



Tax News Flash

- Transfer Pricing

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Samjong KPMG Transfer Pricing & Customs Service Group provides readers 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

It is appropriate for the tax authority to re-examine the arm's length interest rate of the borrowings since the interest rate applied is likely higher than an arm's length rate and no evidence of its arm's length nature has been provided.

< Decision 2018 Jeon 3997, 2023.01.09 >

Background

- The taxpayer is a foreign-invested corporation jointly invested by a multinational group (hereinafter "AAA") headquartered in the United States and OOO Group in Korea. At the request of AAA, the taxpayer conducted a AAA stock retirement transaction, and its funds were borrowed from a corporation in the OOO Group ("BBB"). The taxpayer recognized interest expenses paid to BBB in the 2014-2015 financial year as deductions after BBB became the wholly owned parent company(100%) of the claiming corporation and a creditor at the same time.
- The tax authority notified the corporate tax by denying deductible expenses on the interest paid for the 2014-2015 financial year by claiming that the purpose and substance of the transaction was a stock exchange between AAA and OOO Group, the taxpayer initiated an indirect and unconventional loan transaction regardless of its business purpose and paid interest, which resulted in tax avoidance. In the case of interest dispute for the 2016-2018 financial years, the tax authority rejected the claim of the taxpayer for rectification which denied deductibility of the interest to be recognized as deductible expenses.
- The taxpayer argued that the interest paid was deductible because it was no different from the interests from a general loan transaction. Also, argued that the tax authority should

clearly demonstrate the existence of tax avoidance intention by the taxpayer. However, the tax authority only demonstrated the reconstruction of the transaction by arbitrary presumption. Therefore, the taxpayer filed an appeal to the Tax Tribunal, arguing that there was no proof of the nature of tax avoidance intention.

The Tax Tribunal Decision

- The Corporate Tax Act and Commercial Act strictly classify equity and debt based on legal, economic, and accounting differences. As long as the disputed loan correspond to liabilities raised by means of borrowing, it is difficult to see those liabilities as equity just because the creditor is the parent company of the debtor. While the Corporate Tax Act stipulates that “interest on borrowings” is deductible expenses, there is no separate provision for special cases of deductibility depending on the creditor’s status (equity ownership of the debtor, etc.). In the end, even if the creditor is the parent company of the taxpayer and disputed debt borrowing itself is a liability, it is reasonable to assume that the interest on the debt to be included in deductible expenses under the Corporate Tax Act.
- However, even if the disputed interest is regarded as a loan interest, in accordance with Article 4 of the Law for the Coordination of International Taxes Act, the tax base can be adjusted based on the arm’s length price. The Tax Tribunal judges that it is appropriate for the tax authority to re-assess the arm’s length interest rate of the loan for each financial year because applied interest rate of 8% seems higher than the conventional interest rate and the fact that the taxpayer did not demonstrate that the applied interest rate is arm’s length.



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