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Overview

Yulchon LLC, Taxand Korea

Yulchon's Transfer Pricing Team provides top-tier one-stop service for leading Korean and foreign multinational enterprises (the "MNEs") in relation to all types of transfer pricing issues, including the following:

- Establishment of global transfer pricing policies (including benchmarking analysis, tax review, and intercompany agreement preparation)
- Preparation of transfer pricing documentation (including local file, master file, and country-by-country report)
- Tax risk assessments and tax audit defense
- Tax due diligence
- Assistance with APA (Advance Pricing Agreement) and MAP (Mutual Agreement Procedure) applications
- Assistance with tax appeals and tax litigation

International Tax Review selected Yulchon as the "*South Korea Transfer Pricing Firm of the Year,*" and various other international organizations have recognized Yulchon's transfer pricing expertise and capabilities.

General : Transfer Pricing Framework

The transfer pricing legislation is governed by the Adjustment of International Taxes Act (the "AITA"), which is commonly known as the Law for Coordination of International Tax Affairs in practice. The AITA, the Presidential Decree

of the AITA, and the Enforcement Regulation of the AITA do not specifically contain a reference to the OECD Guidelines, but the AITA is mostly consistent with the OECD Guidelines, which are used as a reference in making and implementing transfer pricing related policies and amendments.

The AITA specifies the arm's length principle to be applied to overseas intercompany transactions and also requires transfer pricing documentation for certain types of MNEs.

Accepted Transfer Pricing Methodologies

The AITA generally follows the OECD principles that it enlists the same 5 transfer pricing methods, which include the (1) Comparable Uncontrolled Price Method, (2) Resale Price Method, (3) Cost Plus Method, (4) Profit Split Method, and (5) Transactional Net Margin Method.

Without a hierarchy of methods, the most appropriate and reliable method should be adopted among the five transfer pricing methods above considering all relevant factors and circumstances. Only where such five transfer pricing methods cannot be applied, other reasonable method (alternative method) can be selected and applied.

Transfer Pricing Documentation Requirements

Based on the currently effective AITA, MNEs with (i) the total amount of overseas intercompany transactions exceeding KRW 50 billion and (ii) the sales revenue exceeding KRW 100 billion are required to prepare and submit a Master File and Local File within 12 months from the fiscal year-end.

In addition, ultimate parent companies of MNEs with the sales revenue on the consolidated financial statement in the immediately preceding tax year exceeding KRW 1 trillion, etc. are required to prepare and submit a Country-by-Country Report (the "CbCR") within 12 months from the fiscal year-end. A reporting entity's CbCR notification form must be filed no later than 6 months of the fiscal year end of the Korean entity.

Other taxpayers engaged in overseas intercompany transactions below the threshold for the Master File and Local File are still required to maintain reasonable transfer pricing documentation (the "Contemporaneous Transfer Pricing Documentation") by the due date of filing the corporate tax return and submit it within 30 days upon the NTS's request.

Local Jurisdiction Benchmarks

Based on the AITA, benchmarks are required to compute a relevant arm's length price (range) for covered intercompany transactions.

Depending on selection of the tested party, regional / global or local comparables can be utilized. In case that the tested party is a Korean entity, local comparables using the local database, namely NICE BizLINE / Value Search (formerly KIS-Line / KIS-Value), are usually used and requested by the Korean tax authority, the National Tax Service (the "NTS").

During tax audits, the NTS challenges the appropriateness of taxpayers' benchmarks such as applied screening criteria, etc., and in particular, the NTS mostly likely raises an issue of using regional / global benchmarks when the tested party is a Korean entity. The NTS, however, does not use secret comparables for transfer pricing assessment purposes.

Similar to other countries, the Transactional Net Margin Method is a commonly applied method with various profit level indicators such as operating margin and full cost plus markup.

If a taxpayer may prove appropriateness of internal CUPs, such information can be utilized to defend its transfer prices.

Focus on Financial Transactions

Under Korean law, the tax authorities' approach to intercompany financial transactions heavily focuses on the factual attributes of the debt and the borrower's economic profile. More specifically, the regulations require that the arm's-length interest rate be assessed by reference to the principal amount, debt maturity, the existence of guarantees, and the borrower's creditworthiness. This entails verifying the rate through the comparable uncontrolled price (CUP) method with appropriate comparability adjustments, or by utilizing internationally accepted financial pricing models. Additionally, while a safe harbor rate is prescribed, recent case law dictates that the tax authorities cannot uniformly impose it in place of a taxpayer's own arm's-length benchmarking analysis.

Furthermore, the Korean tax authorities' regulatory framework—reflecting the OECD 2020 guidance—demands a strict assessment of treasury functions and economic substance within cash pooling arrangements. Entities performing only limited intermediary or coordination functions are evaluated under service transaction methods, whereas the assumption of financial risks and active management of group funds must be evaluated under financial transaction methods.

Finally, this transfer pricing analysis involves a detailed allocation of synergy benefits among cash pooling participants, which must account for the duration of participation, group risk management policies, cross-guarantees, and the respective functions, assets, and risks of each entity.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Based on the AITA, both unilateral APA (the "UAPA") and bilateral APA (the "BAPA") applications are possible, and general APA process is same as other jurisdictions as follows:

- [Step 1] Pre-filing Meeting
- [Step 2] Application and Commencement
- [Step 3] Examination and Negotiation (Exchange of Position Paper and CA Meeting)
- [Step 4] Closing (Closing Letter and Notification of APA Approval)
- [Step 5] Follow-up Management (Annual Report)

There are no specific qualification requirements for the APA applications, and there is no APA application filing fee in Korea.

Based on the NTS' most recent 2024 APA Annual Report, the average time to conclusion for all years was 21 months for UAPAs and 31 months for BAPAs. Of the 809 APAs concluded by 2024 on a cumulative basis, 542 (67%) cases covered a period of 5 years, and 419 (52%) cases were concluded with a roll-back, of which 118 cases covered a 3-year rollback.

Transfer Pricing Audits

The NTS conducts tax audits at random, and all MNEs are subject to tax audit for any open period. The ordinary statute of limitations period is 5 years in Korea. Under current guidance, when an MNE is audited, the transfer pricing documentation reports are to be requested as one of the initially requested information. Tax auditors usually review all transfer pricing related topics (e.g., all overseas intercompany transactions with all related parties).

The Burden of Proof in Transfer Pricing: Theory versus Practice

In Korea, the allocation of the burden of proof in transfer pricing disputes is a key factor in determining tax assessments and litigation outcomes. The fundamental principle is that the tax authorities bear the initial burden of proving that a taxpayer's transfer prices deviate from the arm's length principle. However, this burden may shift to the taxpayer if they fail to meet statutory documentation obligations. Korean tax law mandates that taxpayers maintain sufficient documentation to substantiate their transfer prices, particularly through Master File and Local File (or contemporaneous transfer pricing documentation) requirements under the Adjustment of International Taxes Act.

In practice, however, the distribution of the burden of proof does not always align with this legal framework. Rather than presenting substantive evidence, tax authorities frequently rely on broad assertions, shifting the practical burden onto taxpayers. This is particularly evident during tax audits, where authorities often challenge a company's pricing methodology without first demonstrating that their own adjustments are reasonable. As a result, taxpayers may find themselves required to provide extensive justification for their pricing, even when tax authorities have not adequately substantiated their claims. Since Supreme Court Decision 99Du3423 Decided October 23, 2001, the Korean Supreme Court has consistently ruled that tax authorities must first establish the reliability of their own transfer pricing determinations before shifting the burden to the taxpayer. However, despite these precedents, taxpayers frequently end up in a defensive position, compelled to submit extensive evidence to counter tax authorities' often unsubstantiated challenges.

Given this practice, companies must take a proactive approach to transfer pricing compliance. Fulfilling statutory documentation requirements is necessary but often insufficient to withstand scrutiny. Taxpayers should go beyond minimum compliance and prepare detailed economic analyses, comparability studies, and functional reviews to ensure their pricing positions are defensible. The OECD Transfer Pricing Guidelines advocate for reasonableness and balance in tax authority adjustments, but in Korea, disputes often hinge less on whether tax authorities have proven their case and more on whether the taxpayer can sufficiently justify its pricing. As a result, high-quality documentation is no longer just a regulatory obligation but a strategic necessity. Companies should anticipate that their transfer pricing methodologies may be challenged and ensure they are well-prepared to defend their positions with substantive evidence. A proactive stance in documentation and dispute resolution is essential to mitigating the risk of unfavorable tax adjustments and securing a stronger position in transfer pricing compliance.

Transfer Pricing Penalties

There are no specific transfer pricing penalties for under-reporting and late payment of tax, but general penalties apply for transfer pricing assessments, which include (i) the penalty for under-reporting, 10% of the assessed tax amount (60% for fraudulent cross-border transactions) and (ii) the penalty for late payment, which is interest charge in nature, at 8.03% per annum.

If a taxpayer has reasonably prepared and submitted a Local File and Master File or a Contemporaneous Transfer Pricing Documentation in good-faith, the under-reporting penalty tax may be waived.

Failure to submit transfer pricing-related documents or the submission of false or incomplete information may result in administrative fines ranging from KRW 30 million to 70 million. If non-compliance continues after a corrective notice period (generally 30 days), additional administrative fines of up to KRW 200 million may be imposed. Furthermore, newly introduced enforcement fines apply when taxpayers fail to submit requested books or documents during a tax audit without justifiable cause. These enforcement fines accrue on a daily basis—up to 0.3% of the average daily revenue or KRW 5 million per day—until the submission is made or the audit is closed.

Local Hot Topics and Recent Updates

The NTS has recently conducted more aggressive tax audits challenging various transfer pricing issues, and some of the notable developments are as follows.

- General view and approach: Tax auditors frequently target industries that have experienced significant profit pattern shifts in recent years. Furthermore, the mere filing of an APA application prior to its formal conclusion remains subject to a full transfer pricing review during a tax audit. Overall, transfer pricing issues continue to be a top priority for multinational enterprises, regardless of whether they are domestically or foreign-headquartered.
- Significant factual findings based on substance-over-form rule: Tax auditors persistently request substantial transfer pricing information from foreign affiliates. In addition, they conduct extensive functional interviews to verify consistency with the taxpayer's transfer pricing documentation. There is also an increasing emphasis on scrutinizing both the legal form and the economic substance of transactions, along with a strict requirement for a legitimate business rationale in relation to business restructurings.
- Reconstruction of a taxpayer's transfer pricing policy: Tax auditors conduct various simulations and scenario analyses that ultimately lead to transfer pricing assessments. This often involves adjustments to the selected transfer pricing method, modifying the profit level indicator, and/or changing the tested party. Additionally, auditors frequently challenge the arm's length interest rates of intercompany loan transactions by expecting the application of safe harbor rates.

Effective January 1, 2026, a Korean downward transfer pricing adjustment now requires either a prior tax assessment or a corresponding adjustment by the counterparty jurisdiction in respect of the same intercompany transaction. This provides a domestically administered route that can be utilized when a foreign tax authority makes an assessment, though the NTS retains full authority to review the arm's length basis of the requested adjustment during the refund claim process.

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Documentation Threshold

Master file	(i) the total amount of overseas intercompany transactions exceeding KRW 50 billion and (ii) the sales revenue exceeding KRW 100 billion
Local file	(i) the total amount of overseas intercompany transactions exceeding KRW 50 billion and (ii) the sales revenue exceeding KRW 100 billion
CbCR	the sales revenue on the consolidated financial statement in the immediately preceding tax year exceeding KRW 1 trillion

Submission Deadline

Master file	within 12 months from the fiscal year-end
Local file	within 12 months from the fiscal year-end
CbCR	within 12 months from the fiscal year-end

Penalty Provisions

Documentation – late filing provision	an administrative fine of KRW 30 million for each type of documentation, with an additional fine of up to KRW 200 million if non-compliance continues after a corrective notice period (generally 30 days)
Tax return disclosure – late/incomplete/no filing	an administrative fine ranging from KRW 5 million to 70 million depending on the specific tax return form, with an additional fine of up to KRW 200 million if non-compliance continues after a corrective notice period (generally 30 days)
CbCR – late/incomplete/no filing	an administrative fine of KRW 30 million, with an additional fine of up to KRW 200 million if non-compliance continues after a corrective notice period (generally 30 days)
Enforcement fines – failure to submit requested documents during tax audits	enforcement fines accruing on a daily basis (up to 0.3% of average daily revenue or KRW 5 million per day) until submission or audit closure, applied when taxpayers fail to submit requested books or documents without justifiable cause

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