



Tax News Flash

- Transfer Pricing

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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

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 policies 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.



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