



TP News Flash

Supplementing the BEPS documentation approach

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Summary

In accordance with the G20/OECD Base Erosion and Profit Shifting (“BEPS”) initiative, new legislations have been introduced to require qualifying taxpayers in Korea to submit the Combined Report of International Transactions (“CRIT”), consisting of a Master file, a Local file, and a Country-by-Country Report (“CbC Report”), for fiscal years commencing on or after January 1, 2016.

Through the amendments made to the Law for the Coordination of International Tax Affairs (“LCITA”) as part of the tax reform bill enacted on December 20, 2016, the Ministry of Strategy and Finance (“MOSF”) allows taxpayers to submit the CRIT within 12 months after the end of the fiscal year, thereby easing the timing constraint on taxpayers to prepare and submit the required documents with respect to international intercompany transactions.

Furthermore, the MOSF announced its proposed amendments to the Presidential Enforcement Decree of the LCITA (“LCITA-PED”) on December 29, 2016, taking measures to supplement the regulations on BEPS documentation requirements, introduce new rules on arm’s length interest rates for international intercompany financial transactions, and revise the penalty rules on failure to submit the required information.

Supplementary regulations on CbC reporting

The latest proposed amendments to the LCITA-PED require CbC reporting by the ultimate Korean parent company of a multinational consolidated group, whose consolidated revenue for the preceding year exceeds KRW 1 trillion. However, **the Korean subsidiary of a multinational group may be required to file the CbC Report (secondary filing requirement)** if the foreign ultimate parent company’s tax jurisdiction does not have CbC reporting rules in place, or if it is not possible for the Korean National Tax Service (“NTS”) to electronically exchange the CbC Report with the ultimate parent company’s tax jurisdiction due to reasons such as the lack of a double tax treaty between Korea and the ultimate parent company’s

jurisdiction.

According to the proposed amendments to the LCITA-PED, the CbC Report must be submitted in Korean and English, including information on a **multinational group’s revenues earned in each country, profit (loss) before income tax, income taxes paid, stated capital, main business activities**, etc.

Also, the latest proposed amendments to the LCITA-PED require domestic corporations and foreign invested corporations in Korea to **submit to the NTS advance notification on the entity responsible for filing the CbC Report within six months from the end of the fiscal year**. In case a foreign invested corporation fails to submit the advance notification by the deadline, the Korean

subsidiary will be required to file the CbC Report for the fiscal year (further details on the advance notification form will be announced by the MOSF).

The latest proposed amendments to the LCITA-PED can be regarded as an additional effort to align the Korean transfer pricing regulations more closely with the requirements of the OECD BEPS Action 13. It should be noted that the latest proposed amendments require taxpayers to notify the NTS which entity within their multinational group will bear the obligations for filing the CbC Report within six months following the end of the fiscal year, and there is a chance that penalties may be assessed for failure to comply with the advance notification requirement.

Arm's length interest rates for international intercompany financial transactions

The existing regulations specified in the LCITA require taxpayers to calculate the arm's length interest rates for international intercompany financial transactions, considering the amount and maturity of the principal, availability of guarantee, and the credit level of the debtor.

However, the latest proposed amendments to the LCITA-PED state that taxpayers can adopt those rates issued by the MOSF as arm's length interest rates, determined by the Ministry by taking into account various factors including each country's base rates, lending and deposit interest rates.

Such amendments can be seen as a significant measure to provide more convenience to taxpayers. However, where a taxpayer has applied interest rates in accordance with a global TP policy, it may trigger challenges from the NTS and shift the burden of proof to the taxpayer to demonstrate the arm's length nature of the applied interest rates. **In case there is a gap between the interest rates applied by a taxpayer and those deemed as arm's length by the MOSF, it could potentially pose a serious tax risk.** Proper

documentation to support the arm's length nature of the applied interest rates will be key when dealing with a substantial volume of international intercompany financial transactions.

Exemption for filing a Local file if covered by an Advance Pricing Agreement

In response to the legislation for CRIT under the LCITA, many corporations in Korea continuously called for the NTS to relieve the obligation of taxpayers to submit the required information where an Advance Pricing Agreement ("APA") is in place. The latest proposed changes to the LCITA-PED provide that **taxpayers are exempted from submitting a Local file with regard to intercompany transactions covered by an APA for the duration of the APA coverage period.** This decision was made considering not only the fact that the documents required for the application of an APA are similar to those for a Local file, but also an APA approved by the Commissioner of the NTS provides certainty regarding the transfer prices applied, and APA annual reports are submitted every year to the NTS to demonstrate the taxpayer's compliance with the application of arm's length transfer prices.

Revisions to the relevant penalty rules

The draft amendments to the LCITA-PED include the MOSF's intention to refine the penalty assessment methods and the waiver rules in cases of a taxpayer's failure to submit a Summary of International Intercompany Transactions as part of the annual corporate tax return or comply with the CRIT requirements.

In relation to the Summary of International Intercompany Transactions, the draft LCITA-PED proposes imposing a penalty for non-disclosure of KRW 5 million per foreign transaction counterpart, as opposed to the existing single penalty charge of KRW 10 million covering all foreign related entities. Also, the draft LCITA-PED proposes to change the

penalty of KRW 30 million for failure to file the CRIT in whole or in part, to imposing a penalty of KRW 10 million for each instance of failure to submit each element of the CRIT. Accordingly, **such amendments to the existing rules will result in penalties imposed in proportion to the level of non-compliance by taxpayers, while penalties are waived for minor errors.**

Waiver of the under-reporting penalty

Under Article 13 of the LCITA, taxpayers were eligible for a waiver of the under-reporting penalty (if subject to a transfer pricing assessment as a result of the tax audit) if they prepared and maintained contemporaneous transfer pricing documentation (“TPD”) by the time of filing their corporate income tax return.

However, taxpayers required to prepare the Local file for the fiscal year beginning on or after January 1, 2016 have an extended deadline whereby they would have to prepare and submit the Local file within 12 months from the end of the fiscal year. In such case, despite the extended deadline for submission of the Local file, it is expected that those taxpayers that do not prepare the Local file by the time of filing of the corporate income tax return will not be eligible for the waiver of the under-reporting penalty under Article 13 of the LCITA.

For those taxpayers who wish to be eligible for the under-reporting penalty waiver, the Local file must be prepared and maintained by the due date of filing the corporate income tax return. This mismatch between the extended deadline for filing the Local file and the original deadline for the under-reporting penalty waiver provisions is a remaining area which requires further alignment by the MOSF to comply with its original intent of providing more convenience to taxpayers.

Conclusion

With the latest proposed amendments of the LCITA-PED on the CRIT, the LCITA reflects most of

the OECD BEPS Actions 13 requirements. As such, it is recommended that all corporations take into consideration any potential transfer pricing risks that may be identified from the preparation and submission of the CRIT.

In addition, considering that the CRIT is required for the fiscal year beginning on or after January 1, 2016 and the relevant rules will continue to be subject to amendments, it is highly advisable that taxpayers stay up to date with the latest Enforcement Regulations and MOSF Announcements on the CRIT.

Samil is continuing to engage with the MOSF and the NTS, as well as other key stakeholders, to share opinions regarding the proposed amendments and promise the timely delivery of any new information and tax strategy proposals to our clients.

If there are any additional questions regarding the matters above, please contact the Samil PwC Transfer Pricing Team.

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