
Korea introduces new transfer pricing documentation requirements

January 20, 2016

In brief

On December 15, 2015, Korea's Ministry of Strategy and Finance (MOSF) introduced the Combined Report of International Transactions (CRIT) to better align the transfer pricing documentation requirements contained in the Law for the Coordination of International Tax Affairs (LCITA) with Action 13 of the OECD's Base Erosion and Profit Shifting (BEPS) project.

The CRIT, in its current form, is comprised of a Master file and Local file. Proposed amendments to the Presidential Enforcement Decree (LCITA-PED) released on December 24, 2015 provide more detailed guidance on the specific application of the new CRIT requirements. Under the proposed amendments, all corporations (domestic or foreign) engaging in cross-border related-party transactions exceeding KRW 50 billion and reporting sales revenue exceeding KRW 100 billion during the relevant fiscal year must submit both a Master file and a Local file to the local tax office by the corporate tax return filing deadline (i.e., three months after fiscal year-end). The new requirements will apply to taxpayers with fiscal years beginning on or after January 1, 2016.

In detail

Who is subject to CRIT?

According to the proposed amendments to the LCITA-PED, the CRIT requirement will apply to domestic corporations and foreign corporations having a domestic place of business that meet both of the following criteria during the fiscal year:

- Cross-border related-party transaction volume in excess of KRW 50 billion; and
- Sales revenue in excess of KRW 100 billion.

While taxpayers falling below either of these thresholds will

not be subject to the CRIT requirement, they still will be obligated to submit transfer pricing documentation requested by the tax authority (typically in the context of an information request or during a tax audit) in accordance with Article 11, Paragraph 3 of the LCITA.

What needs to be submitted?

The CRIT, in its current form, is comprised of two elements: a Master file and a Local file. The Master file should provide a perspective on the overall business, including organization structure, description of business, intangible assets, and

financing activities. The Local file should include information on local organizational structure, business information, and financial summary, and demonstrate the arm's-length nature of the local entity's intercompany transactions with overseas related parties.

While further details on the type of information that should be included in the CRIT are expected to be set forth in the Enforcement Decree of the LCITA, the contents of the Master file and Local file likely should be consistent with the guidance set forth in the OECD's Final Report on BEPS Action 13.

The Master file should be submitted by either the corporation responsible for submitting the Local file or the ultimate parent company of the business segment that owns voting shares of the corporation and has substantial influence over business operations. For example, if a domestic holding company maintains ownership of multiple entities across various industries, the subsidiary maintaining the highest level of control within each business segment may be responsible for the preparation and submission of the Master file. If the aforementioned ultimate parent company is not located in Korea, the corporation responsible for submitting the Local file must obtain the Master file from the ultimate parent company.

Both the Master file and Local file should be prepared in Korean. While the Master file initially may be submitted in English, a Korean translation of the Master file must be prepared and submitted within one month of the submission date of the English version.

Note: While country-by-country reporting (CbCR) has not been included in the CRIT in its current form, it is anticipated that the MOSF will draft legislation adopting CbCR as early as next year.

Deadline for submission

Taxpayers that are subject to the CRIT requirement must submit both a Master file and Local file to the local tax office by the corporate tax return filing due date (i.e., within three months of the fiscal year-end). A taxpayer may apply for an extension of the deadline for up to a year based on legitimate reasons. Note that an extension request must be made at least 15 days prior to the deadline and that extensions are granted at the discretion of the local tax office.

Penalties for noncompliance

Taxpayers failing to submit the CRIT (in whole or in part) or found to submit incorrect information will be subject to penalties of KRW 30 million. In addition to penalties, a taxpayer also may forfeit the ability to effectively utilize the content of the CRIT to support the arm's-length nature of its transfer pricing arrangements.

Effective date

The CRIT requirement is effective for fiscal years beginning on or after January 1, 2016.

The takeaway

The introduction of CRIT represents a fundamental change in the Korean transfer pricing documentation requirements. Taxpayers subject to CRIT essentially must “file” their transfer pricing documentation with the local tax office as a matter of annual compliance, as opposed to submitting documentation upon request under the prior regime.

While the new CRIT requirement is intended to better align the Korean transfer pricing documentation requirements with Action 13 of the OECD's BEPS project, it does not represent full alignment, at least not in its current form. Most notably, CRIT currently comprises only a Master file and a Local file and does not include CbCR, although CbCR likely will be adopted as early as next year. Another important point of distinction is the relatively low threshold set for companies subject to the CRIT requirement, i.e., companies engaging in cross-border related-party transactions exceeding KRW 50 billion and reporting sales revenue exceeding KRW 100 billion during the fiscal year.

Finally, there are several aspects of the CRIT requirements that may be

challenging to comply with, particularly for foreign-based MNCs. First, the short deadline for submission (three months after the close of the fiscal year if extension is not granted) falls well ahead of tax return filing deadlines in most other jurisdictions. Second, the requirement for documentation to be submitted in Korean represents an additional layer of compliance burden on taxpayers. Accordingly, taxpayers subject to the CRIT requirement should be mindful of deadlines and language requirements to ensure that fully compliant documentation is prepared in a timely manner.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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