



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

Since the regulations on special cases concerning mergers apply only to domestic corporations, it is lawful to tax the capital gains on the shares in the case of a foreign corporation transferring shares through a merger. Furthermore, if the arm's length pricing method claimed by the taxpayer is not appropriate, it is held that the tax authorities did not err in making a tax assessment of the shares on the basis of the appraised value under the INHERITANCE TAX AND GIFT TAX ACT which reflects the premium valuation (Rejected)

< Recent Ruling/Case: Tax Tribunal 2023 Seo 3145, November 19, 2024 >

1) Background

- The claimant is a foreign corporation located in France. On July 1, 2021, in accordance with the procedures under the French Civil Code, all the assets owned by a wholly owned subsidiary (A) [including 44% of the shares of the not listed domestic corporation B Co., Ltd. ("the corporation and shares in dispute")] were comprehensively transferred ("transfer in dispute"). According to this, the claimant upon the view that since the book value of the subsidiary should be transferred as it is, "domestic source income from capital gains on transfer of securities" under Article 93 (9) of the CORPORATE TAX ACT does not incur, did not fulfill its tax obligation (such as tax withholding).
- The Tax Authorities deemed the transfer in dispute as a domestic transfer of securities between foreign corporations, and thus the arm's length price of the shares in dispute at the time of the transfer in dispute should be the price of transfer

in accordance with Article 92 (2)-2 of the CORPORATE TAX ACT. Furthermore, the Tax Authorities deemed that the arm's length price cannot be calculated by applying the methods under Article 8 of the ADJUSTMENT OF INTERNATIONAL TAXES ACT in accordance with Article 131 (1) of the ENFORCEMENT DECREE OF THE CORPORATE TAX ACT. As such, the Tax Authorities calculated the arm's length price per share by calculating the standard market value provided in Article 99 (1)-4 of the INCOME TAX ACT in accordance with Article 131 (3) of the ENFORCEMENT DECREE OF THE CORPORATE TAX ACT and adding a premium calculated in accordance with Article 63 (3) of the INHERITANCE TAX AND GIFT TAX ACT. On October 11, 2022, the Tax Authorities made a tax assessment for the corporate tax and securities transaction tax that should have been withheld for 2021 and notified such decision to the claimant. On January 9, 2023, the claimant appealed against such decision filing a request for trial.

2) Matters in Dispute

- In accordance with the French Civil Code, according to the procedures for the transfer of the shares in dispute, no capital gains are generated.
- Even if the transfer value is calculated separately as the arm's length price the sales price of the shares in dispute takes precedence over the disposal value.

3) Claims of the Counterparties

Claimant	Tax Authorities
<p>(1) Main: Matter in Dispute ① According to the French Civil Code, which is the basis for the transfer in dispute, in the case in which the parent company receives the assets of the subsidiary through a comprehensive transfer, it is mandatory to succeed the book value of the subsidiary. As such, in the first place, not only does no capital gain is generated, but also the transfer in dispute is only a comprehensive asset succession process according to a formal restructuring procedure, and thus an actual transaction value (book value) exists at the time of the transfer in dispute. Nonetheless, it is difficult to find any grounds, justification or rationality to regard the disposal value artificially calculated without reasonable consideration as the transfer value of the shares in dispute.</p>	<p>(1) Main: Matter in Dispute ① In a merger between foreign corporations, in which the shares of the domestic corporation owned by the merged corporation (absorbed corporation) are transferred (absorbed corporation → surviving corporation), domestic source income from capital gains on transfer of securities subject to taxation under the CORPORATE TAX ACT is generated. This is a matter that has already been established by the relevant Supreme Court cases (Supreme Court 2021 Doo 7208, October 30, 2013 & Supreme Court 2015 Doo 1984, December 13, 2017) in the past. In the case of the transfer in dispute, the shares in dispute traded between the foreign related parties at a price (book value) lower than the arm's length price. According to relevant regulations, the transfer value of the shares in dispute must be at the arm's length price and thus it is natural that capital gains are generated accordingly (the book value applied in the transfer in dispute is a low price and thus not a lawful transfer value).</p>

(2) Preliminary: Matter in Dispute ②

Even if there is an actual transaction value (book value), in order to find a separate arm's length price and deem it as the transfer value, it is necessary to find the price premised on reasonableness in accordance with Article 8 of the ADJUSTMENT OF INTERNATIONAL TAXES ACT in light of the substance and practice of the transfer in dispute. However, the Tax Authorities did not make the best effort to find a reasonable arm's length price but focused solely on administrative convenience and tax assessment concluding that the disposal value is the arm's length price, which is unlawful and unjust.

- According to Article 131 (1) and (3) of the ENFORCEMENT DECREE OF THE CORPORATE TAX ACT, the calculation of the arm's length price premised on reasonableness should be given priority before applying the supplementary valuation based on the standard market value under the INCOME TAX ACT. As such, prior to deem the disposal value as the arm's length price, the priority should be to find a reasonable arm's length price, such as actual transaction cases. However, in this case, the shares in dispute were traded at KRW 000 per share ("sale and sales price in dispute") approximately 2 months before the transfer in dispute occurred. Furthermore, since it was a transaction between third parties post a fair valuation conducted by an external rating agency, the sales price in dispute is sufficient to be the arm's length price (transfer value) of the shares in dispute at the time of the transfer in dispute.
- Since the arm's length price in international transactions is not necessarily the same as the concept of "market value" under domestic tax laws such as the CORPORATE TAX ACT, it is not reasonable and fair to hastily deem the disposal value based on the standard market value as the arm's length price unless there are special circumstances such as the fact

(2) Preliminary: Matter in Dispute ②

The ENFORCEMENT DECREE OF THE CORPORATE TAX ACT 131 (3) stipulates that "Only if it is impossible to calculate the arm's length price under paragraph (1), the value assessed by applying mutatis mutandis Article 99 (1) 3 through 6 of the INCOME TAX ACT and Article 63 (3) of the INHERITANCE TAX AND GIFT TAX ACT shall be deemed the arm's length price. In the case of the transfer in dispute, there was no other reasonable way to calculate the arm's length price, and thus, it was lawful to assume that the disposal value was deemed as the arm's length price in accordance with the relevant regulations.

- On the other hand, the claimant claims that the sales price in dispute should be the arm's length price prior to the disposal value. However, the sales price in dispute is the transaction value acquired by the corporation in dispute as treasury shares for odd-lot disposal of shares incurred in the process of merging of the shares in dispute in which the transaction cannot be regarded as a general sale of securities. Furthermore, the sales price cannot be deemed as the arm's length price calculated by applying either the comparable uncontrolled price method or other reasonable methods defined in Article 8 (1) of the ADJUSTMENT OF INTERNATIONAL TAXES ACT. In such case, since there is no other reasonable methods to calculate the arm's length price, it is lawful to deem the disposal value calculated in accordance with the provisions of the INCOME TAX ACT and the INHERITANCE TAX AND GIFT TAX ACT as the arm's length price.

that there is no actual transaction value that can be regarded as the arm's length price, considering the fact that the disposal value does not properly reflect the situation, substance and characteristics of the corporation in dispute at the time of the transfer in dispute. At the very least, if there is an actual transaction case and there are no circumstances to reject it, such as that the transaction is unfair, the transaction value (the sales price in dispute) should be acknowledged as the arm's length price.

4) Ruling & Conclusion

With regard to Matter in Dispute ①,

the claimant claims that no capital gains are generated since the shares in dispute was succeeded at the book value.

Whether the transfer of the shares in dispute is taxable or not should be determined according to whether the increase in value implied in the shares on the occasion of the transfer can be considered as capital gains and thus be treated as taxable income. In the case of a domestic corporation, only in exceptional cases (qualified mergers) an exception is provided to defer taxation whereas no exception to defer taxation exists for foreign corporations. As such, there is no reasonable reason not to regard the transfer of domestic assets from a merger between foreign corporations as a transfer of assets in which capital gains are realized (Supreme Court 2021 Doo 7208, October 30, 2013).

Lastly, the tax assessment cannot be regarded as discrimination merely because the governing law of establishment is different and is difficult to view that it violates the principle of non-discrimination under the tax treaty (Supreme Court 2015 Doo 1984, December 13, 2017). Therefore, it was deemed difficult to accept the claim.

With regard to Matter in Dispute ②,

the claimant claims that the sales price in dispute is the arm's length price in accordance with the comparable uncontrolled price method or other reasonable methods in Article 8 of the ADJUSTMENT OF INTERNATIONAL TAXES ACT and that the premium valuation should be excluded.

The sales price in dispute is calculated from a separate transaction in the form of a sale between the shareholders and the corporation in dispute and is not comparable since the transaction is different in size and nature from the transfer in dispute in which the shares were transferred comprehensively.

Furthermore, since there is room for the evaluator's subjective judgment on the main variables (future cash flow, discount rate, growth rate, residual value, etc.) when applying the discounted cash flow method ("DCF method"), it is difficult to reflect the current value of the assets, thus, the application of the DCF method should be strictly examined (Tax Tribunal 2022 Joong 6301, March 16, 2023).

On the other hand, it is viewed that the management rights of the corporation in dispute have been formally transferred by the transfer in dispute. Even if there was no transfer of management rights, the premium valuation provision in Article 63 (3) of the INHERITANCE TAX AND GIFT TAX ACT did not stipulate that the valuation of the shares would vary depending on whether the transfer of management rights occurred (Supreme Court 2001 Doo 8292, February 11, 2003).

In light of the above, it was deemed difficult to accept the claim.



The following are key updates regarding the Korea-Philippines Free Trade Agreement (FTA), effective December 31, 2024.

*The source is the reference material published by the Ministry of Trade, Industry, and Energy regarding the implementation of the Korea-Philippines FTA.

Korea-Philippines FTA to Take Effect on December 31, 2024: Eliminating Tariffs on Korean Automobiles

1. Background

- The Korea-Philippines FTA, effective December 31, 2024, eliminates tariffs on automobiles, auto parts, and other key products, fostering economic growth for both countries. The Philippines, with its growing demand for imports, offers Korea opportunities to strengthen its presence in major industries such as automobiles and eco-friendly vehicles.
- Through this agreement, the Philippines gains enhanced access to Korean technology, consumer goods, and investments, promoting industrial development and infrastructure upgrades. This partnership contributes to enhancing the global market competitiveness of both nations.
- With improved supply chain connectivity and resource access, the Philippines strengthens its role as a gateway for Korean exports into ASEAN, while Korea supports the Philippines in expanding its trade network.

2. Details of Korea-Philippines FTA

(1) Automobile Market Analysis

- The Philippines, with a population of approximately 110 million and a consumption-driven economy, is one of the fastest-growing markets in Southeast Asia. The automotive sector is a key part of this growth, with strong demand for both passenger and commercial vehicles. As of 2024, Japanese brands dominate the Philippine automotive market, holding 82.5% of the market share. Toyota leads with 44.9%, followed by Mitsubishi (17.75%) and Ford (7.10%). Korean automakers, Hyundai and Kia, hold smaller shares at 2.07% and 1.29%, respectively. However, the Korea-Philippines FTA, which eliminates tariffs on Korean vehicles and auto parts, creates opportunities for Korean brands to challenge the established dominance of Japanese competitors by offering more competitively priced products.
- The Korea's automotive market is a global leader in vehicle production and export. In 2023, Korea ranked as the fifth-largest automobile exporter globally, with its vehicles renowned for quality, advanced technology, and design. Hyundai Motor Company and Kia, in particular, have established themselves as pioneers in eco-friendly vehicle production, with a strong focus on electric vehicles (EVs) and hybrids. Korea's domestic market also demonstrates robust demand for eco-friendly

and technologically advanced vehicles, driven by government incentives for sustainable mobility.

(2) Key Provisions of the Korea-Philippines FTA

1) Elimination of Auto Tariffs

- Internal Combustion Engine Vehicles:
 - The 5% tariff previously imposed on Korean-made passenger cars, trucks, and commercial vehicles has been eliminated with the FTA's implementation. This reduction significantly enhances the price competitiveness of Korean vehicles, particularly in the cost-sensitive passenger car and commercial vehicle segments.
- Eco-Friendly Vehicles:
 - Tariffs on hybrid and electric vehicles, previously set at 5%, will be phased out over five years, decreasing by 1% annually. This gradual reduction will provide a stronger foundation for Korean exports of eco-friendly vehicles, aligning with the increasing demand for sustainable transport in the Philippines.

2) Elimination of Auto Parts Tariffs

- Tariffs on auto parts, which ranged from 3% to 30%, will be phased out within five years.
 - Key items include engine components, suspension systems, braking systems, and exhaust systems. This will positively impact Korean manufacturers involved in CKD (Complete Knock Down) exports and bolster the supply chain for parts in the Philippines.

3) High Level of Market Access for the Automotive Sector

- The FTA provides greater market access for Korean automakers compared to the ASEAN-Korea FTA and the Regional Comprehensive Economic Partnership (RCEP).
 - The Philippines agreed to eliminate tariffs on 96.5% of Korean products, while Korea will remove tariffs on 94.8% of Philippine goods. This reciprocal approach promotes trade balance and strengthens industrial collaboration.

4) Strategic Resource Access for the Automotive Industry

- The Philippines is a key producer of critical minerals like nickel and cobalt, essential for electric vehicle (EV) battery manufacturing.
 - The Philippines, a major producer of essential minerals like nickel and cobalt for electric vehicle batteries, benefits from increased trade cooperation under the FTA. Korea secures a stable supply of these resources, strengthening its EV production capabilities and global supply chain competitiveness.

3. Implications

- The Korea-Philippines FTA exemplifies how strategic bilateral agreements can drive global trade integration and competitiveness. By eliminating barriers in key sectors like automobiles and eco-friendly technologies, the FTA strengthens supply chains, promotes sustainable industries, and enhances economic resilience.
- Through the adoption of green technologies and increased access to critical minerals like nickel and cobalt, the agreement addresses global priorities such as sustainability and supply chain stability. It also fosters industrial modernization and regional collaboration, benefiting not just Korea and the Philippines but also the broader ASEAN and global markets.
- This FTA highlights the potential of partnerships between complementary economies to promote sustainable growth, trade diversification, and innovation, setting a model for future global trade agreements.

4. Conclusion

- The Korea-Philippines FTA removes tariffs on automobiles and auto parts, fostering greater competitiveness and supply chain integration in the global market. By gradually eliminating tariffs on hybrid and electric vehicles, the agreement supports the adoption of sustainable technologies and bolsters the development of eco-friendly industries.
- Additionally, improved access to critical minerals like nickel and cobalt strengthens the foundation for electric vehicle production and global supply chain stability. Positioned as a key link to ASEAN, the FTA provides a strategic platform for driving long-term economic growth and enhancing regional and global trade collaboration.

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