



Tax News Flash

- Transfer Pricing

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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

Failure to receive accrued interest receivable or guarantee fee is subject to the denial of unfair act calculation and transfer pricing adjustment
< High Court Decision 2021Nu5308 Decided 2022.07.22 >

Background

The plaintiff engages in the business of manufacturing and supplying gas locally and internationally, refining and selling its by-products, constructing and operating a natural gas (including liquefied) station and supply chain. The case has two parts:

- 1) The plaintiff lent its subsidiary a loan procured from a third-party. For this loan transaction, the tax authority used cost-plus method and taxed the plaintiff by the arm's length interest rate which is adding certain markup to the borrowing interest corresponding to the procured cost from the third-party.
- 2) The plaintiff provided a performance guarantee to its subsidiaries, however failed to receive the performance guarantee fee from them. The tax authority judged the non-receipt of the guarantee fee is not an arm's length transaction, so taxed the plaintiff based on the TP report in which the accounting firm calculates the appropriate performance guarantee fee rate by calculating the credit rating based on the financial information of the company in accordance with the risk approach.

1. Whether the plaintiff's failure to receive the interest income for the loan is subject to the tax adjustment based on arm's length price

Court Decision

Since the plaintiff is obligated to pay interest to its third party, it is reasonable to receive corresponding interest from the subsidiary as well unless there are special circumstances. Although the development project carried out by the subsidiaries is a high-risk, high-return project with a very low probability of success, the plaintiff did not take any minimum measures to preserve the security for its loan. It is judged to be an unreasonable transaction if there is no special relationship.

In addition, in order to judge the rationality of the loan transaction itself and the receipt of interest, it is reasonable in light of social common sense and commercial practice to comprehensively consider the characteristics of the source of financing, that is, the payment deadline or contracted interest, collateral or guarantee, other repayment conditions, loss of profit over time, delay damage rate, etc.

In this case, the loan was obtained via a method of issuing foreign currency bond to finance the overseas resource development project in the exploration, development, and production stages. The plaintiff proposed a CUP method, but it is judged that comparable third-party transaction proposed by the plaintiff is a special transaction (government subsidized interest rate in accordance with the 'Overseas Resource Development Project Act'), that is different from an ordinary transaction. Therefore, an arm's length price cannot be calculated according to a Comparable Uncontrolled Price Method ("CUP method").

Considering the unique characteristics of the loan transaction, it is necessary to calculate the arm's length rate according to the 'cost plus method', the most reasonable transfer pricing method.

2. Whether the plaintiff's failure to receive the guarantee fee for the performance guarantee is subject to the denial of unfair act calculation or tax adjustment based on arm's length price

Court Decision

The performance guarantee in this case is a transaction in which the plaintiff fulfils the contract or pays a deposit on behalf of the subsidiary if the subsidiary does not fulfil its obligations under the contract related to the overseas resource development project. It is reasonable for the plaintiff to receive compensation for the provision of guarantee service unless there are special circumstances.

Even if the plaintiff establishes a subsidiary for overseas business, the entity performing the overseas business is a subsidiary which is a separate legal corporate entity of the plaintiff and it is determined that the profits from the business is not directly attributable to the plaintiff;

In consideration of appropriate performance guarantee fee, the performance guarantee fee received by the plaintiff from overseas subsidiaries should be evaluated by the Risk Approach

Method, which is specified under the Korea's TP regulation as a typical method of calculating the guarantee fee.



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