

Recent Developments in Korean Transfer Pricing Rules

International Taxation Conference (Mumbai, India)
December 3, 2011

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Part 1

Tax Law Changes during 2010-2011

Part 2

Korea's Efforts to Harmonize Customs Valuation Rules with Transfer Pricing Rules



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Part 1

Tax Law Changes during 2010-2011

1. Priority in the Application of Transfer Pricing Methods
2. Combined Transactions
3. Multiple Year Data
4. Guidelines on the Transactional Profit Method
5. Downward Adjustment - Codification of TT Decision
6. Increase in Penalty for Failure to Submit Data



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Tax Law Changes during 2010-2011

[1] Priority in the Application of Transfer Pricing Methods

- Tax authority's tendency to use traditional transaction method
- In practice, transactional profit methods most frequently used
- Burden to prove the selected transfer pricing method is the most reasonable method

Old (until 2010)	New (from 2011)
Transactional profit methods can be applied only if traditional transaction methods* cannot be used	Most reasonable method should be used among CUP, RPM, CPM, Profit Split Method, Transactional Net Margin Method or other reasonable methods

* Traditional transaction methods

- Comparable Uncontrolled Price ("CUP") Method
- Resale Price Method ("RPM")
- Cost Plus Method ("CPM")

Tax Law Changes during 2010-2011

[2] Combined Transactions

- **Closely related transactions cannot be properly evaluated on a separate basis**
 - **transfer pricing analysis of combined transactions desirable**

e.g., profits in some transactions and losses in some others

Old (until 2010)	New (from 2011)
No provisions on combined transactions	Analysis of combined transactions in case of: <ol style="list-style-type: none">1. Long-term supply agreement of goods or services2. Right to use intangible asset3. Closely-related product group4. Patented technology and supply of core part5. Bundled sale6. Other cases warranting analysis of combined transactions

Tax Law Changes during 2010-2011

[3] Multiple Year Data

- No statutory provision on use of multiple year data
- Possible arbitrary selection of data by tax authority

Old	New
No provisions on use of multiple year data	Multiple year data may be used in case economic condition or business strategy of past years affect current year data: <ol style="list-style-type: none"><li data-bbox="952 901 1870 997">1. Effect of business strategy such as market penetration<li data-bbox="952 1029 1769 1125">2. Cumulative effect of loss or change in economic condition in past years<li data-bbox="952 1157 1456 1204">3. Effect of product cycle<li data-bbox="952 1236 1892 1332">4. Other cases warranting use of multiple year data

11. Tax Law Changes during 2010-2011

[4] Guidelines on the Transactional Profit Method

- Guidelines on the application of the profit split method and transactional net margin method - consistent with 2010

Old	New
<p>Profit allocation rules for the profit split method and transactional net margin method based on 1995 OECD TP Guidelines</p>	<p>Profit allocation for <u>the profit split method</u> based on:</p> <ol style="list-style-type: none">1. Relative function of each party2. Tangible/intangible assets and capital3. Costs for key functions such as R&D, designing, and marketing4. Any reasonably measurable factors such as a sales increase, number of employees or time spent for key functions, and the size of floor area of retail points <p>An addition to <u>the transactional net margin method</u>: Comparable transactions between a domestic taxpayer's foreign affiliate counterparty to a transaction and an unrelated third party can be used</p>

Tax Law Changes during 2010-2011

[5] Downward Adjustment - Codification of TT Decision

- OECD guidelines leave this to the discretion of each country's tax administrator
- Downward adjustment may be made by the NTS (within its discretion) - under interpretation of statutes and tax ruling of MOSF (Jaekukjo-223, 2008.9.26)
 - In practice, downward adjustment in tax is very rare
- Tax Tribunal decision (Josim 2008 Seo 1588, 2009.9.16)
When the NTS makes a transfer pricing adjustment for multiple taxable years, the same arm's length price must be to all years – i.e., no discretion on the part of the NTS to make only upward adjustments without any downward adjustments

Old	New
No explicit provision reflecting MOSF tax ruling or Tax Tribunal decision	Codification of MOSF tax ruling: Downward adjustment when applying the same transfer pricing method for multiple taxable years

Tax Law Changes during 2010-2011

[6] Increase in Penalty for Failure to Submit Data

- Taxpayer used to have an incentive for not submitting unfavorable data – penalty not substantial, rarely imposed
- Practical consequence:
Tax authority's use of comparables which lack comparability due to insufficient data often leads to an excessive transfer pricing adjustment

Old	New
Penalty of 30 million Korean Won or less in case of failure to timely submit data	Penalty of <u>100 million</u> Korean Won or less Standards for setting penalty amount: Degree of importance of document/ Documents on transfer pricing method / Documents on foreign related party/ Documents on domestic entity

Part 2

Korea's Efforts to Harmonize Customs Valuation Rules with Transfer Pricing Rules

1. Background
2. Proposed Tax Reform Package
3. Evaluation



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1. Background

- In Korea, since 2002, Issue of convergence of customs valuation and Transfer Price have been raised by Multi-National Enterprises
- But, this is a universal issues confronting not only **in Korea, but also in most of Countries.**
- Discussions toward convergence taken place among International Organizations such as WCO, OECD

1. Background

WCO/OECD Conference on CV and TP

In 2006 & 2007, Conference on T.P & C.V was held at WCO toward convergence in approach

Views of Convergence

- **Desirable and possible** vs. **Cautious**

General Views:

- **A whole of the government approach is needed**
- **Customs and Tax authorities need better understanding**
- **Build administrative capacity in better addressing transfer pricing and customs valuation.**
- **Explore the possibilities of a joint approach**

Discussions continues Focus group & TCCV at WCO

1. Background

Korea's Internal Efforts for harmonization

- ◆ In Jan. 2009, **MOU** was co-signed by relevant authorities.
“MOU on Cooperation among MOSF, NTS & KCS for Harmonization of Transfer Price and Customs Valuation”
 - Common investigation and adjustment
 - Information sharing
 - Mutual training for better understanding
 - Establishing a Governmental body to handle this issue
- ◆ Since then, several meetings of Governmental body were held to produce concrete measures for harmonization
⇒ In vain
- ◆ In 2011, **Joint T/F** was set up to introduce legal framework into domestic laws for harmonization of CV and TP
 - Officials of MOSF, NTS, KCS and experts from private sectors

2. Proposed Tax Reform Package

- ◆ **Correlative adjustment of income tax and customs duty for import transactions**
 - If NTS or KCS adjusts tax base in related party trade, **taxpayer can apply for adjustment to other authority**
 - Each should adjust its tax base(customs value), if acceptable based on the provisions of the law
 - Mutual consultation between authorities for appropriate adjustment

2. Proposed Tax Reform Package

Mediation Committee for Adjustment

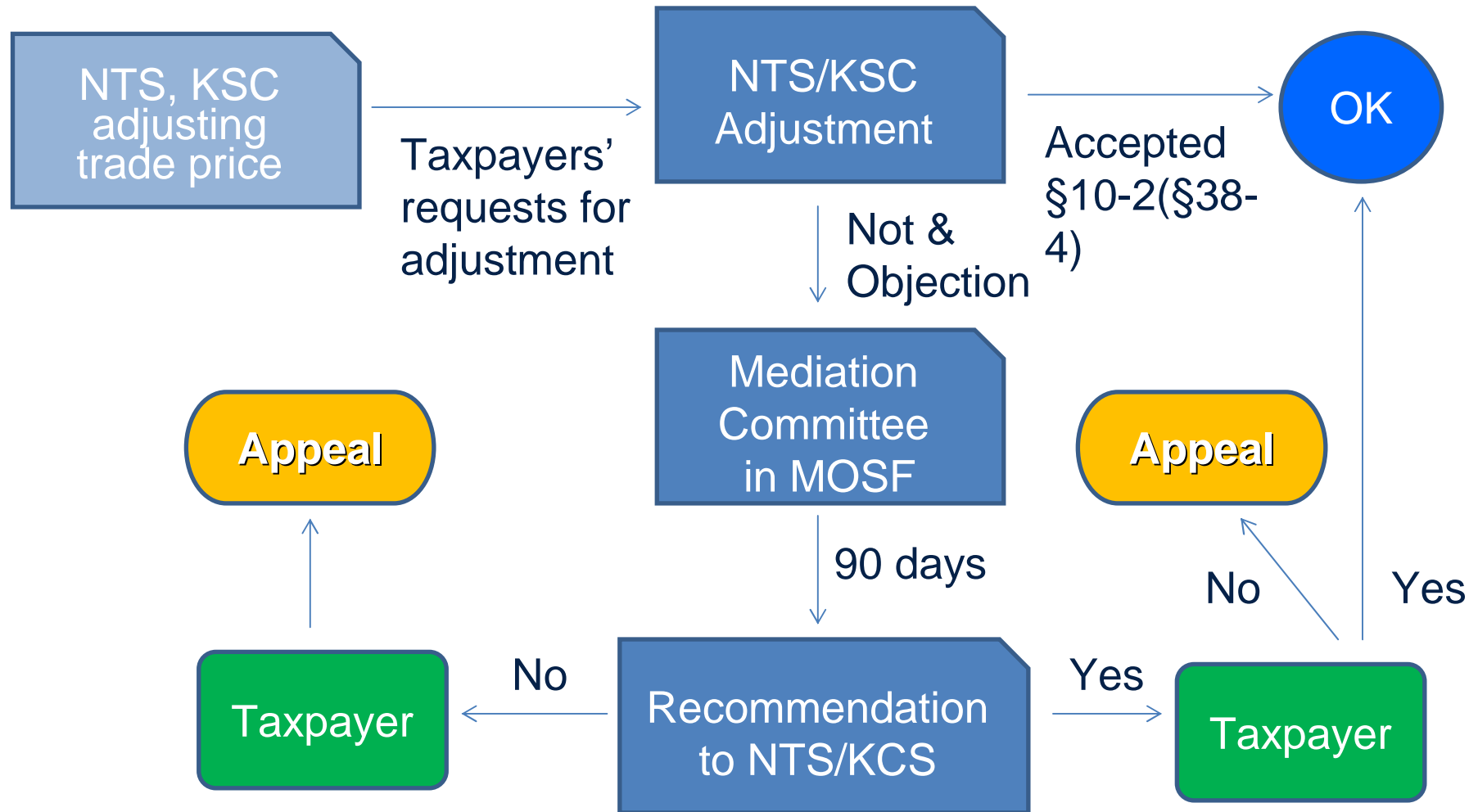
- ◆ If the adjustment request is rejected, **taxpayer can apply for adjustment, within 30 days, to MOSF.**
- ◆ MOSF should establish **Mediation Committee** to adjust tax base or customs value and make **recommendations on adjustment** to NTS or KCS.
- **Mediation Committee** consists of tax/customs authorities and experts from private sector.
- ◆ Once recommendations are decided, NTS and KCS must submit **implementation plan** to MOSF

2. Proposed Tax Reform Package

Exchange of Information between Tax/Customs Authorities

- Taxation information can be exchanged between NTS and KCS for an appropriate adjustment
- **Limited information** only for the adjustment purposes can be provided to secure confidentiality
- Detailed guidance for the implementation will be included in Enforcement Decree.

<Flow chart of Adjustment>



3. Evaluation

- ◆ Only Legal basis for adjustment to be established,
: **Practical adjustment may be a different thing**

Remaining Concerns

- Administrative capacity for adjustment has not been fully developed.
- Lack of understanding on the other side's administration so more experts needed in both administration
- In theory, big gap still remains in the method of CV and TP
- Transactional Profit method is not regulated under CV.
 - ✓ Currently, over 90% cases of TP use TNMM
 - ✓ TNMM could be accepted, but in limited conditions, so high level of technical skills are requested
 - ✓ Profit split method cannot be accepted for adjustment

Thank You