



Tax News Flash

- Customs

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Samjong KPMG provides readers Customs related recent local issues and trends. This newsletter is a monthly publication of Samjong KPMG. If you need more detailed explanation, please feel free to contact Key contacts.



The following is a recent Customs-related Tribunal case in Korea

1. Respecting the principle of liberty of contract between transaction parties, “Offence of Price Manipulation clause should be strictly construed” [Incheon District Court, February 16, 2023, Sentence, 2021gohap924]

1) Background

Article 270-2 of the Customs Act stipulates that “a person filing a correction declaration, amendment declaration, import declaration, or export declaration applies or reports by manipulating the price of goods for the purpose of unfairly property gains or making a third party acquire, shall be punished by imprisonment for not more than two years or by a fine not exceeding the amount which is the higher between the cost of the goods and 50 million won”. This is so-called ‘Offence of Price Manipulation’ clause introduced in the revised Customs Act from August 13, 2013.

The background of this provision is to prevent transaction parties from falsely declaring the value of the goods for unfair purposes, such as illegal subsidies, trade finance (loan) defrauding, and evasion of corporate taxes, in accordance with the quantitative growth and qualitative complexity of international trade.

1) Facts

Defendant K, engaged in the research, development, and manufacturing of high-tech devices, signed a supply agreement for high-tech products with overseas supplier L, agreeing to comply with the specifications and raw material standards requested by L.

Afterwards, K informed L of the sources, quantities, and prices of raw materials required to meet the product performance and specifications. Accordingly, K imported the raw materials from a third-country supplier M and used them to manufacture the finished products, which were subsequently exported to L.

K declared the import price of raw materials based on the payment made to supplier M. The export price of the products was declared to the customs authority based on the price received from L, using the same price as agreed upon in the supply agreement.

However, the customs authority determined that the price of the raw materials declared by K for import was higher than that of identical or similar items, and accordingly, the exported product price was found to be overvalued. They raised suspicions about the discrepancy between the manufacturer and exporter of the raw materials, the involvement of multiple transaction parties, and the accuracy of the import/export pricing data. They also suspected that K manipulated the import/export prices at a higher value for the purpose of providing financial benefits to the overseas related party. Consequently, an investigation against K was initiated on the grounds of price manipulation under the Korea Customs Act.

2) Issue

- Whether the defendant K manipulated the prices of imported and exported goods to be overpriced for the unfair purpose of providing benefit to the third parties

3) Decision

The first instance court found that K has paid and declared the price of the imported goods in accordance with the import and export agreement with L and M. **i)** The raw materials that the customs authority considered to be overpriced were necessary to produce the goods, and **ii)** given the diversified types of international trade, it is possible for an exporter rather than a manufacturer to conduct a kind of intermediary trade, **iii)** it is legitimate business judgment for transaction parties to impose contractual conditions on the determination of costs, materials, and prices of products for mutual benefit, and **iv)** the illegal overseas financing alleged by the customs authority was either a misinterpretation of the relevant materials or an unsubstantiated allegation, therefore the court acquitted K on this issue.

4) KPMG's comment

In recent years, even if the import price is higher than that of identical or similar items or there is no customs duty payment issue, it is increasingly becoming an issue if the declared value is not properly managed in customs audits. In the past, importer expected that only low prices would be challenged in customs audit, but the auditors have comprehensively reviewed not only the undervalue declaration but also whether the price was arbitrarily determined, including the company's pricing policy and whether the price was determined under normal commercial practices.

As can be seen from the above court case, it is meaningful to note that in determining whether the import and export prices were reasonable, the court carefully examined whether was price manipulation between the parties to the transaction and whether there was a purpose for the parties or a third party to obtain benefits.

We also agree that the judicial principle of liberty of contract should be respected wherever possible and that it is reasonable to conclude that transaction parties cannot be found to have manipulated prices merely because they have agreed to a seemingly unusual or unfamiliar contractual arrangement.

Finally, when dealing with a customs audit, especially on related party transfer pricing issues, it is desirable to present a positive image of the company to the customs auditors and efficiently provide a sufficient explanation of the pricing policy. To this end, it is important to note that professional assistance in customs audits will be a way to minimize the risk of tax penalties of the company.



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