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Key Issues Related to NFT (4)

Over a four-part series of newsletters, Kim & Chang's Fintech & Virtual Asset Team discusses potential legal issues and considerations related to non-fungible tokens ("NFTs").

As discussed in our previous newsletter on the legal nature of NFTs (Part 1), it is difficult to provide a uniform definition on the legal nature of NFT. Depending on the characteristics of a particular NFT, various issues may arise, such as whether the NFT constitutes a virtual asset under the Act on Reporting and Using Specified Financial Transaction Information (the "AML Act") or an investment contract security under the Financial Investment Services and Capital Markets Act (the "FSCMA"). In addition, as discussed in our previous newsletter on intellectual property issues (Part 2), from the Copyright Act perspective, if a transfer of an NFT encompasses a transfer of copyright to the underlying work or a digitized version of the underlying work, it may be deemed that rights to the underlying work are also transferred upon the NFT transaction. This Part 4 provides a general overview of potential tax issues related to NFTs.

I. Individual Income Tax and Corporate Income Tax for NFT Transactions¹

We will discuss the tax treatment of NFTs and NFT transactions under existing tax law principles on the assumption that a certain NFT constitutes (i) a virtual asset, (ii) an investment contract security, or (iii) a right to the underlying asset (e.g., copyright or neighboring rights to a copyrighted work).² However, given the novel nature of NFTs, no direct guidance is currently available in Korea, and related discussions are still in the early stages. Therefore, there are still many open questions about NFT's legal and tax treatment. For instance, the question of whether a transfer of an NFT should be treated as a transfer of the underlying asset may depend

¹ A domestic corporation will likely be subject to corporate income tax on its NFT-related income regardless of the legal nature of an NFT due to the generally applicable corporate income tax principle, which provides for the taxation on increases in the net asset value of domestic corporations. A foreign corporation generally faces the same income tax consequences as a non-resident under the Individual Income Tax Law with respect to any NFT-related income.

² This newsletter intends to examine and explore potential tax issues under existing tax law principles assuming that a certain NFT is classified as a virtual asset, an investment contract security, or a right to the underlying asset and does not express our opinion on whether NFT transactions will be taxable nor how NFT transactions should be treated for tax purposes.

on various factors, including the classification of the underlying asset, whether the legal and beneficial rights to the underlying assets are conveyed along with the transfer, or whether the NFT is fractionalized. Until guidance directly addressing NFTs is issued, taxpayers will have to analyze NFT transactions by applying existing tax law principles while continuing to monitor the relevant developments from the financial and tax authorities.

1. NFT as Virtual Asset

Under the amended Individual Income Tax Law, income generated from a transfer and lending of virtual assets (“virtual asset gains”) by a Korean resident individual will be subject to taxation as “other income” starting from January 1, 2023.³ Therefore, income generated from an NFT transaction may be treated as other income, depending on whether an NFT constitutes a virtual asset under the AML Act.

In this regard, the Financial Services Commission (the “FSC”) has recently announced its position that whether a particular NFT may be considered as virtual assets should be determined on a case-by-case basis (i.e., when such NFTs are used for payment settlement or investment purposes), as it is difficult to generalize the treatment of all NFTs as virtual assets under the AML Act, given that NFTs take various forms.⁴

Under the amended Individual Income Tax Law, if a certain NFT constitutes a virtual asset as defined under the AML Act, a resident individual will be subject to income tax as other income on their virtual asset gains realized from a transfer or lending transaction on or after January 1, 2023.

In the case of non-resident individuals, virtual asset gains realized from a transfer or lending transaction of virtual assets (including a withdrawal of virtual assets stored in a virtual asset service provider defined under the AML Act) on or after January 1, 2023 is subject to withholding tax as domestic source other income.⁵ A non-resident individual eligible for the benefits of a tax treaty may be subject to non-taxation or exemption with respect to such other income, depending on the provisions of the treaty.

2. NFT as Investment Contract Security

As discussed in Part 1, an NFT may potentially be considered as an “investment contract security” depending on its characteristics and features. Under the amended Individual Income Tax Law, gains from a transfer of an investment contract security by a resident individual will be subject to taxation as financial investment income from January 1, 2023.

Unlike other income, a resident individual is allowed to utilize loss carryforwards with respect to their

³ As the proposed amendment to the Individual Income Tax Law on deferment of income taxation on virtual asset gains passed the plenary session of the National Assembly on December 2, 2021, the taxation on virtual asset income has been postponed for one year with the effective date delayed until January 1, 2023.

⁴ FSC Press Release on Whether NFT Constitutes Virtual Assets, November 23, 2021.

⁵ Note, however, there are ongoing tax appeals on the issue of whether an individual non-resident's virtual asset gains realized in or before 2022 can be subject to taxation as domestic source other income.

financial investment income and is subject to a different tax rate.⁶

According to the amended Individual Income Tax Law, financial investment income appears applicable to Korean residents only. However, if the investment contract security held by a non-resident is issued by a domestic corporation, the amount of gains realized from the transfer of the security may be deemed as capital gains of the non-resident, subject to withholding. However, a non-resident individual eligible for the benefits of a tax treaty may be subject to non-taxation or exemption with respect to such capital gains, depending on the provisions of the treaty.

3. NFT as Right to Underlying Asset

As discussed in Part 2 on intellectual property issues, a plain vanilla NFT transaction involving an NFT containing only the metadata on its underlying work is unlikely to constitute a transfer of any copyright to the underlying work. However, it may be possible to structure an NFT transaction to include an assignment of copyright to the underlying work.

According to the Individual Income Tax Law, consideration received by a resident individual as a creator of a work of art, music, or photography in connection with such artwork is subject to tax as other income. Likewise, remuneration received by a person other than an author, stage performer, music producer or a broadcasting company in consideration of the transfer or use of copyright or neighboring rights associated with the artwork is also subject to tax as other income. Thus, when a creator mints an NFT using their original artwork and subsequently transfers the NFT along with certain proprietary rights to the underlying artwork, gains from the transfer may be deemed as consideration derived from the artwork and can be subject to taxation as other income. In addition, if a person other than the creator of the underlying work transfers an NFT along with copyright or neighboring rights to the underlying work, gains from such transfer may also be subject to taxation as other income.

In the case of a non-resident individual, the Individual Income Tax Law generally treats gains realized from a transfer of copyright to an artwork as royalty income. However, certain tax treaties exclude from the royalty income treatment gains from certain transfer of copyright. Therefore, a non-resident individual eligible for the benefits of a tax treaty should take into account their particular circumstances, such as the terms of the tax treaty, in order to assess the tax consequences of an NFT transaction.

As such, tax consequences of an NFT transaction may vary depending on whether an NFT transaction at issue constitutes a transfer of a virtual asset, an investment contract security, or copyright. If none of the above categories would define an NFT, it is difficult to conclude that, in the absence of a clear legal definition of an NFT, profits and losses arising from an NFT transaction would come within any one of the categories of income enumerated in the current Income Tax Law, which subscribes to the source of income theory. Therefore, it is important to monitor the latest legislative and regulatory developments with respect to taxation of NFTs and to conduct a legal and tax review of a particular NFT at issue and the terms of the transaction prior to engaging in an NFT transaction.

⁶ In the case of virtual asset gains (other income), 22% (including local income surtax) applies to the taxable amount in excess of KRW 2.5 million. In the case of financial investment income, 27.5% (including local income surtax) applies to the tax base in excess of KRW 300 million (22% (including local income surtax) to the tax base of KRW 300 million or less).

II. Valued Added Tax for NFT Transactions

There is no specific provision under the current Valued Added Tax Law (the “VATL”) that imposes valued added tax (“VAT”) on virtual assets. However, the Ministry of Economy and Finance (the “MOEF”) has recently issued a ruling that the supply of virtual assets is not subject to VAT.⁷ And it appears that the National Tax Service has taken a position that is consistent with the MOEF ruling.⁸

The VATL imposes VAT on the supply of goods and services. The term goods is defined as any property or rights that have property value, and the term rights is defined as anything with property value, other than things defined as goods, such as mining rights, patent rights, and copyrights. In determining the definitional scope of the term, the Supreme Court held that a right must have objective property value, meaning that it should have practical application and have an economic exchange value.⁹

An NFT may not be subject to VAT, if the NFT itself is (i) used as a means of payment and classified as a virtual asset or (ii) issued with an interest entitling to a distributive share of income, akin to a security. However, for instance, if an NFT is combined with copyright to the underlying original work, and there is a readily available market for such NFT, it may be deemed to have an economic exchange value. In such case, such NFT may constitute an independent “right” within the meaning of the VATL, giving rise to a possibility that the NFT may be subject to VAT, depending on its particular nature and characteristics. Thus, it is necessary to continuously monitor the relevant legislative and regulatory developments on this issue and to review the transaction from the VAT perspective prior to engaging in an NFT transaction.

Key Issues Related to NFT

[Key Issues Related to NFT \(1\) - The Legal Nature of NFTs](#)

[Key Issues Related to NFT \(2\) - General Overview of Copyright Issues Related to NFT](#)

[Key Issues Related to NFT \(3\) - General Overview of Legal Issues Related to Blockchain Games Including NFT](#)

⁷ MOEF Value-Added Tax Division-145, March 2, 2021.

⁸ Gijun-2017-Bupryunghaesukbuga-0313, March 4, 2021.

⁹ Supreme Court Decision 2017Du65524, April 12, 2018.

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