

Samil TP & Customs Report

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About the Customs Practice:

Samil PricewaterhouseCoopers ("Samil PwC") is the preeminent transfer pricing and customs advisor. With nearly 60 full-time professionals, we are the largest transfer pricing and customs practice in Korea - by far. Our multidisciplinary team of specialists includes experts in law, economics, finance, tax, customs, international trade and accounting. Our senior professionals serve as external advisors to the National Tax Service ("NTS"), Korea Customs Service ("KCS") and Ministry of Strategy and Finance ("MOSF") on tax and customs policy and regulatory matters. We are an active member of the PwC Global Network and an integral part of the Samil PwC tax practice, which is comprised of nearly 600 professionals and is the largest in Korea.

For more information on how the Samil PwC transfer pricing and customs practice can help you, please contact:

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2011 Proposed Amendments to Transfer Pricing and Customs Laws

The Ministry of Strategy and Finance ("MOSF") has recognized that differences between transfer pricing rules under the Law for Coordination of International Tax Affairs ("LCITA") and customs valuation rules under the Customs Law pose difficulties to taxpayers. The amendments are to not only harmonize the differences in regimes but also to improve transfer pricing and customs valuation systems as well as customs duty assessments to protect the rights and interests of taxpayers.

Major Amendments:

1. Correlative Adjustments between Transfer Pricing and Customs Value for Import Transactions

Currently, if either the National Tax Service ("NTS") or the Korea Customs Service ("KCS") makes an assessment to a taxpayer's import transactions with related parties, the other authority is not obliged to make a corresponding adjustment (i.e. refund) of customs duties or corporate tax. This has resulted in double taxation and burdensome penalties for the taxpayer.

However, under the proposed amendment, if the NTS or KCS makes an assessment on import transactions between related parties and the taxpayer files a request for refund to the other authority, the other authority must make a correlative adjustment if it is determined that the adjusted price is appropriate.

In particular, in case where transfer prices and customs value in a related party transaction are determined differently, the taxable value can be adjusted through the Price Adjustment Decision Committee upon the taxpayer's request (Article 10(3) of the LCITA, Article 36(3) of the Customs Law). Furthermore, the amendment includes a newly established legal provision that allows the exchange of information between the NTS and the KCS in order to enhance accuracy in transaction value adjustments and improve the corporate tax and customs duty assessment process (Article 11(2) of the LCITA, Article 3(2) of the KCS). The amendment is expected to not only resolve the issue of double taxation and unreasonable penalties but also allow multinational companies to apply a harmonized transfer pricing policies. The amendment reinforces the importance of maintaining transfer pricing documentation not only for tax or customs audits but also to substantiate the appropriateness of transfer prices or customs value in the event of a correlative adjustment.

The amendment is expected to come into effect as of January 1, 2012. (The Price Adjustment Decision Committee comes into effect after July 1, 2012).

2. Opportunity to Present Taxpayer's Opinion in Determining Customs Value

Currently, taxpayers are not given the opportunity to justify themselves in the event that the KCS denies the transaction price that the taxpayer reported and re-determines the dutiable price. Going forward, if the transaction price is determined to be unacceptable due to a related party relationship, the KCS should notify the taxpayer of the basis of the decision and provide the taxpayer with an opportunity to present their position. (Article 30 of the Customs Law)

It is expected that this amendment will push the KCS to practice the principle of documentary taxation and determine reasonable dutiable prices. In addition, it is essential for a taxpayer wishing to present an opinion to prepare thorough and detailed documentation in the form of a transfer pricing study to justify the transaction value prior to the customs examination.

This amendment will take effect on imports after January 1st, 2012.

3. Improvement on Profit and General Expense Ratio under Method 4 of Customs Valuation

The customs price using Method 4 is calculated by deducting profit and general expenses from the domestic sales price. Currently, the profit and general expenses are calculated based on a standard ratio published by the Commissioner of the Korea Customs Service. The standard profit and general expense ratio is for the entire industry rather than just for the same kind or similar goods and may lead to distortions in calculating the dutiable customs value. Hence to increase accuracy of the customs value, the standard ratio will be abolished under the proposed amendment and the average general profit and expense ratio for importers of the same kind of goods is to be applied. (Article 27 of Enforcement Decree of the Customs Law)

By applying a profit and expense ratio more appropriate to the taxpayer (importer), the amendment is expected to improve the accuracy of the dutiable customs value and enhance taxpayer's rights. Thus for importers applying Method 4 (including taxpayers applying the tentative price), it is anticipated that a benchmarking study of similar importers should be periodically prepared.

This amendment will be effective from the enforcement date of the Customs Enforcement Decree.

4. Exemption from Penalties in Relation to Advance Customs Valuation Arrangement (ACVA)

Under the Advanced Customs Valuation Arrangement

(ACVA), taxpayers can obtain approval on the customs valuation method of goods to be imported in the future from the KCS in advance. However, taxpayers have been hesitant to enter into an ACVA with the KCS due to concerns over potential penalties for under-reporting customs duties prior to entering into the ACVA.

Under the proposed amendment, the 10% penalty will not be imposed on prior under-reporting if the taxpayer (1) has substantiating documents in place and (2) did not engage in any fraudulent activities such as manipulation of transactions. This provision will be applicable to applications for ACVA after the relevant Enforcement Decree comes into effect.

By providing retroactive coverage, the ACVA program is expected to provide elimination of customs risk for taxpayers for not only future periods but also for prior periods.

This amendment will be effective from the enforcement date of the Customs Enforcement Decree.

5. Establishment of Customs Ruling Examination Committee (CREC)

The proposed amendment calls for the establishment of the CREC under the Ministry of Strategy and Finance (MOSF) to interpret customs laws and thereby support inquiry and appeal procedures. (Article 5-2 of the Customs Law)

As such, taxpayers with inquiries in relation to interpretation of customs laws may first make inquiries to the KCS and if desired, then appeal against the KCS' interpretation to the MOSF.

Accordingly, it is expected that inquiries in relation to established regulations will be encouraged through this amendment, thereby minimizing disputes between the tax authorities and taxpayers in the field of customs similar to international tax.

This amendment will take effect from April 1st, 2012.

6. Establishment of Duty Amendment System

Currently, there is no remediation for a taxpayer whose customs base has changed after the statute of limitations has expired.

Through this proposal, however, a taxpayer may file a revised customs value after the expiration of the statute of limitations if there have been changes as a result of a court decision etc. (Article 21 and Article 38-3 of the Customs Law)

This amendment will be applicable for revised customs

filings made after January 1st, 2012.

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It is anticipated that these proposed amendments of the LCITA and Customs Law will significantly contribute to improving the drawbacks faced by taxpayers as a result of different legal systems and customs practices and harmonizing differences between transfer pricing and customs valuation systems. In particular, the proposed amendments contain measures that will protect taxpayers' interests and ensure reasonable customs duty taxation.

Therefore, taxpayers should familiarize themselves with the proposed amendments and be aware of the need to determine transfer prices (import prices) in advance, confer with the KCS, and posthumously manage customs prices.

While the proposed amendments are expected to provide benefits to taxpayers, they also increase the need for good faith effort on the part of taxpayers to maintain proper documentation to justify the reasonableness of transfer prices (import prices). As a result, going forward, it will be necessary for taxpayers to regularly prepare and maintain proper documentation not only for transfer pricing purposes but also for customs purposes.