Individual countries are entering into a double taxation avoidance treaty, which is a treaty signed between governments to avoid double taxation in order to promote the exchange of goods and services, increase flows of capital and people, and prevent tax avoidance or evasion. However, the increasing number of double taxation avoidance treaty cases have resulted in a surge of paper companies simultaneously enjoying tax benefits from their home countries and those from such treaties.

The OECD and G20 have already agreed to strengthen the practice of transfer pricing documentation to prevent Base Erosion and Profit Shifting (BEPS), which refers to tax planning strategies by multinational corporations that exploit the gaps and mismatch between different countries’ tax treaties or taxation systems to shift profits to low-tax countries.

As a result, the signatories to BEPS consented to implement the transfer pricing documentation. The practice will ensure taxation transparency among multinational corporations and allow the tax authorities of the participating countries to obtain transfer pricing information on a timely basis, as the system incorporates a master file, local file and country-by-country report.

A tighter implementation of transfer pricing documentation will lead to multinational corporations to maintain their financial transparency and consistency and will manage transfer pricing policy and its operation more systematically. There are still multinational corporations that have yet to establish any transfer pricing policy and those that have such policy already in place, but do not monitor the outcomes. As such, it has become necessary for these corporations to establish and implement a transfer pricing policy and build a new system to monitor the results.

In Korea, the Adjustment of International Taxes Act (the “Act”) in December 2015 was amended as part of the effort to be in line with international norms. Under the amended Act, it has become necessary to provide information on the international transactions performed by multinational corporations. Since a number of foreign-invested companies now need to prepare the international related party transaction integrated report, the Office of the Foreign Investment Ombudsman (OIO) has decided to provide necessary information in order to correctly prepare such reports.

Under the Act, any domestic corporation, or any foreign corporation with permanent establishments in Korea conducting foreign related-party transactions of an amount above a certain threshold (i.e. annual combined amount of transactions regarding services, goods and loans or borrowings exceeding KRW 50 billion (USD 43.75 million)) and involving a certain amount of sales (i.e. over KRW 100 billion (USD 87.5 million)) must submit the international related party transaction integrated report.

The report shall accompany an integrated corporate report as the master file, and an individual corporate report as the local file. The integrated corporate report shall contain such information as the organization structure, items of business, intangible assets, capital raising activities and financial status, among others, while the individual corporate report shall contain information on the description of the organization or business of individual corporations within an affiliated group, transaction details with persons with a special relationship, calculation of the transfer price of relevant transactions and financial status.

Corporations required to prepare an integrated corporate report must prepare a consolidated financial statement that includes taxpayers. If the number of such consolidated financial statement including taxpayers is two or more, the report shall be prepared by the corporation responsible for the preparation of the consolidated financial statements at the highest level.

The international related party transaction integrated report shall be submitted to the head of the competent tax office by the deadline for filing of the corporate tax return. The individual corporate report may be submitted in Korean, but the integrated corporate report may be submitted in English subject to the condition that a Korean translation version shall follow in one month.

Failure to submit the said reports within the due date shall be subject to a penalty surcharge of KRW 30 million (USD 26,250). However, the period may be extended by up to one year if applicable.

The purpose of the amendment to the Adjustment of International Taxes Act is to prevent tax evasion by improving transparency in cross-border transactions by multinational corporations. Please note that the application of the Act begins with the cases that require a submission of the international related party transaction integrated report on the tax year commencing from January 1, 2016, and make sure to allow sufficient time for its preparation.

Should there be any questions in relation to the preparation and submission of the report, please contact Mr. Tong-Wha Oh, Executive Consultant specializing in the area of tax and accounting at the Office of the Foreign Investment Ombudsman (02- 3497-1687).

By the Office of the Foreign Investment Ombudsman dhwa@kotra.or.kr