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# Global Transfer Pricing Review

South Korea

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TAX



# South Korea



## KPMG observation

The Korean Transfer Pricing Regulations, namely, the Law for the Co-ordination of International Tax Affairs (LCITA) and the Presidential Enforcement Decree (PED) of the LCITA (PED of LCITA), were extensively amended in 2010 to reflect changes made to the Organisation for Economic Co-operation and Development (OECD) Guidelines at the same time. They were also modified in other ways with the intention of increasing transparency and broadening the scope for interpreting and applying the LCITA.

In recent years, offshore tax evasion and profit shifting have made the headlines in Korea, and the Korean government has repeatedly announced its intention to fight such tax behaviors.

In 2015, the Korean government announced that they are reviewing the Base Erosion and Profit Shifting (BEPS) Action Plan recommendations and intend to incorporate the recommendations into the LCITA in 2016.

Lastly, to promote proactive transfer pricing risk management, the Korean government introduced in 2015 two new advanced management tools:

- a new “Simplified APA” for non-resident taxpayers with gross revenues less than 50 billion South Korean won (KRW); and
- a mechanism for combined filing and review of unilateral Advance Pricing Agreements (APA) and advanced customs valuation arrangements
- both new tools have been introduced to provide taxpayers with more clarity and simplified processes.

## Transfer pricing study snapshot

### The purpose of a transfer pricing study

	Applicable	Required to be contemporaneous	Submission to tax authority required
Legal requirements		●	
Protection from penalties	●	●	●
Reduce risk of adjustment	●		●
Shifts burden of proof	●		●

## Basic information

### Tax authority name

National Tax Service (NTS).

### Citation for transfer pricing rules

The Law for the Coordination of International Tax Affairs (LCITA) and Presidential Enforcement Decree of the LCITA (PED of LCITA).

### Effective date of transfer pricing rules

1 January 1996.

### What is the relationship threshold for transfer pricing rules to apply between parties?

Ownership of greater than 50 percent, based on voting power, is under common control, and under de facto control in substance.

### What is the statute of limitations on assessment of transfer pricing adjustments?

The general statute of limitations for transfer pricing adjustments is five years from the date the annual tax return filing due date (within three months of the last day of the fiscal year). However, in the case where a company utilizes its net operating losses (NOL) incurred after 1 January 2009 to offset taxable income, a different statute of limitations may apply. If the NOL is used within five years, the statute of limitations is still five years. If the NOL is used for a period of up to 10 years, then the statute of limitations is one year greater than the number of years of taxable income offset by the NOL.

## Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. The transfer pricing details are to be submitted on a prescribed foreign reporting form with the annual tax return.

### What types of transfer pricing information must be disclosed?

A taxpayer is required to submit with the annual tax return:

- a detailed statement of the cross-border intra-group transactions
- summarized income statements of the foreign affiliates
- the transfer pricing method selected and description of the reasons for the selection, if:
  - (i) the total accumulated volume of annual cross-border tangible intra-group transactions of the taxpayer is greater than KRW5 billion or the total volume of annual cross-border intra-group service transactions of the taxpayer is greater than KRW1 billion; or

- (ii) the volume of annual cross-border tangible intra-group transactions to each foreign affiliate is greater than KRW1 billion or the volume of annual intra-group service transactions to each foreign affiliate is greater than KRW200 million.

### What are the consequences of failure to submit disclosures?

The failure to provide the requested information on the prescribed form may result in penalties up to KRW100 million.

## Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

No. The document should be filed in Korean. English is acceptable only with the tax authorities' approval.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

## Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes.

## Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 60 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

In general, the NTS expects the taxpayer to submit transfer pricing documentation immediately in the case of a tax audit due to the specified number of days set for each tax audit. Failure to do so may lead to suspension or extension of audit. Generally, the responses should be made within 60 days to avoid non-compliance penalties.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

There are three levels of appeals in South Korea.

1. Review by the NTS
2. Appeal to Tax Tribunal or Board of Audit and Inspection (but taxpayers may elect to by-pass this step and appeal in Court)
3. Appeal in the Courts
4. Initiate MAP

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes. Generally speaking, a 10 percent under-reporting penalty and 10.95 percent interest on the income tax assessment will be levied as penalties for the transfer pricing income adjustment. In case of gross negligence additional penalties could apply.

To what extent are transfer pricing penalties enforced?

If a transfer pricing income adjustment is sustained, transfer pricing penalties are likely to be enforced.

What defenses are available with respect to penalties?

LCITA provides a relief from under-reporting penalties where a taxpayer has exercised due care as demonstrated either by contemporaneous documentation or through mutual agreement procedure (MAP).

In addition, where new information (e.g. comparables' most recent financial information) is obtained subsequent to

the filing of the tax return, resulting in an upward adjustment to taxable income, a relief from under-reporting penalties is granted where the taxpayer, within 60 days of the findings, files an amended tax return.

### What trends are being observed currently?

Payments of royalties (for brand, know-how, intangibles, et.), intra-group service charges and intercompany guarantees are heavily scrutinized during tax audits. The level of details on the information requests have intensified making it difficult to defend.

## Special considerations

### Are secret comparables used by tax authorities?

No.

### Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes. Only local comparables are accepted when the tested party is a Korean entity.

### Do tax authorities have requirements or preferences regarding databases for comparables?

The tax authorities use the local database called Korea Information Service Line (KIS-Line). The KIS-Line database contains financial data on various companies, many of which maintain assets over KRW10 billion and thus are subject to an independent annual audit.

### Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, always.

### Does the tax authority have other preferences in benchmarking? If so, please describe.

Generally, interquartile ranges are used but other more reasonable methods can be explored. If the results of the tested party falls outside the interquartile range, the adjustments are made to the median of the comparables.

### What level of interaction do tax authorities have with customs authorities?

Ministry of Strategy and Finance amended the LCITA and the Korea

Customs Act to harmonize the transfer pricing and customs regulations. The harmonizing legislation, which became effective on 1 July 2012, states that transfer pricing or customs valuation adjustments made by one tax authority should be respected by the other.

Additionally beginning 2015, the new legislation has been enacted to allow for combined advanced pricing review of transfer pricing and customs valuation (joint APA/ACVA).

### Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes. Any compensation above the arm's length price will likely be denied for taxable deduction.

### Are management fees subject to withholding?

No.

### Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. Any compensation above the arm's length price will likely be denied for taxable deduction.

### Are royalties subject to withholding?

Yes.

### Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. There may be permanent and temporary timing differences which require reconciliation between book and tax. However, these items should be tracked and reconciled each year.

### Other unique attributes?

If the company does not receive remuneration from related parties for the transfer pricing income adjustment assessed by the tax authorities, the tax authorities can assess secondary adjustment in the form of deemed dividend subject to withholding tax and additional investment of capital.

## Tax treaty/double tax resolution

### What is the extent of the double tax treaty network?

Extensive.

### If extensive, is the competent authority effective in obtaining double tax relief?

Frequently.

### When may a taxpayer submit an adjustment to competent authority?

The taxpayer can file a request for competent authority procedure within three years from the date when a notice of income tax assessment is received.

### May a taxpayer go to competent authority before paying tax?

Yes. In the case of a transfer pricing income adjustment, the taxpayer is allowed to make the request to suspend the tax payment until the conclusion MAP. However, this option is only available when the other contracting state also allows the suspension. The taxpayer may still be subject to interest penalty upon the conclusion of MAP.

## Advance pricing agreements

### What APA options are available, if any?

Unilateral, bilateral, multilateral.

### Is there a filing fee for APAs?

No.

### Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Yes.

### Are there any difficulties or limitations on the availability or effectiveness of APAs?

Not applicable.

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