



Tax News Flash

- Transfer Pricing & Customs

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Samjong KPMG Transfer Pricing & Customs Service Group provides readers Transfer Pricing & Customs related recent local tax issues and trends.

This newsletter is a monthly publication of Samjong KPMG Transfer Pricing & Customs Service Group. If you need more detailed explanation, please feel free to contact key contacts or Tai-Joon Kim for transfer pricing matters and Tae-Joo Kim for customs matters.



The following is a recent Korea's tax ruling in relation to transfer pricing

A re-examination of whether the taxpayer is deemed as the beneficial owner of royalty.

<Tax Tribunal Decision 2021Suh5598, 2023.08.09>

Background

- The taxpayer was established by its parent company to operate a global coffee chain business. On October 1st, 2019, the taxpayer purchased the trademark rights and global coffee franchise business rights from its related party and its subsidiary (hereinafter referred to as the related parties).
- On the other hand, one of the local entities paid brand royalty for the trademark rights to the related parties and paid withholding tax in accordance with the related tax treaty. The local entity was made aware that the trademark right was transferred to the taxpayer and requested the taxpayer to provide evidentiary material regarding its residency and economic ownership of the trademark rights. During the meantime, the local entity deferred the payment of the royalty to the taxpayer, but the taxpayer notified that the franchise agreement would be ceased if the royalty was not paid. After October 1st, 2019, the local entity paid the royalty to the taxpayer, and it withheld 22% as the withholding tax according to the domestic tax laws. The taxpayer claims that the royalty was not subject to withholding tax in accordance with the related tax treaty. Accordingly, in May 4th, 2022, the taxpayer made a request to the relevant local tax office for a tax refund for the withholding taxes that were previously paid.
- The Tax Office claimed that it is not clear who the beneficial owner and substantive owner of the royalty was, thus, on December 12th, 2022, it rejected the taxpayer's request. For the tax office's rejection, the taxpayer appealed to Tax Tribunal on May 28th, 2021.

Tax Office's (Defendant) Claims

- The Tax Office claimed that it is difficult to view that the taxpayer to be structured to make independent decisions due to the fact that not only the physical facilities but also the actual employees excluding the CEO belong to the parent company. Moreover, the board meetings were all held online and has not been confirmed that offline meetings were actually held at the registered location of the taxpayer. The taxpayer's main business activities such as invoicing, allocation, and settlement of royalty were also seen as performed by the parent company. Accordingly, the taxpayer is seen to have been established only for the receipt of royalty while all key functions and decision making is performed by the parent company.
- Accordingly, it is difficult to view the taxpayer to be in a position that completely holds and controls the royalties and accordingly accept the taxpayer as the beneficial owner of the royalty amount.

Taxpayer's (Plaintiff) Claims

- The taxpayer was established as an independent entity for the purposes operating the global coffee franchise business. Moreover, the taxpayer purchased the exclusive trademark and franchise business rights legitimately and accordingly is the beneficial owner of royalty.
- The taxpayer performs independent decision making regarding key matters for business operation including board meetings and the board consists of members who have the experience and qualification to be a board member. Moreover, the board members directly participated in the board meetings excluding the period in which offline meetings could not be held during COVID-19.

Result

- Although the Tax Office does not accept taxpayer's request for a tax refund if the taxpayer cannot be confirmed to be the beneficial owner, the ownership of a certain property and the ownership of income generated from the property such as a trademark right is determined in principle by the nominal owner of the property except in the case where there is a substantial difference between the form and the substance (2011doo9935).
- The taxpayer is seen to have the legal structure of an entity and a residence and accordingly, the taxpayer is the business operator. In this regard, the Tax Office's refute of the taxpayer's claim requires clear evidentiary grounds. However, the Tax Office simply refuted the taxpayer's argument without specifying the actual beneficial owner of the royalty. Especially considering that the other local and overseas franchisees paid royalty to the taxpayer applying the related tax treaty, the Tax Office was not appropriate in refuting the taxpayer's claim without substantiating evidence.
- However, the taxpayer was established only to demonstrate a minimum level of physical facilities, and the taxpayer's specific roles and responsibilities as the global coffee franchise and the actual operation of a franchise business cannot be seen. Accordingly, it is also not appropriate to completely accept the taxpayer's claim.

Accordingly, it is appropriate to perform the re-examination of the facts and circumstances to determine the actual beneficial owner of the royalty and to further investigate the claims of the taxpayer.



The following is a recent Customs-related Court case in Korea

1. Background

A. Series of Defeats in Tax Litigations against Multinational Corporations

In a recent inspection of government administrations conducted by the National Assembly of Korea, the Commissioner of Korea Customs Service, Goh Kwang-hyo addressed concerns over the series of defeats in tax litigations against multinational corporations. He pointed out the difficulties in securing documents in relation to taxations as a key obstacle and indicated the initiation of amendments to *Customs Act* to enhance the effectiveness of securing multinational corporation's tax information especially in connection with transfer pricing of the intercompany transactions.

Although *Customs Act* stipulates a maximum fine of KRW 300 million for delaying or not submitting documents requested by the customs officials, there have been no records of fines imposed for non-submission of data in the past five years. In response, the Commissioner mentioned that conducting special customs investigations as part of sanction measures to address the issue to the multinational corporations.

B. Customs Investigations into Violation of Import License Acquisitions

Customs audits have intensified their scrutiny on compliance, specifically reviewing the acquisition of import licenses in accordance with individual laws and regulations, including *Chemical Substances Management Act*, *Electronic Devices Safety Act*, and *Radio Waves Act*.

Several companies including Korean conglomerates and foreign multinational corporations have been identified for either not obtaining import licenses before filing import declarations or bypassing the import license procedures by utilizing international couriers such as FedEx, DHL, and UPS. In cases where violations are detected during the customs audit phase, the officers notify the cases to the investigation department, and in severe cases, the matter may even be reported to the prosecution for further legal action.

2. KPMG's Comment

A. Series of Defeats in Tax Litigations against Multinational Corporations

Following the Commissioner's statement of strengthened taxation measures for multinational corporations during the parliamentary inspection, it is expected that there will be a prompt initiation of procedures for relevant legal amendments. Considering the existing reporting obligations to tax

authorities in corporate income tax, there is a likelihood of introducing a similar system from a customs perspective.

In this scenario, it is expected that reporting obligations will be triggered when transactions with related parties exceed a specific monetary threshold. For instance, companies engaging in transactions of goods and services with foreign-related parties exceeding USD 50 million may become subject to reporting obligations. This threshold is similar to the requirement for companies with transactions surpassing KRW 500 billion to submit BEPS reports by the year-end in the context of corporate income tax.

While many multinational corporations already possess transfer pricing documents from an income tax perspective, different analysis considering the nature of goods, especially HS codes, is essential in the customs context. Unlike previous benchmarking studies that focused on the risks and functions of the entity, customs valuation may require separate benchmarking studies, taking into account the characteristics of the goods involved.

B. Customs Investigations into Violation of Import License Acquisitions

To address the potential risks associated with import license requirements, companies should proactively design and implement robust internal controls over compliance. Given that import licenses from other government agencies are granted based on the 10-digit HSK (Harmonized System of Korea) codes, it is imperative for companies to determine the accurate tariff classification of imported goods in advance. Failure to do so may lead to customs officers alleging incorrect HS codes to circumvent the import license requirements, raising suspicions of intentional misconduct.

Once precise tariff classification is established, companies should proceed to design and implement compliance procedures within their internal control framework. This includes the following procedures. Additionally, regular compliance checks, such as customs health checks, should be conducted to verify the operating effectiveness of these internal controls.

- In accordance with individual laws and regulations, submit the required documents to the relevant agencies before the importation of goods.
- Obtain necessary approvals from the relevant government authorities.
- During the import declaration process, ensure the submission of all required documents to customs authorities without exceptions such as importing through courier services.

- Implement a system for retaining documents for 5 years, aligning with the statute of limitation period of customs duty and import VAT collection.



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