



Tax News Flash

- Transfer Pricing & Customs

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Samjong KPMG Transfer Pricing & Customs Service Group provides readers with Transfer Pricing 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 Young-Ho Lee 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

Comparable companies for the calculation of arm's length price must consider the volume of sales or reasonable adjustments should be made to take into account the sales volume, but in the case of a Chinese corporation, reasonable adjustments were not made, and therefore, the disposition of corporate tax assessment and notification of change in the amount of transfer pricing income adjustment based on such arm's length price is illegal (partial defeat)

<Seoul Administrative Court 2022 GOOHAP 83335 (2024.06.20)>

Background

The claimant is a company established to manufacture and sell polypropylene products, and is owned 50% by XX Chemical Corporation, an affiliated company of XX Group, and 50% by B Corporation, an affiliated company of A (hereinafter referred to as "A"), a multinational petrochemical group. A has three subsidiaries, C ("C Corporation"), D ("D Corporation"), and E ("E Corporation"). C and D are localized in China, and E is localized in Thailand.

As C and D are 100% owned by F, a company in which A holds 100% of the shares, and E is 95% owned by G, a company in which B holds 100% of the shares, Claimant, C, D, and E are subject to the old ADJUSTMENT OF INTERNATIONAL TAXES ACT before being amended in its entirety (hereinafter referred to as the "former Law"), and therefore, they are foreign related parties under the Article 2, Paragraph 1, Items 9 and 8 (hereinafter referred to as "the foreign related parties").

The claimant entered into an export marketing contract with H, an affiliated company of A, in connection with the overseas sales of polypropylene products (hereinafter referred to as the “concerned products”) produced in Korea and sold the concerned products to unrelated third parties or the foreign related parties through the above companies.

The Defendant conducted a corporate tax audit (hereinafter referred to as the “Initial Investigation”) and notified the Claimant of the results of the investigation, stating that the Claimant sold the products to the foreign related parties at a price lower than the arm’s length price pursuant to Article 4 of the former Law. As a result, the taxable base of the Claimant’s corporate income tax was increased by a total of KRW X and the same amount was treated as temporary differences for tax purposes. The Defendant was disposed of the above-mentioned KRW X as a dividend to the foreign related parties on the ground that the amount was not returned to the Claimant from the overseas related parties.

The claimant filed an appeal to the Tax Tribunal, and the Tax Tribunal issued a reinvestigation decision stating that the arm's length prices should be reinvestigated, and the amount of corporate taxes and transfer pricing adjustments should be adjusted according to the results. In accordance with the Tax Tribunal's decision, the Defendant conducted a transfer pricing re-investigation (hereinafter referred to as 're-investigation') on Claimant and issued a decision to reduce corporate tax by a total of KRW X and the amount of transfer pricing adjustments by a total of KRW X.

Taxpayer’s (Claimant) Claims: This decision is unlawful for the following reasons and should be revoked.

The transfer prices between the claimant and the foreign related parties in this case is at arm's length because it was agreed upon between XX Chemical Corporation and B, which are shareholders with no special relationship under the former Law. The defendant did not consider the size of the transactions (turnover) in selecting the comparable transactions at all, and the criteria for selecting the comparable transactions were not reasonable. Article 6, paragraph 4 of the Enforcement Decree of the former Law stipulates that the range of arm's length price should be calculated based on two or more transactions, but the Defendant selected only one comparable transaction.

Decision by Tax Tribunal

Issue ①: Whether the transfer prices of the transactions between the claimant and the foreign related parties in this case was itself an arm's length price under the former Law

Article 4(1) of the former Law provides that the taxing authority may determine the tax base and tax amount of a resident based on the arm's length price in international transactions where one of the parties to the transactions is a foreign related party based on the most reasonable transfer pricing method prescribed in the former Law. Therefore, even if the transfer prices between the Claimant and the foreign related parties in this case was agreed upon by the Claimant's shareholder company without any special relationship, it cannot be said to be an arm's length price under the former Law. This claimant's argument is without merit.

Issue ②: Whether the arm's length price was properly calculated for the transactions between the claimant and the foreign related parties at issue

(1) Regarding the calculation of arm's length price for transactions between Claimant and the C and D corporations in Region XX in fiscal year 20XX

The Defendant selected transactions to be compared with Claimant's transactions with C and D corporations by applying three criteria without considering the size of the sales in the reinvestigation, but the average sales volume of the X companies selected were so different from Claimant's sales to C and D corporations that a sufficient level of comparability was not secured for transfer pricing purposes. Despite the lack of comparability, the Defendant did not make reasonable adjustments to eliminate such differences in applying cost-plus methods. Moreover, as it has been seen that the lower quartile of the cost-plus markup of the goods sold by the Claimant to unrelated third parties in XX region in 20XX business year is X%, and the cost of goods sold to Claimant's C and D corporation is X%, which are within the arm's length range of prices for transactions with unrelated third parties over X amount, it is difficult to say that the prices of transactions with Claimant's C corporation and D corporation lack economic reasonableness.

(2) Regarding the calculation of arm's length price for transactions between the Claimant and E Corporation, a related party in Region XX.

Based on the detailed breakdown of the 20XX comparable companies in Region XX and the 20XX comparable companies in Region XX as listed in [Exhibit 2], unlike the Region XX companies, the volume of the sales does not appear to have a significant impact on the cost-plus markups. The Defendant applied two criteria in order to select the transactions to be compared with the transactions between the Claimant and E, namely: (1) continuity of transactions (whether the transactions was carried out for three consecutive years from 20XX to 20XX, the period under investigation) and (2) price terms (whether the transactions of E was a formula transactions because it was a formula transactions), The above criteria can be used as factors for analyzing comparability (risks involved in the transactions, contract terms, etc.) in accordance with Article 2, paragraph 1 of the Enforcement Decree of the former Law, and there is no reason to believe that the comparable transactions selected by the Defendant are unreasonable.

Issue ③: Whether it was unlawful to select only one comparable transaction to calculate the arm's length price

As the transactions selected by the Defendant as comparable transactions of the transactions between the Claimant and E Corporation are similar in terms of continuity and price, as shown above, it is sufficient to calculate the arm's length price based on those transactions alone, and it is not necessary to add other data to consider the arm's length range. Therefore, this part of Claimant's argument is without merit.

Conclusion

Therefore, since the X comparable transactions selected by the Defendant to calculate the arm's length price for the transactions between the Claimant and C and D, related parties in Region XX, are not comparable, the corporate tax assessment and the notice of change in the amount of transfer pricing income adjustments based on the arm's length price calculated from the comparable transactions are illegal and should be revoked. On the other hand, one comparable transaction selected by the Defendant to calculate the arm's length price for the transactions between the Claimant and E Corporation, a related party in Region XX, cannot be said to be incomparable, and it is not necessary to add other data to calculate the arm's length price as it is similar to the transactions of E Corporation, so the corporate tax assessment and the notice of change in the amount of transfer pricing income adjustment based on the arm's length price calculated by the above comparable transaction cannot be said to be illegal.

It is therefore ordered and adjudged that the Claimant's claim for reversal of the 20XX imputed corporate tax assessment and the transfer pricing income adjustment against the Defendant is granted in its entirety, and that the Claimant's remaining claims against the Defendant are dismissed in their entirety for lack of merit.

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