Tax News Flash
- Transfer Pricing

May 2024

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 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 can be considered that the claimant essentially conducted a joint business in Korea with the domestic corporation by establishing an operating committee, directing and approving research and development, and sharing R&D costs according to a cooperation agreement signed with the domestic corporation. Therefore, the claimant has a permanent establishment of business in Korea (Dismissed).
< Tax Tribunal Judgment 2017Joong0661, 2024.02.19>

Background

- The claimant is a limited liability company located in Italy, engaged in the manufacture and sale of pharmaceuticals. ○○○ is a limited liability company located in Germany, engaged in the same business, and both are members of the ○○○ Group.

- On April 30, 2001, the claimant and ○○○ entered into a cooperation agreement (hereinafter "the Agreement") with the domestic corporation a ("aKorea") and a Dutch corporation ○○○ to develop a combined vaccine for five major pediatric diseases. According to the Agreement, the claimant and ○○○ would produce and deliver antigen raw materials for four pathogens to aKorea. aKorea would then combine these with the hepatitis B antigen raw material to produce and sell the 5-valent vaccine, and the claimant and ○○○ would receive 'the manufacturing cost of the four antigen raw materials plus 60% of the gross profit margin of the Vaccine sold by aKorea.'

- Following an corporate tax audit, the tax authority determined that the claimant had

formed a permanent establishment in Korea under the Agreement but failed to report and pay corporate tax on domestic-source income attributable to this permanent establishment business. As a result, corporate tax amounting to OOO was assessed and notified. Accordingly, the claimant filed an appeal against this decision.

Tax Office's (Defendant) Claims

- The claimant conducted a joint business in Korea with aKorea under the Agreement.
    - The determination of a joint business should consider various factors beyond the contract's form.
    - The claimant and aKorea shared R&D costs in a 60:40 ratio and divided profits and losses accordingly.
    - They jointly owned the cooperation technology and managed the business through an operating committee.
    - Both parties were represented as business operators to external parties.
- The claimant had a permanent establishment in Korea since it conducted part of its business in Korea through a joint business arrangement with aKorea.

Taxpayer's (Claimant) Claims

- Under the Act on restriction on special cases concerning taxation, the claimant's permanent establishment in Korea cannot be recognized.
    - To apply the partnership tax regime under the law, an application must be submitted to the district tax office, which the claimant and aKorea did not do, making the regime inapplicable.
    - It violates the principles of tax treaties to deem a permanent establishment based solely on a partnership relationship.
    - The claimant only engaged in joint R&D activities with aKorea and supplied raw materials, which does not constitute a partnership business.
    - The operating committee was merely for coordination, and each party operated its own business with its assets, not meeting the requirements of a partnership business.
- The claimant does not have a business place in Korea, and aKorea's business place cannot be deemed as the claimant's business place. Therefore, the income from the sale of the Vaccine should not be considered business income subject to corporate tax in Korea.
- The transfer pricing method applied to the four antigen raw materials transaction was determined according to the profit split method under the International Tax Adjustment Act. This fact alone cannot substantiate the claim that the business profits and losses are shared and that a joint business is being conducted.

Decision by Tax Tribunal

- Considering the facts and relevant laws, the claimant argues that it does not have a permanent establishment in Korea and thus no domestic-source income is subject to corporate tax. However, under the Agreement, the claimant and aKorea jointly developed and commercialized the Vaccine, shared R&D costs, maintained ownership and sales

rights in their respective regions, and managed the project through an operating committee. Given these points, the claimant effectively operated a joint business with aKorea in Korea. Therefore, it is difficult to accept the claimant's claim that it does not have a permanent establishment in Korea. Accordingly, the corporate tax assessment is deemed appropriate.

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

Young-Bin Oh
Customs Partner
T. +82-2-2112-0435