



# Tax News Flash

## - Transfer Pricing

April 2023

Samjong KPMG Transfer Pricing & Customs Service Group provides readers 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 is appropriate to establish selection criteria and reinvestigate comparable companies whose functions are similar to those of the plaintiff.**

< Decision 2020 Seo 2311, 2022.06.09 >

### Background

- The taxpayer is a local entity of ○○○, and sells automotive and industrial semiconductors imported from ○○○ during the 2015-2018 financial year. The income was calculated and reported using the Transactional Net Profit Margin Method "TNMM" (Profit Level Indicator: Operating Margin "OM") under Article 5 Paragraph 1 Item 5 of the 「Law for the Coordination of International Tax Affairs」.
- As a result of the tax audit, the tax authority determined that the taxpayer purchased a semiconductor product from a related party at a higher price than the arm's length price (the same arm's length calculation method was selected as the taxpayer, but the selected comparable companies were different). The tax authority included ○○○ KRW, the sum of the difference between the arm's length price and the declared income amount in the gross income and disposed the income as a dividend. Accordingly, the tax authority notified the taxpayer of the total KRW ○○○ for the 2015-2018 financial year.
- To verify the appropriateness of the transfer price reported by the taxpayer, the tax authority selected the TNMM as the transfer pricing method, used OM as the profit level indicator with the taxpayer's industry code (46594, Electrical machinery equipment and related equipment wholesalers). Total of seven companies were finally selected as

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comparable companies after excluding companies with low comparability. The tax authority believes that there is a difference in the wholesale method, as the taxpayer sells semiconductor products to customers through dealers, while four of the comparable companies directly sell products purchased from manufacturers to customers. The difference was adjusted by deducting the operating margin corresponding to the dealer operating margin of the company concerned.

- The taxpayer did not agree to the adjustment and filed an appeal to the Tax Tribunal.

### **The Tax Tribunal Decision**

- In order to calculate the arm's length price of the semiconductor parts purchased by the taxpayer from ○○○, the tax authority first selected comparable companies based on the market structure, physical characteristics of products, and sales volume. Then, after considering the similarity of products, the size of customer, and post-sales technical support, seven comparables were selected. However, if there is a difference in the transaction structure of the company and a difference in the transaction stage, there will inevitably be a difference in sales and marketing functions or distribution margins.
- In order to exclude cases where the sales volume of the comparable companies is significantly different from that of the taxpayer, the comparables were selected by rejecting the 5-year average sales of ○○○ KRW or more, and it resulted in a fluctuated scale of operating margin(median) from 2.72% to 7.08%. When the rejection criteria of 25% or less and 400% or more of the sales of the taxpayer presented by the taxpayer is applied, the operating margin(median) is between 2.72% and 3.60%, showing a consistent range. To this extent, it seems necessary to consider the characteristics of customers, R&D function, and overseas sales. Therefore, the taxpayer's claim that some of the comparable companies selected by the tax authority are inappropriate seems reasonable.
- In addition, the tax authority divided the semiconductor distribution market into the market for large corporations and the market for small and medium-sized enterprises, and then excluded semiconductor agency from the comparable pool for the reason that they mainly deal with small and medium-sized enterprises. However, since the taxpayer is functionally similar to a semiconductor agency, it is reasonable to include semiconductor agencies that have a significant proportion of transactions with large companies as comparable companies.
- Therefore, the Tax Tribunal decides that the tax authority will correct the tax base and tax amount by preparing comparability criteria in consideration of the transaction stage, sales volume, customers, business environment, etc. of the taxpayer, and reinvestigate the comparable companies, including semiconductor agency with similar functions to the taxpayer.



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