



Tax News Flash

- Transfer Pricing

June 2023

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

Taxpayer should receive arm's length loan interest from the overseas related parties when the taxpayer remunerates loan interest to domestic related parties and fund owners.

<Decision 2022 Joong 2863, 2023.03.20>

Background

- The taxpayer established an overseas fabric dyeing entity(AAA) in September of 1994 and an overseas sweater manufacturing entity(BBB) in 1997 (AAA and BBB together referred to as the overseas entities). The taxpayer provides yarn to AAA to which AAA sells the yarn to BBB and local vendors. Then, BBB uses the yarn provided by AAA to manufacture and sell sweaters.
- In accordance with the results of the comprehensive corporate tax audit for fiscal year 2016~2020, the tax audit team levied corporate tax due to the below reasons to which the taxpayer submitted an appeal to the Tax Tribunal.
 - ① The tax audit team considered that the taxpayer did not try to collect accounts receivables (ARs), which passed the typical collection period, regarding the sale of the yarn products to AAA and BBB. Accordingly, the tax audit team calculated the arm's length interest amount based on the weighted average borrowing interest rate from 3rd parties stipulated in Article 4 of the Law for the Coordination of International Tax Affairs ("LCITA") [Adjustment of Tax Amount based on Arm's Length Price] and included the interest amount as taxable income.

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- ② The taxpayer provided guarantee service to AAA that borrowed a loan from a bank in 2014, and the loan was paid back by the taxpayer in FY2018 and FY2019. The taxpayer accounted for the subrogation as a loss from the discontinued business in FY2018 and as a 'miscellaneous loss' in FY2019. The tax audit team considered that the taxpayer arbitrarily gave up the loan and viewed the subrogated amount as an expense unrelated to the taxpayer's business and denied the deductibility in accordance with Article 52 and Subparagraph 2 Article 19 of the Corporate Income Tax Act ("CTA") [Exclusion of Bad Debt as a Deductible Expense] and consequently disposed the amount as AAA's 'other income'.

Issue

- ① Taxpayer's claim that the tax adjustment according to arm's length price regarding the AR is unreasonable.
- ② Taxpayer's claim that the denial of deductibility of the subrogated amount and disposition as other income is unreasonable.

The Tax Tribunal Decision

- Issue ①

The tax audit team's calculation of the arm's length interest amount based on the weighted average loan interest rate and adjustment of the interest amount as taxable income is reasonable under the following grounds. 1. Despite that the taxpayer incurred losses from the uncollectible AR in relation to the supply of yarn in 2007, the taxpayer continued to sell yarn to AAA on credit without developing any measure to collect the account receivables, 2. The taxpayer recorded the loan interest amount paid to domestic related parties and fund owners as a deductible expense on the books, but it did not collect the arm's length interest regarding the AR, 3. It is difficult to analyze the credit rating of the overseas entities due to the capital impairment and that the tax audit team cannot identify comparable transactions as the maturity of the AR from the overseas entities is not fixed.

- Issue ②

Due to that Article 3-3 of the Enforcement Decree of the LCITA stipulates that the disaffirmation of wrongful calculations shall be applied to the 'exemption from the debt obligation' and Subparagraph 2-1 Article 19-2 of the CTA stipulates that bad debt expense which arise from debt guarantee cannot be deductible. Therefore, it is difficult to accept the taxpayer's claim as the treating the subrogation amount as a loss can be considered as an exemption from debt obligation.



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

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27th Floor, Gangnam Finance Center, 152, Teheran-ro, Gangnam-gu, Seoul, Korea

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