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Tax News Flash
- Transfer Pricing

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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 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

The disputed interest, possibly considered financial expenses, seems higher than the interest rate in usual situation. Therefore, it is appropriate for the tax authority to reexamine the arm's length interest rate of the disputed loan transaction for each fiscal year in question and adjust the taxable base and tax amount accordingly.
< Tax Tribunal Judgment 2018Jeon3997, 2023.01.09>

Background

- The claimant, established as a joint venture between a multinational corporate group ("OOO Group") headquartered in the United States ("OOO") and a Korean AAA Group on April 20, 1995. According to an agreement ("dispute agreement") between the OOO Group and the Korean AAA Group on October 22, 2013, the claimant conducted a series of transactions ("disputed transactions") and OOO became the claimant's 100% parent company and a creditor simultaneously. Subsequently, the claimant recognized the interest expenses paid to OOO by the claimant in the fiscal years 2014 and 2015 ("disputed interest") as tax deductible.

- The tax authority, based on the assessment result notification from the commissioner of BBB Regional Tax Office ("Tax Office") through a corporate tax assessment on the claimant, denied the deduction of disputed interest for the fiscal years 2014 and 2015. Moreover, regarding the disputed interest, the tax authority notified a beneficiary change and refused the adjustment claim made by the claimant requesting tax deductible on the Disputed Interest for the fiscal years 2016 to 2018. Accordingly, the claimant has filed an appeal.

Tax Office's (Defendant) Claims

- Although the purpose and substance of the disputed transactions is to exchange stocks between the shareholders, the claimant evaded tax by paying the disputed interest incurred from indirect and unconventional transactions, which make it non-deductible expense.

- Furthermore, the disputed transactions do not satisfy any of the requirements for deductible expenses, which are business related, customary nature, and income related.

Taxpayer's (Claimant) Claims

- The disputed interest is essentially the same as interest payments incurred from regular borrowings and is therefore tax deductible in itself. It does not fall under the category of non-deductible expenses such as unrelated business expenditures. In order to deny and restructure the transaction structure, the tax office must vindicate the intention of the tax evasion. However, it is purely based on arbitrary assumption.

Decision by Tax Tribunal

- Taxpayers have the right to choose among various legal approaches to achieve the same economic objectives. Unless there are special circumstances such as the chosen transaction being solely for tax avoidance purposes, and it being an unreasonable transaction that a normal and rational economic actor would not choose, the legal approaches chosen by the parties should be respected. Moreover, considering that in the past, methods similar to the disputed transactions, such as share buybacks, have been used to terminate joint venture relationships, it would be difficult to conclusively determine that the disputed transactions alone were abnormal transactions that a rational economic actor would not choose. Therefore, it is judged that the disputed transactions cannot be restructured as share exchange transactions based on the principle of substance over form in tax law.

- However, it is important to consider the facts that the interest rate of 8% applied to the disputed interest in this case appears higher than the usual interest rate, and that the tax office initially denied only a portion of it as non-deductible expenses for the fiscal year 2014 but later revoked the decision and denied the entire disputed interest, and that the claimant does not claim it as an arm's length interest rate. Therefore, it is considered appropriate for the tax office to re-examine the arm's length interest rate of the disputed interest for each fiscal year and determine the taxable base and tax amount accordingly.

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