



# 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

**It is appropriate for the tax authority to re-examine the arm's length interest rate of the borrowings since the interest rate applied is likely higher than an arm's length rate and no evidence of its arm's length nature has been provided.**

**< Decision 2018 Jeon 3997, 2023.01.09 >**

### Background

- The taxpayer is a foreign-invested corporation jointly invested by a multinational group (hereinafter "AAA") headquartered in the United States and OOO Group in Korea. At the request of AAA, the taxpayer conducted a AAA stock retirement transaction, and its funds were borrowed from a corporation in the OOO Group ("BBB"). The taxpayer recognized interest expenses paid to BBB in the 2014-2015 financial year as deductions after BBB became the wholly owned parent company(100%) of the claiming corporation and a creditor at the same time.
- The tax authority notified the corporate tax by denying deductible expenses on the interest paid for the 2014-2015 financial year by claiming that the purpose and substance of the transaction was a stock exchange between AAA and OOO Group, the taxpayer initiated an indirect and unconventional loan transaction regardless of its business purpose and paid interest, which resulted in tax avoidance. In the case of interest dispute for the 2016-2018 financial years, the tax authority rejected the claim of the taxpayer for rectification which denied deductibility of the interest to be recognized as deductible expenses.
- The taxpayer argued that the interest paid was deductible because it was no different

from the interests from a general loan transaction. Also, argued that the tax authority should clearly demonstrate the existence of tax avoidance intention by the taxpayer. However, the tax authority only demonstrated the reconstruction of the transaction by arbitrary presumption. Therefore, the taxpayer filed an appeal to the Tax Tribunal, arguing that there was no proof of the nature of tax avoidance intention.

### The Tax Tribunal Decision

- The Corporate Tax Act and Commercial Act strictly classify equity and debt based on legal, economic, and accounting differences. As long as the disputed loan correspond to liabilities raised by means of borrowing, it is difficult to see those liabilities as equity just because the creditor is the parent company of the debtor. While the Corporate Tax Act stipulates that "interest on borrowings" is deductible expenses, there is no separate provision for special cases of deductibility depending on the creditor's status (equity ownership of the debtor, etc.). In the end, even if the creditor is the parent company of the taxpayer and disputed debt borrowing itself is a liability, it is reasonable to assume that the interest on the debt to be included in deductible expenses under the Corporate Tax Act.
- However, even if the disputed interest is regarded as a loan interest, in accordance with Article 4 of the Law for the Coordination of International Taxes Act, the tax base can be adjusted based on the arm's length price. The Tax Tribunal judges that it is appropriate for the tax authority to re-assess the arm's length interest rate of the loan for each financial year because applied interest rate of 8% seems higher than the conventional interest rate and the fact that the taxpayer did not demonstrate that the applied interest rate is arm's length.



## Introduction to Advance Customs Valuation Arrangement in Korea

### 1. Overview

The prices of goods in cross-border transactions are of great interest to both Customs and Transfer Pricing ("TP") authorities. While the importance of setting TP based on the OECD Guidelines is well recognized, the importance of reviewing the transfer prices for customs purposes is often neglected. This gives rise to the tax friction between MNEs and customs authorities in Korea as shown in Table 1.

[Table 1. Customs Audit Result by Additional Collection Type]

(Unit: number of companies, 100 million)

Year	Customs valuation		Tariff classification		Reduction / Exemption		Duty drawback		Etc.		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
2019	162	828	33	26	8	3	15	65	19	6	237	928
2020	146	967	31	22	9	1	14	57	24	56	224	1,103
2021	149	885	39	103	5	3	19	79	19	10	231	1,080

As compliance from both a customs and TP perspective is challenging, the Korea Customs Service (KCS) introduced the Advance Customs Valuation Arrangement (hereinafter referred to as the "ACVA") program in 2008 to reduce frequent conflict between MNEs and customs authorities due to its complex and diverse types of transactions.

ACVA refers to an advance arrangement between a taxpayer and the customs authority, at the request of the taxpayer, on customs valuation of imports traded between related parties, i.e., an overseas parent company and its domestic subsidiary. This program is intended for taxpayers to determine customs value prior to import declaration (even after import declaration) in cooperation with the customs authorities so that they can steer clear of potential risks and make informed decisions for their business.

The number of companies using this program is increasing due to the combination of the customs authorities' active promotion of the program and the taxpayer's effort to hedge the risk of being imposed duties by customs authorities as shown in Table 2.

[Table 2. ACVA Application and Approval Status]

(Unit: Cases)

Category	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20	'21	Sum
Application	3	1	-	5	5	3	4	8	15	9	24	25	28	21	31	182
Approval	-	-	2	3	-	4	3	5	4	6	6	15	14	31	22	115

## 2. ACVA Benefits

### 1) Secure legal stability in the customs valuation area

The taxpayer can secure legal stability in the customs valuation area for up to 11 years, including ACVA review and effective period. The uncertainties arising from the customs audit can be resolved and stable management on customs valuation, which is the main issue when it comes to the customs audit, can be secured.

### 2) Waive on penalty

If taxpayers correct previous import records based on the ACVA result, they will be exempted from penalties for misdeclaration (equivalent to 10% of tax deficiency) if they do so within two months after the ACVA ruling is issued.

### 3) Provisional-Definite price declaration

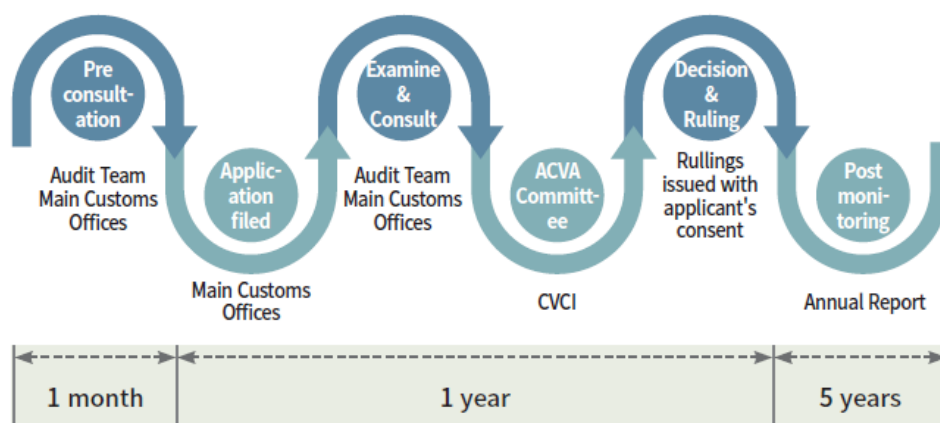
ACVA applicants are eligible for provisional value declaration from the time of filing the ACVA application. They are exempted, in full, from penalties for tax deficiency that may arise at the time of final value declaration at a later stage as per ACVA rulings. In particular, if there is a year-end adjustment of transfer prices, the taxpayer can consider utilizing a provisional-definite price declaration since the final value might not be settled yet at the time of importation. ACVA makes the taxpayer fulfill the basic requirements for provisional value declaration.

### 4) Pre-arrangement scheme between ACVA and APA

Pre-arrangement scheme between ACVA and APA enables taxpayers to apply for ACVA with the customs authorities (KCS) and APA with the tax authorities (NTS) at the same time for the sake of the taxpayer's convenience. Upon the application from taxpayers, customs and tax authorities work together to coordinate on customs value for the purpose of duties and on arm's length price for the purpose of internal taxes.

## 3. ACVA Process

[Picture 1. Flow Chart of ACVA Process<sup>1</sup>]



**1) Step 1: Pre-consultation**

It is not a mandatory procedure, but through the pre-consultation process, taxpayers can consult the main customs office about the availability of ACVA applications, application methods, and procedures.

**2) Step 2: Application**

Applicants should submit the application form along with the statutorily required documents.

**3) Step 3: Examination and Consultation**

The main customs office examines decision methods of customs value as well as reasons transaction value may be unacceptable such as whether the relationship between parties has influenced the price, factors of addition/deduction from the price actually paid or payable.

**4) Step 4: ACVA Committee**

Once the main customs office examines the ACVA application, ACVA Committee will be held. The Committee deliberates whether the ACVA application has been properly examined in accordance with relevant regulations.

**5) Step 5: ACVA Approval**

Once the final decision on the ACVA application is made through the deliberation of the ACVA Committee, the taxpayer will receive the Letter of ACVA Decision.

**6) Step 6: Annual Report for 5 years**

Taxpayers should submit the annual report within 6 months from the last day of the business year, including if there are any changes to statements in the ACVA application.



<sup>1</sup> 2021 ACVA Annual Report issued by KCS

# Key Contacts

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