary of 'Research on setting the scope of tax investigation: Focusing on the relationship between integrated investigation and partial investigation (Korea Tax Law Association)'

an integrated investigation 'targeting all taxes reported and paid in accordance with tax laws in relation to the business.' Must be implemented.

- In other words, the reality is that even in the case of a partial investigation to confirm specific matters, it cannot be conducted for reasons other than those specified in the Framework Act on National Taxes, so administrative elasticity is significantly reduced.
 - Even if you want to check only specific parts, you must inevitably conduct an integrated tax investigation targeting all taxpayers' tax details, or stop at the level of fact-checking within the scope of the taxpayer's voluntary cooperation and give up further verification.
- First of all, it is necessary to look at the legislative history in this regard. The 'Principle of Integrated Investigation' was first enacted in 2010. At the time, the National Tax Service announced that when conducting a tax investigation, an integrated investigation would be the principle, and that exceptions to the integrated investigation would be specified in the law and operated flexibly.
- It is difficult to guess the exact legislative purpose of this, but the Supreme Court ruled on June 2, 2006, 'After receiving a value-added tax audit conducted by the tax office with jurisdiction over the value-added tax, the tax office with jurisdiction over the income tax investigated whether or not there was income tax evasion, and during this investigation, additional value-added tax evasion was found. Since it was stated that "increasing the amount in cases where facts are discovered are illegal because it violates the principle of prohibiting duplicate investigations," it appears that the legislator intended to minimize the possibility of such problems by comprehensively investigating major details related to the taxpayer's business.

- Afterwards, through the revision of the Framework Act on National Taxes on December 19, 2017, it was legislated to allow partial investigations limited to specific matters despite the integrated investigation principle. In the case before that, a partial investigation was conducted in accordance with the National Tax Service's directive, 'Investigation Processing Regulations', without any separate legal basis.
- Afterwards, through an opposing interpretation of Article 12, Paragraph 3 of the Affairs Regulations at the time, we interpreted that if a partial investigation is conducted for a specific tax period for a specific tax item and then the investigation is conducted again excluding that part, it does not violate the provisions prohibiting duplicate investigations. I was doing it.
- However, the Supreme Court interpreted this differently and stipulated that a re-examination cannot be conducted for the same tax item and tax period unless there is an exception stipulated in the provisions of the Framework Act on National Taxes, which prohibits duplicate tax audits. It was ruled that it violated the principle of prohibiting duplicate investigations, except in special circumstances such as that it was unreasonable to conduct investigations on all items in the relevant tax period. (Supreme Court decision 2014두12062, February 26, 2015)
- Due to this ruling, the partial investigation authority of the tax authorities was significantly reduced. Once a partial investigation is conducted on some areas, the tax authorities may either conduct a partial investigation with the intention of abandoning the integrated investigation in accordance with the principle of prohibiting duplicate investigations in the future, or conduct a partial investigation on business-related details and taxation in order to investigate areas that require partial

investigation. We encountered many situations where we faced the problem of having to conduct an integrated investigation for the entire period.

- To solve this problem, on December 19, 2017, the Framework Act on National Taxes was amended to add Paragraph 3 to Article 81-11, and at the same time, Paragraph 6 to Paragraph 2 of Article 81-4, which stipulates exceptions to the principle of prohibiting duplicate investigations. can be seen as having been newly established to regulate “cases where a partial investigation pursuant to Article 81-11, Paragraph 3 is conducted and then an investigation is conducted into parts not included in the relevant investigation.” In other words, when a partial investigation is conducted to confirm part of a specific tax period for a specific tax item, exceptions to duplicate investigations must be clearly defined in order to conduct a future investigation on the remaining part of the same tax period for the same tax item, so this is stipulated.
 - However, in foreign countries, greatly relaxed standards are applied for the principle of prohibiting duplicate tax investigations, and it is difficult to find cases in which abuse of investigation rights or duplicate investigations are judged to be illegal. Above all, it is difficult to find cases that adopt prestigious legislative precedents such as Korea's integrated investigation principle, and tax authorities are allowed to select an appropriate method between integrated investigation and partial investigation by considering the efficiency of investigation and the burden on taxpayers in a balanced manner. In other words, in order to conduct tax investigations more efficiently with limited manpower and resources in the future, the international trend is to improve the use of partial investigations rather than integrated investigations.
- Accordingly, after examining the reasons for the current partial investigation, we will review the future direction of revision.

- First, Article 81-4, Paragraph 2 of the Framework Act on National Taxes stipulates that 'a tax official may not conduct a re-investigation on the same tax item and the same tax period unless any of the following cases apply' and the reasons for allowing a duplicate investigation are: is permitted in each subparagraph, but in subparagraph 6, 'cases where a partial investigation is conducted pursuant to Article 81-11, Paragraph 3 and an area not included in the relevant investigation is investigated' is set as a ground for exception.

※ Framework Act On National Taxes Article 81-4 (Prohibition of Abuse of Authority to Investigate Tax-Related Matters)

- (2) No tax officials shall re-investigate the same item of taxes and for the same taxable period, except in any of the following cases:
<Amended on Jan. 1, 2013; Dec. 23, 2014; Dec. 15, 2015; Dec. 20, 2016; Dec. 19, 2017; Dec. 31, 2018>
6. Where an investigation is conducted into a part not included in the relevant investigation, after a partial investigation provided for in Article 81-11 (3) is conducted;

- Due to the revision at the end of 2017, a total of 9 reasons are listed as exceptions under the current law and enforcement ordinance. Rather than being a comprehensive regulation, each reason is listed in detail and the reasons are strictly limited by stipulating that a partial investigation cannot be conducted other than these. Among these, Legal Reasons Item 1 and 2, and Enforcement Decree Reason Item 4 are partial investigations for a more favorable decision for the taxpayer, and the remaining reasons are for confirming suspicions of tax evasion.

※ Reasons for Framework Act On National Taxes Article 81-11 (3)

1. Where it is necessary to verify whether requests for correction, etc. under Article 45-2 (3); 156-2 (5) or 156-6 (5) of the Income Tax Act; or 98-4 (5) or 98-6 (5) of the Corporate Tax Act are processed; or national tax refunds under Article 51 (1) are determined;
2. Where it is necessary to verify the facts, etc. in accordance with the determination of re-investigation provided for in the proviso of Article 65 (1) 3 (including cases Article 66 (6) and Article 81) or in the proviso of Article 81-15 (5) 2;
3. Where it is necessary to verify part of a transaction in the middle of tax investigation for the other party to the transaction;
4. Where the tax evasion of a taxpayer is informed in detail and it is necessary to verify the suspicion of the relevant tax evasion;
5. Where it is necessary to verify the suspicion of tax evasion by means of the use of fake names and the use of borrowed accounts;
6. Other cases prescribed by Presidential Decree, where it is necessary to verify specific places of business, specific items or specific transactions in consideration of the efficiency of tax investigation, taxpayers' convenience, etc.

※ Reasons for Enforcement Decree Of The Framework Act On National Taxes Article 63-12

1. Where there is a specific accusation that a corporation distributes profits to other stockholders, etc. in a special relationship with the relevant corporation due to trading stocks or investment stakes at values higher or lower than market prices, or capital transactions prescribed in the items of Article 88 (1) 8 of the Enforcement Decree of the Corporate Tax Act and in subparagraph 8-2 of the same paragraph, or receives distributed profits, and confirmation is required for the relevant accusation;
2. Where there is a specific accusation that the details of specific transactions are different from the truth, such as undertaking transactions without authentic documentation and fraud and fictional transactions, for which urgent investigation is required for the security of tax claim;

3. Where an investigation is conducted to handle data which an agency other than a tax authority has prepared or acquired for official purposes and then has submitted to a tax authority;
4. Where it is necessary to verify the details of an application for non-taxation or tax exemption under a tax treaty pursuant to Article 156-2 (1) or (2) of the Income Tax Act or Article 98-4 (1) or (2) of the Corporate Tax Act.

[This Article Wholly Amended on Feb. 13, 2018]

- However, whether to specifically confirm suspicions of evasion and conduct a tax investigation through an integrated investigation or a partial investigation basically depends on the size and type of business, the sincerity of the relevant taxpayer, and the type of evasion suspicion, especially the personnel of the investigation agency. This is a matter that the tax authorities must decide by comprehensively considering the resource situation, such as budget. This is the reason why most countries, including the United States and Japan, grant tax authorities wide discretion in determining the method and scope of investigation.³⁹⁾
- In other words, even if the reasons for partial investigation were legislated in an enumerated and limited manner, this should be seen as naturally assuming the possibility of additional reasons requiring partial investigation, and if partial investigation is necessary due to changes in circumstances or that were not anticipated at the time of legislation, this should be considered. Adding a new reason should be viewed as something that was already fully planned at the time of legislation.⁴⁰⁾
- At the time of enactment of the partial investigation, Article 81-11, Paragraph 4 was newly established, and a restriction was

39) Summary of 'Research on setting the scope of tax investigation: Focusing on the relationship between integrated investigation and partial investigation (Korea Tax Law Association)'

40) Same as above

imposed that it could not be conducted more than twice for the same tax item and the same tax period for reasons other than items 1 and 2, which are favorable reasons for the taxpayer. The same purpose can be seen in the fact that measures to reduce the burden on taxpayers have been prepared by enacting regulations as well.

※ Framework Act On National Taxes Article 81-11

(4) No partial investigation on grounds falling under paragraph (3) 3 through 6, shall be conducted more than twice for the same tax item and for the same taxable period. <Newly Inserted on Dec. 19, 2017>

- However, in Korea, tax audit procedures are more strictly controlled by law than in any other country, and the protection of taxpayer rights and interests is an important tax value beyond fair taxation, so it is difficult to allow partial investigations indefinitely. Accordingly, what can be proposed as an alternative is that if suspicions of evasion are revealed or false data is submitted during simple verification procedures such as 'tax report verification(confirmation or verification of report details)' or 'on-site verification(confirmation)' that do not fall short of a tax investigation, a tax investigation can be conducted. This opens the door to conducting this as a partial investigation rather than an integrated investigation.
- 'Confirmation of report details' or 'on-site verification' are confirmation procedures by investigative officials that do not lead to a tax investigation, and are not official terms in tax law, but are usually regulated through National Tax Service directives, etc. Since most of the national tax revenue comes from taxpayers' voluntary reporting and payment, verification by investigative officials and contact with the taxpayer are inevitable procedures in the process of confirming the report.
- For example, in 2018, the tax audit rate for individual taxpayers

was 0.07% of reported taxpayers, and for corporate businesses, it was only 0.6% of reported taxpayers. If the tax authority must go through a formal tax audit procedure in a situation where tax verification is required, the burden on taxpayers increases exponentially. Therefore, a simple confirmation procedure such as 'confirmation of report details' is a procedure to relatively simply confirm and quickly conclude a specific suspicion that requires confirmation.

- 'Confirmation of report details' is a process that reviews the report contents, selects specific types of errors, selects business operators suspected of omission for verification, and guides them to provide explanations and corrected reports. This is stipulated in the regulations for handling each tax, including corporate tax, income tax, and value-added tax (National Tax Service directive).
- Until 2017, the name 'Post-verification' was used, but since 2018, the name 'Confirmation of report details' has been used.
- The characteristics are as follows. ①Confirmation work is completed within 2 months from the date of selection of the target ②Conducted through an indirect verification method without direct contact with the taxpayer ③The person in charge is guided to submit explanation materials by writing down specific allegations within a specified period of 15 days ④If errors are confirmed as a result of reviewing the explanation materials, a result is issued Instructions for correcting a tax return along with guidance ⑤If the suspicion of evasion is clear and a tax audit is necessary, the investigation department will be notified.
- In some studies, there is a view that 'confirmation of report details' or 'on-site verification' conducted in Korea is similar to formal tax investigation procedures such as 'correspondence audit' in the United States, but the substance must be examined

according to the position of our country's Supreme Court ruling. It appears that the side effect of a procedure that would otherwise be sufficient for taxpayer cooperation based on simple questions to be included in the scope of a tax audit and burdening the taxpayer with the obligation to comply is likely to be significant. In other words, it is necessary to examine whether tax officials' questioning actions affect the taxpayer's freedom of doing business by actually accepting the inspection.

- In the United States, in the case of 'real' audits such as actual field audits, office audits, and correspondence audits, which are classified as tax audits, approximately 0.7% of the report as of 2016 can be verified, while verification of mathematical errors in the report that requires data submission within 60 days. It is known that about 6% of all reports are verified through so-called 'non-real' audits, such as wage verification and underreporting (AUR) that are filtered out through an automated system, so Korea's 'verification of report details' system and the United States' specific system are known to be verified. It is difficult to make uniform comparisons, and the United States is also known to be planning to increase 'non-real' audits, which impose a relatively lower burden on taxpayers. In the case of AUR, if necessary, it can be transferred to the subject of a communications investigation, so there is room to see that AUR is subject to verification of report details in Korea due to its nature.
- In Korea, the number of cases of 'confirmation of report details' continues to decrease due to the development of cleaning technology, while the amount of additional tax per case shows an increasing trend, so its effectiveness is considerable. The tax authorities are selecting types of evasion with great precision. If there is a suspicion of false submission or insincere response, the investigation department is notified and an investigation is conducted. However, currently, based on

specific and local evasion charges, the business operator's extensive transaction history is being investigated. The reality is that there is no choice but to conduct an integrated investigation.

- There are many cases in which the tax management department requested the taxpayer to explain the charges through 'confirmation of report details', but the tax investigation was conducted by notifying the investigation department of charges of insincere response, such as false/non-submission. Some taxpayers complain that this is a violation of the 'principle of prohibiting duplicate tax investigations', and attempts at relief through the Taxpayer Advocate Committee(TAC) are as follows.
- ① It was analyzed that the amount of eligibility certificates received was 0 million won short of the reported amount of necessary expenses, and the taxpayer was selected as a person to confirm the reported contents. The taxpayer submitted a review of the major necessary expenses submitted and submitted a partially revised return → The department in charge of confirming the reported contents made some corrections Closing the report confirmation process with the amount excluding the reported amount as the final amount suspected of evasion → Selection of tax audit subject based on sincerity analysis for reasons such as lack of explanation: In this case, the taxpayer claimed that the report confirmation process was a de facto tax audit, but as a result of deliberation by TAC, it was concluded that correction was not possible (NTS TAC-2018-024)
- ② The tax management department analyzes that the taxpayer omitted KRW 1 billion in compensation during the reporting process and selects those subject to 'confirmation of report details' and guides the revised return → The taxpayer includes the compensation in the total income and deducts the related acquisition price of KRW 1 billion as necessary expenses.

Submission of explanatory materials for recognition → Requested to submit ledger and supporting documents to prove this, but the taxpayer did not submit them and did not respond to revised return → Selection of subject to tax audit due to lack of explanation, etc.: In this case, the taxpayer was also requested to submit ledger and supporting documents This is a case in which the confirmation of the report details was terminated without responding to this, and as a result of the deliberation by the 'Payment Committee', correction was not possible (NTS TAC-2018-024)

- After confirming the details of these reports, if suspicions of evasion or insincerity are confirmed, most cases develop into an 'integrated investigation', but this is a huge burden on the taxpayer and also consumes a lot of manpower and budget of the tax authorities. The OECD explains the lowest level of audits, the so-called desk audit, and mentions that if serious problems are discovered in the process, it can be developed into a limited scope or comprehensive audit. To this end, the tax law was revised. There will be a need to open the way to conduct a 'partial investigation' after 'confirmation of the report details'.⁴¹⁾

※ Tax verification method of IRS⁴²⁾: The part marked in red corresponds to the 'real' audit.

유형	내용
Math Error	<ul style="list-style-type: none"> - Electronically extracts returns with obvious arithmetic errors, such as calculation errors, items exceeding the legal limit, and errors in applying the calculation formula announced by the IRS. - Correct errors without contact with the taxpayer

41) OECD, The Changing Tax Compliance Environment and the Role of Audit, Sep. 2017

42) Case study on differentiated tax investigation strategies according to the degree of tax evasion risk, Yoon Seung-chul, May. 2014

유형	내용
Automated Underreporter (AUR)	<ul style="list-style-type: none"> - Verify underreporting of income, unfair expenses, or tax deductions by comparing tax data submitted by a third party with the taxpayer's reported amount. - Due to manpower constraints, it is not possible to verify all reports with discrepancies, and only reports where the related tax amount exceeds a certain standard are reviewed. - Sending a letter to the taxpayer asking them to explain the discrepancy. If necessary, <u>the report is subject to correspondence examination.</u>
Automated Substituted for Return (ASFR)	<ul style="list-style-type: none"> - Utilizes taxation data submitted by third parties to identify taxpayers who have not submitted returns and then generates substitute returns electronically - Due to manpower constraints, it is not possible to process all reports generated, and they are processed sequentially starting with the highest priority.
Correspondence examination	<ul style="list-style-type: none"> - The investigation is conducted only through mail, phone, etc. without any face-to-face contact with the taxpayer. - Investigation issues are limited to those that are not complex and can be easily explained through documentation. - Subjects to investigation are extracted electronically according to pre-determined standards, but investigators have the authority to review issues other than those extracted electronically.
Office Examination	<ul style="list-style-type: none"> - This is an investigation conducted at a local tax office, and an investigator is requested to visit the office with materials to prove the investigation issue. - The method of correspondence investigation may be used in parallel, and in limited cases, it is also possible to conduct verification by visiting the taxpayer's place of business.
Field Examination	<ul style="list-style-type: none"> - Conduct face-to-face investigation at the taxpayer's place of business - Because the scope of the investigation is wide and the issues are complex, a revenue agent with extensive relevant knowledge and experience is in charge. - An experienced investigator reviews reports subject to preliminary investigation (potential cases) and applies a classification process to decide whether to conduct an investigation.

※ The U.S. Taxpayer Advocate Service(TAS) pointed out that in addition to the IRS's 'actual' audits, 'non-actual' audits account for a large portion of tax verification and that taxpayers are feeling a great burden because of this. The main contents are as follows.⁴³⁾

- Under Section 7602 of the Internal Revenue Code (IRC), the IRS is authorized to inspect books, documents, records, or other data that may be relevant to verifying the accuracy of your return. I call this type of inspection, which may be conducted by letter at a taxpayer's home, business, or IRS office, a 'real' or traditional audit.
- But a "real" audit doesn't quite end the story. The IRS has several other types of compliance contacts with taxpayers that are not considered "real" audits. These types of contacts, so-called "non-real" audits, include math error correction, Automated Underreporter (AUR) (document matching program), identity and wage verification, and Automated Substitute for Return (ASFR) (non-filer program). First of all, these regulations require taxpayers to provide documents or information to the IRS and can feel very similar to a "real" investigation to the taxpayer. More importantly, "non-real" audits typically lack taxpayer protections typically found in "real" audits, such as the opportunity to seek administrative review with the IRS Office of Appeals or statutory prohibitions on repeat investigations. It means that it does. The IRS plans to increase the use of "non-real" audits through automated means through its "Future State" Initiative.
- Let's take a closer look at the differences between "real" and "non-real" audits. On the most serious issue, I raised concerns that the IRS reports only "real" audit statistics and that this distinction causes the IRS to publicly report incomplete and even misleading information. This distorts coverage rates and underestimates the IRS' actual level of compliance. To help you understand the numbers, let's look at the most recent year for which we have both "real" and "non-real" audit figures. In fiscal year 2016, the IRS conducted more than one million "real" audits, resulting in an audit rate of 0.7%.

43) Taxpayer Advocate Service 2017 Annual report to Congress, Most Serious Problems No.4

Adjusted Gross Income Category	FY 2016 Exams	Exam (Audit) Coverage Rate %	FY 2016 ASFR	FY 2016 AUR	FY 2016 Math Error	FY 2016 Taxpayer Protection Program	FY 2016 Wage Verification	Combined	Calendar Year 2015 Returns	Combined Coverage %
No adjusted gross income	151,639	6.3%	50,722	12,210	32,606	123,151	60,811	402,349	2,392,293	16.8%
\$1 under \$25,000	409,246	0.8%		771,410	681,795	1,182,997	313,754	3,157,201	54,347,216	5.8%
\$25,000 under \$50,000	156,209	0.5%		961,431	483,641	425,734	106,362	2,056,907	33,929,692	6.1%
\$50,000 under \$75,000	74,014	0.4%		498,649	257,347	184,367	45,817	1,023,476	19,389,871	5.3%
\$75,000 under \$100,000	60,343	0.5%		317,359	160,690	113,611	32,126	657,091	12,566,667	5.2%
Subtotal - under \$100,000	851,451	0.7%	50,722	2,561,059	1,616,079	2,029,860	558,870	7,297,024	122,625,739	6.0%
\$100,000 under \$200,000	99,155	0.6%		570,898	227,269	200,413	76,680	1,112,913	17,258,123	6.4%
\$200,000 under \$500,000	46,596	0.9%		208,363	53,183	110,113	78,921	451,177	4,985,176	9.1%
\$500,000 under \$1,000,000	15,258	1.9%		32,577	6,517	32,940	42,058	112,373	801,738	14.0%
\$1,000,000 under \$5,000,000	15,529	4.2%		12,327	3,000	20,069	37,899	76,985	365,701	21.1%
\$5,000,000 under \$10,000,000	2,518	9.6%		603	289	1,943	5,049	9,032	26,111	34.6%
\$10,000,000 or more	2,849	17.4%		318	297	1,471	3,554	7,470	16,390	45.6%
Total	1,033,356	0.7%	50,722	3,386,145	1,906,634	2,396,809	803,031	9,066,974	146,078,978	6.2%

- However, during that same period, the IRS conducted approximately 8.5 million "non-real" audits. Adding these "non-real" audit figures to the "real" audit figures significantly increases the IRS's combined coverage to over 6%. Accordingly, NTA pointed out problems such as the need to review the comprehensive definition of 'audit' for reporting verification, but the IRS did not accept this and instead stated its position that there was a need to activate necessary contact with taxpayers. Bar available.⁴⁴⁾

44) NTA Objectives Report to Congress, Fiscal Year 2019

- The most important point is that the definition of audit stipulated in the National Tax Service's Revenue Procedure 2005-32 should be reexamined and reapplied to the Taxpayer Bill of Rights to reflect recent taxpayer contact activities.
- However, the IRS already internally stipulates in its procedures book various forms of contact with taxpayers even though it is not a tax audit or similar activity, and these are just four representative examples. No matter how it develops, it should not be overlooked that such contact with taxpayers is 'the nature of the IRS' and mentioned that the IRS always makes taxpayers aware of their rights not only during tax audits but also during other contact processes.
- In addition, in a similar context, it was pointed out that tax verification should be performed through a 'real' audit procedure rather than a 'non-real' audit, but a significant number of non-reporting/underreporting cases were reduced by using an automatic verification system or mathematical error correction. It has been stated that conducting a tax audit during a relatively simple verification process would 'increase taxpayer burden unnecessarily', and it is also difficult in practice, and in particular, a tax audit is the best available method. As a verification method that requires a lot of budget, the position was expressed that it is appropriate to go through an automatic verification system under the current resource constraints.
- In the current situation where manpower and budget constraints are increasing, the IRS's position is that in order to reduce the burden on taxpayers and carry out work efficiently, it is more effective to verify reports through faster and easier contact with taxpayers rather than increasing the number of tax audits. It is reasonable, and in fact, if the taxpayer does not comply or submits false information during this 'easy contact' process, the use of 'partial investigation', which can effectively investigate only this part more closely, is expected to increase further.

IV. Scope of authority for tax investigation⁴⁵⁾

1. United States

- An overview of the U.S. tax audit system is as follows.
 - For information related to U.S. tax investigations, see '26 U.S. code, Subpart F - Procedure and Administration (§7601~7613), and specific details are determined through notices on the IRS website and other places.
 - The U.S. Internal Revenue Code (IRC), which corresponds to Korea's Framework Act on National Taxes, regulates the authority of the IRS as follows and regulates it in a more general manner than Korea's Framework Act on National Taxes. This may be because it is difficult for legislators to regulate all matters in detail, so much of it has been delegated to the Treasury and IRS.
 - A similar concept to Korea's enforcement ordinance is Treasury Regulations (TR), and in addition, details are regulated through Revenue Procedure (RV) or IRS Internal Revenue Manual (IRM), which correspond to National Tax Service directives.
 - A significant portion of U.S. laws are related to summons, and this is where the difference is most notable compared to our country's system, where enforcement cannot be enforced.
 - §7601 (Taxpayer and Taxable Person) This means that IRS staff can conduct tax investigations on taxpayers and taxable entities. Additionally, TR 301.7601-1 also provides that, under the supervision of each regional director, he or she has the authority to investigate all persons liable for taxes within the region.
 - §7602 (Examination of books and witnesses) A tax inspector has the right to inspect books and records, summon taxpayers, and

45) There are already existing studies that have partially addressed this, so each country's systems are briefly mentioned and the implications are summarized.

collect evidence and testimony, and also has the same rights to investigate, summon, and collect evidence against third parties related to taxpayers. However, if an investigation is requested to the Ministry of Justice, further administrative subpoenas are prohibited. TR 301.7602-1 describes not only the general authority, but also the authority to investigate civil and criminal tax liabilities through summons issued by the court, and procedures such as interviews related to the summons.

- §7603 (Service of summons) : The summons must be delivered directly to the subject in the form of a certified copy or delivered to the subject's most recent place of residence, and a proof of delivery document with the signature of the person issuing the summons must be submitted at the hearing on the application for execution of the summons to verify the facts stated in the summons. Become a testament to the relationship
- §7604 (Enforcement of summons) : If a taxpayer who has been requested to appear, submit documents or records, or testify in accordance with the Internal Revenue Code fails to comply with the subpoena, the US district court where the taxpayer who received the summons resides will request attendance, submit documents, records, etc., Has the power to compel testimony. In addition, if the duty is neglected or refused, an arrest warrant for the summoned person may be requested from the local district court judge or U.S. magistrate judge. Similar provisions exist in TR 301.7604-1.
- §7605 (Time and place of examination) The time and place of a tax audit can be determined in a reasonable manner, taking into account all circumstances. Additionally, the person subject to the investigation must not undergo unnecessary tax audits, and only one tax audit is possible per year unless the tax office notifies the taxpayer after the investigation that an additional investigation is necessary. However, the IRS procedural regulations (RV 2005-32) list the reasons for allowing duplicate

investigations. Detailed information will be provided later in the duplicate investigation section below.

- TR 301. 7605-1 describes the time and location of the tax audit in some detail. In general, the decision is made by the person in charge considering the balance between taxpayer convenience and efficient tax administration. It can be decided whether the tax investigation will be conducted in the office (office examination) or at the taxpayer's location, such as the taxpayer's residence (field examination). Location may be changed upon request. As shown above, the fact that the enforcement ordinance describes the location and time of the investigation in detail is something worth appreciating.
- §7606 (Entry of premises for examination of taxable objects) In principle, the investigation of taxable objects must be conducted during the day, and if the taxable objects can only be investigated at night, the investigation can also be conducted at night. TR 301. 7606-1 also provides similar provisions.
- §7608 (Authority of internal revenue enforcement officers) Revenue enforcement officers have the authority to not only possess firearms but also issue search warrants, make arrests without warrants, and seize property in order to enforce laws related to Subtitle E, such as alcohol, tobacco, and firearms, and tax criminal investigators issue search warrants in accordance with relevant laws. , has the power to make arrests and seize property without a warrant.
- §7609 (Special procedures for third-party summonses) When summoning a third party, describe relevant details such as the need to notify the taxpayer of the third party summons.
- §7610~§7613 Other information includes testimony costs, church tax investigations, and summons for computer software.

- In addition, the contents of TR 601.105, another law that governs tax audit-related matters, are as follows:
- First, TR 601.105.(b) briefly mentions the procedure for conducting a tax investigation on a return and stipulates that an office investigation and an on-site investigation are generally conducted. In addition, it contains content related to the process of deriving tax audit results and technical advice.
- (c) In the Correspondence Examination, the matters found by the person in charge are sent to the taxpayer by mail, and the details of the office investigation are provided, including the process in case of agreement and disagreement, interview with the person in charge at the office, and defense procedures. In addition, if the taxpayer does not consent to the on-site investigation, a simple process such as 30-day letter is stipulated.
- (d) explains the appeal procedure, such as the so-called 30-day letters and protests, and (e) specifies the appeal procedure after the taxpayer pays taxes (Claims for refund or credit).
- (f) describes the legal procedures that the National Tax Service can take if the investigation is interrupted due to the imminent expiration of the statutory limitation period for tax assessment.
- (g) is related to fraud, criminal prosecution, and punishment, and (h) is related to Jeopardy assessments related to omission of seizure notification.
- (j) refers to cases where a reinvestigation is possible for an investigation that has already been concluded, that is, an exception that allows duplicate tax audits under Korea's Framework Act on National Taxes. The reasons for the exception are as follows.
 - (i) there is fraud, misconduct, conspiracy, concealment or

misrepresentation of material fact;

- (ii) there was already a clearly defined substantive error based on the then-current IRS position at the time of the previous tax audit;
 - (iii) In addition, if there are other circumstances in which a reinvestigation is possible.
- As we have seen so far, US laws and enforcement regulations do not regulate tax audit procedures in detail. Unlike Korea, it mainly consists of compulsory summons issued by the court, and arbitrary procedures seem to be delegated to self-regulation.
 - In fact, there are regulations on the tax audit period, extension of the period, regulations on the scope of tax audit, regulations on duplicate tax audit, partial tax audit, definition of tax audit, etc. as stipulated in Korea. It is difficult to find in the law, and this also applies to questions other than examination.
- 1-1. The U.S. tax audit system only provides rough outlines, at least at the legal level, and gives the IRS broad discretion on how to operate it in detail.
 - 1-2. Tax audit subject selection method
 - Methods for selecting investigation subjects are divided into random selection, computer screening, and related examinations.
 - Random selection is a method of selecting people subject to tax deductions when it is judged that the report has been filled out inaccurately based on information such as news, public records, and informants.
 - Computer selection is a method of assigning scores to individual and corporate taxpayers using the 'Discriminant Inventory Function System (DIF)' and selecting those with higher scores as subjects of tax audit.

- Selection of related parties is a method of selecting as subjects of tax audit those who have transactions related to business partners, investors, etc. who have been selected as subjects of tax audit.
- 1-3. Tax audit period
 - The tax audit period is not set separately, and in principle, there is no time limit (unlimited) and can be applied differently for each individual taxpayer.
- 1-4. Degree of prohibition of duplicate tax audits⁴⁶⁾
 - As mentioned before, IRC §7605(b) stipulates the prohibition of unnecessary tax investigations and duplicate investigations as follows, but grounds for permission are left open according to the IRS procedural regulations corresponding to the directive.

IRC §7605(b). Restrictions on examination of taxpayer.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer’s books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

- It grants a fairly wide range of exceptions, and precedents also take a similar attitude by stating, “If information on the taxpayer’s ledger is needed even though the IRS does not have it, the investigation is no longer unnecessary.”
- In other words, although controlling the tax investigation process is important, the role of the tax authorities in realizing fair taxation is also considered to be of utmost importance. The 1984 U.S. Supreme Court decision (US v. Arthur Young & Co., 465 US 805, 1984) explains the reasons as follows:

46) Re-thinking of the Prohibition of Duplicate Tax Audits Principle, Hongik Law Review, Vol. 22, No. 1, Aug 25, 2020

“Our complex and comprehensive system of federal taxation, relying as it does upon self-assessment and reporting, demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities. Without such disclosure, and the concomitant power of the Government to compel disclosure, our national tax burden would not be fairly and equitably distributed. In order to encourage effective tax investigations, Congress has endowed the IRS with expansive information-gathering authority; § 7602 is the centerpiece of that congressional design.”

- In another commentary, Saltzman & Book stated, “The purpose of the limitations on tax audits under IRC §7605(b) is not to limit the number of audits, but rather to reserve discretion for re-examination of a taxpayer's books by field officials. agent to higher management personnel.”
- It is granted a fairly broad discretion, to the extent that it is sometimes pointed out from outside that it is necessary to control the tax audit process.

※ Materials with a similar purpose

- 1) TAS, FIELD EXAMINATION: The IRS’s Field Examination Program Burdens Taxpayers and Yields High No Change Rates, Which Waste IRS Resources and May Discourage Voluntary Compliance (2018)
- 2) GAO, IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened, GAO 16-103 (Dec. 2015)
- 3) GAO, IRS Return Selection: Improved Planning, Internal Controls, and Data Would Enhance Large Business Division Efforts to Implement New Compliance Approach, GAO 17-324 (Mar. 2017)
- 4) TAS, CORRESPONDENCE AUDITS: Low-Income Taxpayers Encounter Communication Barriers That Hinder Audit Resolution, Leading to Increased Burden and Downstream Consequences for Taxpayers, the IRS, TAS, and the Tax Court(2021)

2. JAPAN

○ 2-1. Overview of the Japanese tax audit system⁴⁷⁾

- There is no limitation on the tax audit period, and there is no separate restriction on duplicate tax audits, giving considerable discretion.

※ The tax audit period in Japan is not legislated and is not separately calculated.

- In practice, the investigation field trip lasts between 2 and 6 months for corporations, and there are cases in which it is completed in 3 to 4 days for small individual taxpayers.
- However, the important thing is that the Korean tax audit period is automatically calculated even if there is no contact with the taxpayer, but the Japanese investigation period only considers the number of days of on-site visit.
- If the taxpayer's explanation is unclear or the data presented is insufficient, an extension is possible. For example, even if the on-site visit lasts about a week, it may take more than a month to go through processes such as explanation of issues and reach an actual conclusion.

- It is true that it has been pointed out several times that Japan's tax audit (questionnaire inspection) regulations are somewhat abstract and weak, run counter to tax legalism, and may lead to tax disputes over their interpretation. Accordingly, in order to legislate tax audit procedures, the National Tax Rules Act was revised in December 2011 and went into effect in January 2013.
- Briefly looking at the revisions at the time, first of all, the questionnaire inspection regulations that were scattered in each tax law were integrated into the newly established National Tax

47) 'Organized with a focus on 'Tax Inquiry Scheme under Japan's Tax Law and Its Implications, Lee Im-dong, 2021'

Rules. Major regulations such as prior notice and exceptions, retention of submissions, explanation to taxpayers at the end of investigation, prohibition of re-investigation and exceptions, etc., which were previously operated by administrative rules and practices, have been legislated.

- Before that, there were no specific regulations regarding inquiry inspections, so the exercise of investigation rights was possible at the discretion of employees as long as it did not conflict with the principle of proportionality. However, the revision of the law was significant in that it increased the predictability of exercising tax investigation rights. However, it is true that a considerable amount of discretion is still allowed, such as the requirement for starting an investigation, ‘questions can be conducted when necessary’, as before.
- The ‘National Tax Rules Act’, which regulates tax investigation procedures in Japan, stipulates the right of tax officials such as the National Tax Service to make inquiries and inspections for each tax item.⁴⁸⁾
- Looking at the law in detail, first, Article 74-2 is income tax, corporate tax and related local taxes, Article 74-3 is inheritance tax, Article 74-4 is liquor tax, Article 74-5 is cigarette tax, etc., and Article 74-6 is aviation fuel tax. It stipulates the exercise of the right to question and inspect tax audits regarding related tax items by tax officials such as the National Tax Service.
- It is stipulated that inquiries regarding various details, etc. can be conducted ‘when necessary.’ Accordingly, questions may be asked to the relevant person, books, documents and other items related to the person’s business may be inspected, or the relevant items may be requested to be presented or submitted. In other words, tax authorities have broad discretion.

48) Japan NTA ‘税務調査手続に関するFAQ (一般納税者向け)’
(<http://www.nta.go.jp/sonota/sonota/osirase/data/h24/nozeikankyo/ippan02.htm>)

- Regarding the 'when necessary' provision, the Japanese National Tax Service itself interprets it as being able to investigate not only when there is a significant suspicion of under-reporting, but also when there is a need to confirm whether the tax return was made accurately or what the exact tax base is.
- In response to this, Japan's Supreme Court ruled that the interpretation of when an investigation is necessary should give priority to the reasonable judgment of employees, but since this refers to cases where objective necessity is reasonably recognized, it cannot be judged based on simple personal arbitrariness.
- In addition, because judging the requirements requires considerable expertise, it is known that there are very few cases in which the illegality of the actual investigation has been recognized.
- As will be explained later, unlike Article 81-6 of Korea's Framework Act on National Taxes, which specifically stipulates the reasons for conducting regular and irregular surveys, it recognizes a somewhat abstract and broad discretion.
- Article 74-7 stipulates that goods submitted in a national tax survey can be detained when necessary, and appears to be a similar regulation to temporary storage in Korea.
- It also stipulates reporting requirements for specific business operators, etc. The director of the competent National Tax Service determines the scope of the specific transaction for specific matters related to the specific transaction to the business or government office that is the counterparty to the specific transaction or provides the location for the specific transaction, and provides the usual time for preparation within the scope of not exceeding 60 days. It is stipulated that a report may be requested by a specified date, taking into account the number of days required. Specific transactions herein refer to businesses using electronic information processing organizations, etc.

- Article 74-8 stipulates that the above-mentioned provisions of the relevant public official's right to question and inspect should not be interpreted as being due to a criminal investigation.
- Article 74-9 provides that when a tax official asks questions, inspects or requests submissions during an on-site inspection of a person liable for tax payment, the contents, date and time, location, purpose of investigation, subject matter, subject period, and ledger of items to be investigated regarding the person liable for tax payment shall be provided in advance. It stipulates that notification must be made by presenting documents, other items, and other items necessary for investigation.
- Article 74-10 does not require prior notification, and if the head of the tax office, etc. determines that it is difficult to determine the tax base or tax amount due to an illegal or unfair act in light of the contents or information of the taxpayer's report or past investigation results, tax It stipulates that no prior notice of investigation is required.

○ 2-2. Tax audit subject selection method

- In Japan, the criteria for selecting tax audit subjects are, in principle, not disclosed.⁴⁹⁾ Taxpayers are selected based on industry or business size based on income tax or corporate tax reports and various data information accumulated in the database using the KSK system (National Tax Management System).
- In order to efficiently collect useful data, the system is being reorganized, such as installing a specialized data collection department.
- The selection of companies subject to investigation is conducted by a general national tax inspector who analyzes the corporation's industry, economic situation by industry and region, survey guidance performance to date, report contents, analysis data extracted from the National Tax Service's

49) Japan NTA '適正・公平な税務行政の推進' (http://www.nta.go.jp/kohyo/katsudou/report/2010/02_3.htm)

computer system, and various transaction data, and provides media information and representative information. After determining whether there is a need for investigation based on various information such as information on living environment and family structure, priority is selected for those with the greatest need for investigation.⁵⁰⁾

○ 2-3. Tax audit period

- Despite the revision of the National Tax Rules Act in 2011, there is no separate provision for the tax audit period, and it is known that there is no limit to the actual investigation period.

○ 2-4. Degree of prohibition of duplicate tax audits

- In accordance with the revision of the law in 2015, it is stipulated that after the initial investigation, a re-investigation is possible when the relevant investigator is deemed to have committed misconduct in light of newly obtained information. Regarding newly acquired information, according to the National Tax Service's Statutory Interpretation and Control, "questionnaire examination in the national tax investigation (limited to field examination) regarding the notice under Article 74-11, Paragraph 1 of the National Tax General Act or the explanation under Paragraph 2 of the same Article. "It is information other than the information that the employee who gave the notice had at the time the notice or explanation was given."
- In other words, in the case of Japan, the requirements for reinvestigation are defined relatively abstractly to prevent abuse of investigation rights, but grant wide discretion to the tax office.

50) Study on foreign tax audit strategy cases, Myung-ho Park, Won-ik Son, 2010

3. Germany⁵¹⁾

- Tax audits in Germany are divided into the so-called ‘external investigation (Außenprüfung)’ and ‘individual investigation procedures’ (Einzelermittlungsverfahren), and the one most similar to tax audits in Korea is the ‘external investigation’ system. However, the purpose of an external investigation is not to investigate a specific tax item during a specific tax period, but rather to ‘overall check whether the taxpayer is complying with tax laws based on all data held by the taxpayer.’ The scope is very comprehensive and the intensity of the investigation is very comprehensive. It is also known to be very high compared to individual investigation procedures.
- While the ‘individual investigation procedure’ is conducted inside the office based on reporting documents, the ‘external investigation’ literally conducts the investigation outside the office, that is, at the taxpayer’s workplace. Like other countries, including Korea, the ‘individual investigation procedure’ is centered on the person in charge of imposing the facts and focuses on determining the facts, and there is less control over the process, whereas the ‘external investigation’ has a legally strict investigation procedure, so the degree of control is limited. It is known as a tax investigation that is strong and places a large burden on taxpayers.
- The normative basis for external investigation is the Tax Rules Act (AO), which is governed by a total of 15 articles from Articles 193 to 207. Since the above article grants extensive discretion (Ermessen) to the administrative agency, the so-called ‘investigation rules (Betriebsprüfungsordnung, BPO)’, which are internal administrative rules of the tax authority, serve as a standard for controlling discretion in the tax investigation process.

51) Germany’s Tax Audit System and Its Implications, Lee Dong-sik, Oct 10, 2017

- In practice, the so-called 'Rationalization Guidelines (Rationalisierungserlass)' are said to play a very important role, and are known to contain key details such as methods for selecting investigation subjects and the number of times a certain taxpayer can be repeatedly investigated, and have been used by external agencies for the past 30 years. It is also worth noting that it was not disclosed in .⁵²⁾
 - As mentioned earlier, the tax audit period is not limited by law, and considerable discretion is granted, including no restrictions on duplicate tax audits.
- When analyzing the German system in depth based on investigation rules, etc., there are two points worth noting from Korea's perspective: 'frequency of investigation' and 'timely investigation system'.
- First, we would like to look at the frequency of external investigation. German tax authorities classify taxpayers into large-scale, medium-scale, small-scale, and micro-businesses depending on their size. Classification standards are determined by the tax agency of each state (Land) through consultation with the Federal Ministry of Finance, and the tax agency of each state is responsible for imposition. Additionally, the frequency of investigations varies depending on the size of each business.
 - Large-scale businesses are subject to continuous investigation during the existing investigation period. That is, if they are classified as a large-scale business, they are subject to an external investigation for the entire investigation period during which they conduct business, and this is called a continuous investigation (Anschlußprüfung).

⁵²⁾ It is understood that practical guidelines, which are internal data, are not usually disclosed not only in Germany, but also in Japan and the United States, and this seems reasonable in that if the guidelines are made public, malicious tax evaders may abuse them.

- As a result, there is a large difference in the frequency of external investigations between large-scale businesses and other businesses. For example, in the 2015 tax audit, 21% of large-scale businesses were investigated, 6% and 3% of medium-sized and small businesses, respectively, and small businesses were investigated. It is known that approximately 1% of business operators have been investigated.
- Secondly, what is unique is the so-called 'timely investigation (zeitnahe Außenprüfung)'. Large-scale businesses are subject to an external investigation once every three to five years, and since the method is the continuous investigation mentioned above, they are actually investigated for the entire period of business.
- The problem is that the request for data required for external investigation is not only from the present, but also goes back a considerable amount of time, so the burden of finding the data is high, and when the person in charge is replaced, there is a great inconvenience of having to find the relevant data through the previous person in charge.
- After reviewing various methods for this, the so-called 'timely investigation' system was introduced in 2012.

※ ‘Timely investigation‘ (Zeitnahe Betriebsprüfung) as provided for in §4a of BpO

(1) ¹Die Finanzbehörde kann Steuerpflichtige unter den Voraussetzungen des Absatzes 2 für eine zeitnahe Betriebsprüfung auswählen. ²Eine Betriebsprüfung ist zeitnah, wenn der Prüfungszeitraum einen oder mehrere Besteuerungszeiträume umfasst.

(2) ¹Grundlage zeitnaher Betriebsprüfungen sind die Steuererklärungen im Sinne des § 150 der Abgabenordnung der zu prüfenden Besteuerungszeiträume (Absatz 1 Satz 2). ²Zur Sicherstellung der Mitwirkungsrechte des Bundeszentralamtes für Steuern ist der von der Finanzbehörde ausgewählte Steuerpflichtige dem Bundeszentralamt für Steuern abweichend von der Frist des § 21 Absatz 1 Satz 1 unverzüglich zu benennen.

(3) Über das Ergebnis der zeitnahen Betriebsprüfung ist ein Prüfungsbericht oder eine Mitteilung über die ergebnislose Prüfung anzufertigen (§ 202 der Abgabenordnung).

- The 'timely investigation' system is a system that allows investigations to be conducted only for the fiscal year in which the investigation is conducted or for two consecutive fiscal years including the fiscal year. At first glance, it appears that under a continuous investigation environment, tax audits may be conducted too frequently. It may seem that the burden on taxpayers will be rather large, but rather than reviewing all of the business's data from scratch, the investigation staff will start with the company's tax base report and conduct the investigation to verify the appropriateness of the report. In other words, it can be seen as somewhat similar to the process by which a corporation that undergoes an external accounting audit receives an annual audit based on the corporate settlement statement and financial statements to confirm its financial statements.

※ Timely investigation progress order⁵³⁾

1. Confirmation of annual accounting settlement
(Aufstellen des Jahresabschlusses)
2. Submission of tax base final return
(Abgabe der Steuererklärung)
3. Send investigation notice
(Prüfungsanordnung durch die Großbetriebsprüfung)
4. Conduct external investigation (Durchführung der Betriebsprüfung)
5. Agreement on investigation results
(Einigung auf die Ergebnisse der Prüfung)
6. Modification of tax base final return (Anpassung der Steuererklärung)
7. Confirmation(Feststellung)

○ (Implications) In the case of Korea's large company periodic investigation, the investigation is conducted every five years, and although there are no externally disclosed regulations, it is known that the survey is usually conducted for 2 to 3 business years as the taxable period for the investigation.

- In addition, the actual tax period and the year in which the investigation is conducted are usually conducted with a gap of more than one and a half years. For example, if a corporate tax return is filed in March 2018 for the 2017 attributable business year and the 2017 attributable business year is selected as the subject of investigation after 2019, there will be a certain amount of time lag in the system.

- If Company A, which is subject to a periodic investigation, conducts the investigation again in 2019, and the investigation is conducted for a total of three business years from 2015 to 2017, the person in charge of the company must remember the transactions in 2015. There is a burden of having to submit

53) Germany's Tax Audit System and Its Implications, Lee Dong-sik, Oct 10. 2017

evidence, and problems arise that make it difficult for researchers to submit data.

- Additionally, if the previous periodic investigation was conducted in 2014, the problem of 2013 and 2014 being excluded from the regular screen will also occur.
- If Germany's timely investigation system is introduced to large corporations subject to periodic investigation, the burden on investigators will be reduced by conducting an investigation targeting only the relevant fiscal year immediately after reporting each fiscal year, while also reducing the burden on investigators and reporting the financial position and profit and loss statement at the end of the previous fiscal year. Since the financial statements and the reports for the previous fiscal year based on them have been sufficiently inspected in the previous tax audit, the amount of data required from companies has also been reduced, which is expected to reduce the burden on companies.
- In addition, the purpose of Germany's 'continuous survey' system, which surveys consecutive business years in succession by eliminating years excluded from verification, can also be achieved, so it is necessary to consider introducing it in Korea as well.
- Given that research shows that tax compliance declines immediately after a taxpayer undergoes a tax audit, it is necessary to consider introducing a continuous investigation system without any excluded fiscal years for major taxpayers.
- Tax years in which tax verification is omitted have no choice but to be verified through irregular investigations after elaborate analysis, but it is not easy for large-scale taxpayers to precisely screen all transactions using only the National Tax Service's internal data without checking the actual ledgers.

※ Research shows that tax compliance is declining - 1⁵⁴⁾

- In 'Study on the difference in tax avoidance before and after a tax audit (2011)', Ko Seong-sam and Park Sang-seop presented the conclusion that taxpayers increased their level of tax avoidance in the year immediately following a tax audit compared to the year immediately preceding the tax audit, and that the reason for this was that investigations were conducted at regular intervals. This is presumed to be because it is expected that the tax will not be investigated for a certain period of time after receiving it once due to the principle of regular tax audits.
- There is also a study (Jeong Dal-seong and Hong Jeong-hwa, 2013) that shows that tax adjustments are made in the direction of reporting less tax in the year of the tax audit compared to the year immediately before or after the tax audit (2016). Analyzed that tax avoidance decreases in the year of a tax audit compared to the previous year or the year immediately after, and interpreted that tax payment is faithfully performed due to the influence of the investigation at the time of the investigation, but the effect gradually decreases thereafter.

54) The Operating State and the Reform Measures for the Tax Audit, An, Sook Chan, Jun 16. 2020

→ Considering the results of the research, it is generally interpreted that there is a tendency to report less tax in the year immediately following the tax audit than at the time of the audit.

※ Research shows that tax compliance is declining - 2⁵⁵⁾

- Numerous research results have proven the Bomb Crater Effect (BoCE) of taxes, that is, the fact that tax compliance declines immediately after a taxpayer undergoes a tax audit. This BoCE is theoretically possible through the so-called gambler fallacy or the loss repair effect. It has been proven. Recent studies have also drawn conclusions that support very strong and robust BoCE.⁵⁶⁾
- BoCE was first introduced by Mittone (2006). In accordance with the so-called belief that “shells do not fall in the same place twice,” there seems to be a belief that just as troops who were shelled are hiding in recent explosion craters, the same will be true in tax investigations. The bomb crater effect has been confirmed in various studies or experiments, and the same appears to be true in similar studies tested in several countries and field experiments (Garrido & Mittone, 2013 / Kastlunger, Kirchler, Mittone, & Pitters, 2009 / DeBacker, Heim, Tran, & Yuskavage, 2015)
- Based on the gambler fallacy, that is, 'false perception of coincidence', taxpayers believe that they will soon be subject to a tax audit because a random event such as a tax audit has not occurred for a certain period of time, or that there will be no tax audit for the time being because they have recently undergone a tax audit. There is a view that BoCE occurs because the possibility is judged to be high, and there is also a view that taxpayers who have been subject to a tax audit participate in tax evasion and attempt to recover losses resulting from the investigation due to the loss repair effect.

55) Luigi Mittone, Fabrizio Panebianco, Alessandro Santoro, The Bomb-Crater Effect of Tax Audits: Beyond Misperception of Chance, 2016. 10월

56) Same as above

- For reference, there are some studies that show that Germany's 'timely investigation' system is similar in purpose to Korea's 'faithful tax payment agreement system' (formerly the 'horizontal faithful tax payment' system).
- However, while the 'timely investigation' system is a system that increases the effectiveness of the investigation and lowers the burden on companies by verifying large corporations in Germany, which are subject to Germany's intensive external investigation virtually every year, in a timely manner immediately after reporting, the 'faithful tax payment agreement system' The difference is significant in that it is a system that focuses on reducing the burden of investigation by establishing cooperative relationships with small and medium-sized enterprises that are relatively weak in tax verification response.
- Considering that the 'Faithful Tax Agreement System' has been inspired by the Netherlands' horizontal tax management system since its introduction, the purpose is also different.
- The OECD also identified member countries that introduced a type of co-operative compliance model-related system around 2013. Among the 24 countries that participated in the survey, about 18 countries, including the United States and the Netherlands mentioned above, introduced the CAP system (Compliance Assurance Process). introduced a system related to cooperative verification, but considering that Germany is not included in it, there is a difference from cooperative verification systems such as the 'timely investigation' system and the 'faithful tax payment agreement system'.
- Cooperative compliance is generally a tax verification procedure at a somewhat relaxed level rather than the area of tax audit, and the number of countries using it has been gradually increasing since the 2000s. Korea's 'horizontal faithful tax

payment' system is also a system with a similar purpose and will not be directly covered in this report, but it is necessary to consider expansion/improvement by referring to each country's system.

- Cooperative compliance is a so-called 'soft law instrument', a process designed to voluntarily comply with tax laws, and at the same time a tool to enforce tax laws more easily and efficiently. The most representative example is Dutch horizontal monitoring (HM), which promotes trust and trust between taxpayers and tax authorities. This is a procedure to enhance transparency and mutual understanding.⁵⁷⁾
- The beginning of cooperative compliance dates back to the 1980s, when some OECD countries, mainly Commonwealth countries (Australia, New Zealand, UK), began to develop cooperative compliance as part of New Public Management (NPM) in the public administration area, and the Netherlands In the case of , it is necessary to consider that the system began to be actively introduced in 2005 to overcome serious budget and manpower constraints.⁵⁸⁾

57) DUTCH HORIZONTAL MONITORING: he Handicap of a Head Start, Sep. 2017

58) Same as above

❖ Status of adoption of co-operative compliance model in OECD member countries⁵⁹⁾

Country	Co-operative compliance model
Australia	Formal co-operative compliance model as of 2001. The premium product in the current model is the Annual Compliance Arrangement (ACA), which sets out expectations regarding disclosure and service between the large business and the Commissioner.
Austria	Pilot project 'Horizontal Monitoring' with more than ten (big) businesses started in 2011 and will be evaluated continuously until 2014. External stakeholders (chamber of tax advisers, chamber of commerce and chamber of industries) are also involved in this project to develop this approach further.
Canada	In 2010, Canada launched a New Approach to Large Business Compliance that relies heavily on closer and more collaborative relationship with taxpayers and tax intermediaries and is the foundation upon which a co-operative compliance approach is being based.
Denmark	Formal co-operative compliance model as of 2012. Started as a pilot project in 2008.
Finland	A pilot project with six LBs started beginning of 2013 and will last two years.
France	Until recently, France had no formal co-operative compliance model. However, there were innovative compliance approaches and programmes in place to assist large taxpayers to meet their obligations and to comply with the tax rules. These were designed to offer a greater degree of responsiveness and openness. In November 2012, France announced the establishment of its own pilot "relation de confiance" programme, commencing in March 2013.
Germany	No formal co-operative compliance model. However Federal States (Länder) have taken a variety of measures with the aim to improve compliance. For instance, in 2012 Lower Saxony introduced a co-operative approach for large businesses in case of tax audits.
Hong Kong	No formal co-operative compliance model. Initiatives are undertaken to achieve some of the major objectives of a co-operative compliance model e.g. dialogue with tax and business community and a risk based approach.

*In the case of Germany, it was confirmed that there is no formal cooperation system, and it is mentioned that various efforts are being made for this at the federal government level, which seems to imply a timely investigation, but at least it does not seem to be viewed as an official cooperation system.

59) OECD, Co-operative Compliance: A Framework., 2013

Hungary	No formal co-operative compliance model. However, the recommendations of the 2008 Study have been taken into consideration in their Strategic Plan. As part of this plan the Large Taxpayers' Directorate (LTU) has been operating a client relationship management system with dedicated staff dealing with operational questions from large taxpayers. This ensures mutual co-operation at the tax directorate and the maintenance of flexible daily relations.
Ireland	Formal co-operative compliance model as of 2005 after a process of engagement and consultation with the various stakeholders, both internal and external.
Italy	No formal co-operative compliance model. However Italian Revenue Agency was reorganised in 2009 and a new Large business division was implemented. The 'Risk Management Monitoring' is a main feature of the reorganisation and it is a risk based approach driven by the specific features of the Industry sector and by any available information concerning the specific taxpayer and potentially affecting its level of compliance. This ensures that investigations are focused on high risk taxpayers, avoiding or minimising intrusive enquiries for non high risk taxpayers. And it enhances the establishment of relationships based on co-operation and proportionality.
Japan	Formal co-operative compliance model for super-large corporations since 2010. When the Agency examines them, it also checks their corporate governance on tax. It plans a pilot project: if it could confirm proper tax processing of high risk transactions in corporations with good corporate governance on tax, it postpones the next examination of them.
Netherlands	Formal co-operative compliance model 'Horizontal Monitoring' (HM) started in 2005 with two pilot projects. Since then it has been integrated in the broader compliance risk management strategy. Essential elements of the steps taken towards a compliance agreement include Board to Board engagement and commitment ("tone at the top") and resolving legacy issues. The model was evaluated in 2012 by an independent Government Committee.
New Zealand	Formal co-operative compliance model. Started with a pilot project after a project team considered the 2008 Study and made recommendations about how to embrace the findings. A small group of taxpayers were invited to consider entering into the programme. The first agreement was signed in November 2010.
Norway	A pilot co-operative compliance project started in August 2011 and will last until December 31, 2013. The pilot includes six groups of companies in different branches. The pilot is based on the recommendations in the OECD 2008 Study. In addition to the pilot project, the Large Taxpayers Office in general is working based on dialogue, and most of the Large Companies have a Client Relationship Manager.
Portugal	No formal co-operative compliance model. However, in early 2012 a Large Business Unit was established with the aim to enhance the relationship with large business taxpayers.

Russia	A pilot project started late 2012. At the end of 2012 four major Russian large businesses have officially signed Co-operation agreement on "Horizontal Monitoring – Enhanced information exchange". The pilot aims to establish a new format of interaction between the tax authorities and companies based on transparency, trust and co-operation.
Singapore	Formal co-operative compliance model 'Enhanced Taxpayers Relationship Program' started in mid 2008 with a pilot project after consulting the Singapore International Chamber of Commerce, an industry association representing multi-national companies and locally-owned business enterprises, to engage and build relationships with the top large businesses.
Slovenia	Formal co-operative compliance model. Started in May 2010 with a public call for all large taxpayers to inform the Davčna Uprava Republike Slovenije (DURS, Tax Administration of the Republic of Slovenia) about their wish to participate in the pilot project.
South Africa	Formal co-operative compliance model 'Taxpayers Engagement Strategy' of 2004. This strategy includes the project "taking tax to the Boardroom", entering into a Banking Accord, sharing taxpayers risk rating and providing South African Revenue Service (SARS) perception of their compliance and influencing sectors of economy.
Spain	Formal co-operative compliance model: 'Code of Good Tax Practice'. Started in 2009 with the creation of the "Large Companies Forum". The Code of Good Tax Practice was finalised in July 2010.
Sweden	Formal co-operative compliance model. Started in 2006 with "the Dialogue". Companies could get answers in advance of filing returns in relation to certain tax issues. Formally launched in spring 2012 on a small scale by inviting 15 companies to become involved.
UK	In 2006 HMRC introduced a formal co-operative compliance approach for large corporate taxpayers, based on a customer relationship management model and using the 'Tax Compliance Risk Management' framework. In 2009 HMRC signed off its 'Large Business Strategy'.
USA	Compliance Assurance Process (CAP) started in 2005 as a pilot project and became permanent in 2012.

4. Conclusion and Implications

- Among the countries being compared, restrictions on the tax audit period exist only in Korea, and major countries do not disclose the selection methods or standards to the outside world. We must reconsider the original purpose of tax audits, which is to realize fair taxation.

[Comparison of tax audit procedures between Korea and major countries] ⁶⁰⁾

Procedure	Korea	U.S.	JAPAN	Germany
Disclosure of method or criteria for selecting tax audit subjects	○	X	X	X
Regulations on tax audit period	○	X	X	X
Period extension restrictions	○	X	X	X
Application for postponement of investigation	○	○	X	○
Presumption of Taxpayer Integrity	○	X	X	X
Prohibition of re-investigation	○	Guaranteeing discretion of tax authorities		
Temporarily storing taxpayer ledger at tax office	○ (very limited)	○	○	○

- Moreover, in the case of Korea, it is difficult to find effective sanctions when a person refuses to submit data under the constraints of the tax audit period. Therefore, various legislative solutions can be considered. The measures suggested by experts are as follows.

60) NTS press release, 'NTARTF Recommendations', Jan 29, 2018

[Legislative solutions to taxpayers' non-cooperation with tax audits] ⁶¹⁾

1) Improvement of monetary sanctions

- Currently, the fine for refusing to submit data during a tax audit is up to 20 million won, and the fine for refusing to submit data related to offshore transactions is up to 200 million won, but this is not enough to secure the fulfillment of tax cooperation obligations.
 - In order for the imposition of fines to be an effective sanction, it is necessary to set different levels of fines considering the size of the taxpayer.
- In addition to the imposition of a one-time fine, it is necessary to increase the effectiveness of sanctions through aggravated sanctions or repeated sanctions for continuous violations of obligations.

2) Forced submission of documents

- In tax investigations, which are administrative procedures, there is no way to secure documents if the taxpayer does not comply with the tax office's request to submit documents (unlike civil and criminal procedures).
- In administrative procedures such as tax audits, it is necessary to consider institutionalizing a document submission order system that can secure documents necessary for taxation under court intervention by referring to the systems of the United States and the United Kingdom. (However, there is a limitation that it must be pursued as a long-term task due to the need for reorganization of the court organization)

3) Shift in burden of proof and restrictions on submission of new materials during litigation

- Referring to the examples of the United States and France, it is possible to consider shifting the burden of proof in cases where a taxpayer violates the tax cooperation obligation or by separately designating an unfaithful taxpayer.
- If taxation data is not submitted in a tax audit, you can consider restricting the submission of data in tax disputes, but immediate implementation is limited because it requires reform of the overall system.

4) Right to access data on offshore transactions, etc.

- It is necessary to strengthen sanctions for violation of obligations and at the same time revise the law to effectively suspend the exclusion period in case of failure to comply with a legitimate request for data submission, and to supplement the lack of sanctions provisions for violation of some obligations to submit data.

61) NTS press release, 'Forum on Tax administration 2022', Dec 19, 2022

- Lastly, we look at duplicate tax investigations. In the case of each country being compared, much more relaxed standards are applied in terms of method and extent compared to Korea's laws and precedents reviewed above, and precedents rarely judge abuse of investigation rights or reinvestigation as illegal.
- In particular, ❶ broad discretion is given to tax authorities regarding which method to take among various types of tax audits, ❷ the scope of tax audits to which the principle of prohibiting duplicate tax audits applies is divided into compulsory investigation (USA) and field investigation (Japan), external tax investigation (Germany), etc. ❸ Exceptional reasons for reinvestigation are 'when necessary' (USA), 'when new information is obtained' (Japan), 'when new facts or evidence are discovered' There is a significant difference from Korea in that very comprehensive and relaxed requirements are set, such as '(Germany) and 'cases where tax evasion was not known at the time of primary investigation' (United Kingdom).

※1 Summary report and institution introduction submitted separately

※2 Reference list included in footnotes