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Tax News Flash

- Transfer Pricing & Customs

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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 followings are recent Korea's Tax rulings and cases in relation to transfer pricing

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Decision : Dismissal

Non-acceptance of the claims of the taxpayer at The Tax Tribunal in Korea

Background

1. The taxpayer was established on July 21, 1998, AAA corporation OOO owns 100% of the taxpayer's shares and manufactures and sells bearings and accessories since its establishment.

2. After conducting a tax audit on the taxpayer from January 21, 2020, to July 16, 2020, the tax auditor, under the Article 4 (1) of the Legislation for Coordination of International Tax Affairs Act ("LCITA"), assessed a taxation by the inclusion in income during the 2015~2017 business year, claiming that the taxpayer sold the bearing products with the OOO trademark attached at a price below the arm's length price to related parties such as BBB OOO corporation, CCC OOO corporation, DDD OOO corporation, and AAA OOO corporation and the four corporations above. The tax authority, accordingly, adjusted the transfer price and reassessed the corporate tax of OOO KRW for the 2015 business year, OOO KRW for the 2016 business year, and OOO KRW for the 2017 business year.

3. The taxpayer objected to the assessment and filed a request for adjudication to The Tax Tribunal on October 30, 2020.

4. The taxpayer filed a tax refund request to the Korean tax authorities for reassessment that the corporate tax for the 2015 business year OOO KRW should be refunded since the sales deduction amount OOO KRW has occurred because of the “agreement on the unit price change” with the OOO, an overseas related party. However, the tax authorities rejected the claim for reassessment on January 15, 2021.

The Tax Tribunal Decision

If the tax authorities with their best efforts selected comparable companies under similar transaction conditions and calculated a reasonable arm’s length price based on all the available data obtained from the taxpayers, it would be reasonable to reach a conclusion that the analysis result can lead to the arm’s length range although the tax authorities had not appropriately adjusted for the differences in transaction items or distribution channels between the taxpayers and the comparable companies (refer to the Supreme Court October 13, 2011 ruling, 2009 Doo24122).

The taxpayer argued that the reassessment of the tax authorities, based on the arm’s length price calculated using the taxpayer as the tested party is unlawful.

However, considering that the taxpayer did not submit the requested financial data at the time of the tax audit even when the taxpayer was asked for the financial reports of the foreign related parties, the tax authority had no choice but to calculate the arm’s length price by using the taxpayer as the tested party for analysis, and a third-party local comparables. Moreover, considering that the local comparables are comparable to the taxpayers, the arguments of the taxpayer are hard to be accepted.

In addition, the taxpayer argued that even if the arm’s length price calculated by the tax authorities is deemed legitimate, the reassessment for arbitrarily selected related party transactions that are only subject to TP adjustment is unlawful since it contradicts the Article 4 (1) of the LCITA.

However, the provision to Article 4 (1) of the LCITA applies to determining or correcting the tax amount by calculating the arm’s length price for two or more tax years, and therefore, it cannot be necessarily interpreted that the arm’s length price must be calculated for transactions with all foreign related parties in the same business sector to determine or correct the tax base and tax amount. Therefore, the arguments of the taxpayer are difficult to be accepted.

The followings are recent Korea's Tax rulings and cases in relation to customs

1. Whether the liquidated damage paid by the buyer for non-fulfillment of the annual minimum purchase quantity of the contract is included in the price actually paid under Paragraph 1 of Article 30 of the Customs Act [Decision 22-01-01 by the Council of Customs Valuation & Classification Institute]

1) Background

According to the terms of the contract, the importer must purchase 1,000 tons of the item in question per year, and if the importer fails to purchase the contracted quantity, 2.5 USD/kg must be paid for the item not purchased as liquidated damage.

2) Issue

If the buyer fails to purchase the annual minimum purchase quantity of the item under the contract, the liquidated damage paid by the buyer to the seller for the items below the minimum quantity by the terms of the contract corresponds to *the price actually paid for the imported goods* prescribed in Paragraph 1 of Article 30 of the Customs Act.

3) Decision

The liquidated damage payable to the seller when the buyer does not meet the minimum purchase quantity is included in the price actually paid or payable by the buyer to the seller since it relates to the imported goods as part of the supply contract of goods between the buyer and the seller and corresponds to the amount payable by the buyer to the seller as a condition of sale for the imported goods.

Whether the price paid by the buyer as liquidated damage is included in the price actually paid under the Customs Act is to be determined considering whether the liquidated damage belongs to the seller and whether such payment is a condition of sale of the imported goods, etc., but the nature of the price (liquidated damage) and the relevance to the price originally paid by the buyer for the imported goods does not be considered.

The amount paid by the buyer when the minimum purchase quantity is not fulfilled belongs directly to the seller for the seller's benefit and is a condition of sale for imported goods, considering the terms for the payment of the liquidated damage in the original purchase contract.

In addition, since there is no transaction of goods, services, or intangible assets between the buyer and the seller other than that of imported goods, even if it is a nominal liquidated damage, it corresponds substantially to a payment for the imported goods.

Moreover, just because the amount of payment in question is calculated based on the quantity below the minimum purchase quantity, it cannot be regarded as a payment for non-imported goods (i.e., unpurchased shortfall); it is only a matter of calculation method and does not affect the determination of whether the liquidated damage is included in the price actually paid for imported goods.

Therefore, the amount paid by the buyer to the seller for failing to meet the minimum purchase quantity (liquidated damage) is not only related to the imported goods as part of the supply contract of goods between the buyer and the seller, but also corresponds to the total amount paid or payable to the seller as a condition of the sale for the imported goods, which should be included in the price actually paid under the Customs Act.

4) KPMG's Comment

When a person making an import declaration has doubts about the price actually paid or payable by a buyer, additional elements, deduction elements, conditions for denying transaction price, or customs valuation method for the goods between related parties, the taxpayer can apply for ACVA (Advance Customs Valuation Arrangement) program and seek pre-consultation on customs valuation to Head of Customs Service before the price declaration as per Article 37 of the Customs Act.

As there is a risk of additional collection by the customs authorities if the contents of the price declaration do not meet the legal requirements, it is necessary to apply for the ACVA program and discuss with the customs authorities the appropriate customs valuation method, to respond to the possible risk in advance.

Category	ACVA for 3rd party transaction	ACVA for related party transaction
Applicable Subject	Imported goods in 3rd party transaction	Imported goods in related party transaction
Review Period	30 days	1 year
Applicant	All taxpayers having transactions with foreign exporters	Taxpayers having a continuous transaction with foreign headquarter and related parties
Main Review Points	- Price actually paid or payable by a buyer, elements to be added to or deducted from the import price - Whether the import price satisfies the requirements for a transaction price - Whether the transaction satisfies "sales for export" - Customs valuation by methods	- Whether the transaction value is affected by a related party - Whether the customs valuation method requested by the applicant is adequate for the subject transactions - Elements to be added to or deducted from the import price - Adequacy of customs value

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