KPMG

Tax News Flash

- Transfer Pricing & Customs

February 2023

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

In favor of the Taxpayer's argument, the Tax Tribunal made the decision that it is reasonable to rectify the tax base and tax amount by reinvestigating appropriateness of the TP policy submitted by the taxpayer

< Decision 2021 Seo 2808 (2022.12.05)>

Background

- Company A (hereafter referred to "the Taxpayer") was established on 08.01.1997 to manufacture and distribute dental implant products. As of 2018, the Taxpayer had 28 entities in 25 countries, and distributed implant products and dental equipment to other overseas related parties (hereafter referred to "local distributors").

- In July 2013, the Taxpayer prepared a 'Group Transfer Pricing Policy', (hereafter referred to "TP policy"), which includes the polices in relation to the arm's length price for the local distributors by region (Asia, America, Europe). On the corporate tax return filed for FY2014 - 2018, the arm's length price was calculated using Transactional Net Margin Method (hereafter referred to "TNMM"). However, no TP adjustments were made to those local distributors whose operating margins exceed or fell below the arm's length range stated in the TP policy.

- During the period from 21.05.2019 to 28.09.2019, the Korean National Tax Services (hereafter referred to "NTS") conducted a tax audit for 2014 - 2018 financial years. After the tax audit on the Taxpayer, total corporate tax of KRW 000 was imposed by TP income adjustment because one of the local distributors (hereafter referred to "'OOO Distributor'"),

had profit margin which exceeded the arm's length range stated in the TP policy.

- On 30.03.2020 after the tax audit result, the Taxpayer requested to rectify the tax base and tax amount of the 2014 - 2018 financial year by applying arm's length price (derived by the TP policy) to other local distributors whose profit margin falls below the arm's length price. On 05.01.2021 the NTS rejected requests for tax return amendment on other local distributors, so the Taxpayer disagreed to the NTS decision and appealed to the Tax Tribunal on 02.04.2021.

The Tax Tribunal Decision

- Once the tax authority begun to examine the arm's length nature of the Taxpayer's foreign related party transactions, it is reasonable to note that tax authority has no discretion to select which entities to choose based on the advantages or disadvantages of taxation.

- OOO Distributor and other local distributors are similar by their establishment purposes, type of business, product type, and the functions・risks・assets profile. Considering that the Taxpayer selected the TNMM as the TP method and calculated the arm's length range of the operating margin for each region to compare with the operating margin of each local distributor, the NTS's decision to reject the request for the tax return amendment for the intercompany transactions with local distributors is judged to be erroneous.

- On the other hand, in general, in cases of taxation where the transfer price with a foreign related party is rationally calculated based on the data obtained by the tax authority with best effort, a taxpayer is responsible for proving that the transfer price with overseas related party does not lack economic rationality. Therefore, it is reasonable to assume that for this case, the Taxpayer bears the burden of proof regarding the fact that the transfer price with a foreign related parties does not fall within the arm's length range.

- The Taxpayer claims that it is reasonable to review comparable companies by grouping geographically adjacent countries into the same region, and the operating losses recorded by the local distributors are due to the transfer pricing. Contrary to the assertion by the Taxpayer, the tax authority claims that, in principle, comparable companies should be selected within the country where the local entity is located, and that the operating losses of the local distributors are not attributable to the transfer price, but to the low sales volume and excessive expenditure expenses.

- Conclusively, the Tax Tribunal understands that it is reasonable that the NTS re-examines the TP policy report including related data from the Taxpayer such as local distributor's functional and risk analysis and identification of local distributor's economic characteristic, selection of transfer pricing method, selection of comparable companies, the local distributor's operating margin, and then rectify the tax base and tax amount accordingly based on the re-examined results.

The followings are recent Korea's Tax rulings and cases in relation to customs

Customs valuation method of imported goods without additional payment by the buyer as the purchasing condition of the contract

[Supreme Court, 2018DU47714, November 17, 2022]

Background

Pharmaceutical company H ("plaintiff") signed a contract ("contract at issue") with AMANO ENZYME INC. ("Amano") to import pharmaceutical raw materials. Under the contract at issue, Amano should provide the plaintiff with goods equivalent to a certain percentage of the annual purchase quantity in the name of 'free samples'. The plaintiff received SKSD ("goods at issue") without additional payment and filed import declarations for the goods at issue with a transaction price of 5,000 JPY per unit.

Seoul Customs House, the disposition authority, denied the customs value reported by the plaintiff on the grounds that the goods at issue were imported free of charge and did not fall under "goods sold for export to Korea", and determined the customs value based on the purchase price per unit stipulated in the contract at issue, using the customs valuation method stipulated in Article 31 of the Customs Act (Transaction value of identical goods). Accordingly, the Customs corrected the customs duties and VAT (including penalties) and notified the plaintiff ("disposition at issue").

Issue

Customs valuation method of the goods imported without payment by meeting the annual standard quantity of the purchase agreement condition

The Supreme Court's Decision

The agreement stipulates that if the purchased quantities are less than 1,688BU per year, 10% or 11% of the annual purchase quantities shall be additionally supplied to the buyer, and if the purchased quantities are more than that, additional goods shall be supplied at a higher percentage than the percentage mentioned above for each quantity range. Therefore, it is already settled that additional goods equivalent to a certain percentage of the annual purchase quantities shall be supplied. In addition, when the plaintiff receives additional goods under the agreement, the 'total annual payment amount' does not change, but the 'total annual purchase quantity' increases, and the transaction price per unit is substantially reduced.

Considering these points, the contract at issue is an annual purchase contract, which sets a provisional base price and determines the final transaction price on an annual basis as per the

annual total payment amount and the annual total purchase quantity when the additional quantities is determined depending on the annual purchase quantity. The number of goods additionally supplied is not small, which corresponds to more than 10% of the annual purchase quantity. Even though the goods at issue were supplied in the name of 'free samples', and the plaintiff did not pay the price for them at the time of the import, it cannot be seen that they were supplied without any cost. Therefore, it is difficult to regard the goods at issue as "goods imported free of charge."

KPMG's Observation

It is the first precedent to state that the goods additionally supplied without payment, in a certain percentage of the annual purchase quantity under the annual purchase contract, do not correspond to the "goods imported as free of charge". Therefore, the transactional value of the goods shall not be denied and determined based on the transaction value of identical goods.

In other words, this case confirms that the transaction price cannot be denied unconditionally even if the goods are imported "free of charge" nominally but are purchased commercially in substance. The customs value can be determined in consideration of the unit price by dividing the total paid amount by the total quantity.

Key Contacts

Samjong KPMG Transfer Pricing & Customs Service Group

Gil-Won Kang
Head of TAX 6
T. +82-2-2112-0907

Seung-Mok Baek
TP Partner
T. +82-2-2112-0982

Sang-Hoon Kim
TP Partner
T. +82-2-2112-7939

Tai-Joon Kim
TP Partner
T. +82-2-2112-0696

Yong-Jun Yoon
TP Partner
T. +82-2-2112-0277

Tae-Joo Kim
Customs Partner
T. +82-2-2112-7448

Hyeon-Man Kim
Customs Partner
T. +82-2-2112-7542

home.kpmg/socialmedia

home.kpmg/kr/ko/home/services/tax.html

Privacy | Legal

27th Floor, Gangnam Finance Center, 152, Teheran-ro, Gangnam-gu, Seoul, Korea