

# Tax Credits

## Personal Details

Document No. 38220-1

Number 1

Number 2

The number above is required.

Your first name and initial

Last name

Nationality

Phone Number

Address (street and number), see instructions.

City, town, street and ZIP code, see instructions.

Checking a box for confirmation (See instructions on page 12)

You  Spouse

Single  Married  Divorced

Yes  No

Others

Income

1 It is a process to allow an organization to focus resources on the greatest.

## Tax News

# Review of deductibility of intra-group service fee for the Korean tax purposes

### Nature of Intra-Group Services

Generally speaking, the intra-group services between related parties in a multinational enterprise ("MNE") group are provided for the improvement of cost-efficiency and effectiveness of business activities of such groups. For example, as all the subsidiaries of a MNE group cannot hire their local lawyer for their legal issues in each jurisdiction from a cost-benefit perspective. Instead, the foreign headquarter can hire the in-house legal counsel in order to mitigate and manage the common legal exposures or issues of the group, which will provide some benefits to all the subsidiaries. In this regard, the costs for the in-house legal counsel plus an arm's length mark-up need to be charged to the subsidiaries. As this is very natural, not only OECD TP Guideline but also the Korean tax law basically allow a Korean subsidiary to bear such charges with that concept from the intra-group service center of the headquarter or regional headquarter if some requirements are met.

### Basic Requirements for the Deductibility

Under the Korean International Tax Coordination Law ("ITCL")<sup>1</sup>, the intra-group service fee paid to the foreign related party can be deductible for Korean corporate income tax purpose when the following four conditions are met.

- (1) The relevant service agreement should be made in advance before the provision of services and the service provider actually perform such services under such agreement;
- (2) The service recipient should get the expectation on income generation or cost reduction from the provided services;
- (3) The service fee is determined at the arm's length price; and
- (4) The service recipient should keep the evidence documents supporting the fulfillment of the conditions of (1)-(3) in the above.

1. Article 6-3 of Presidential Decree of ITCL

**Table** Comparison of Direct-charge Method and Indirect-charge Method

Check point	Direct-charge method	Indirect-charge method
Basic feature	One-to-one mapping between service fee and service deliverable is possible – the services performed and the basis for the payment are clearly identified.	The one-to-one mapping is impossible and the collected costs per service category shall be charged to the service recipients by using allocation and apportionment methods with some mark-up.
Service deliverable	Clear – report, slide deck, manual, program, etc.	Unclear – email, conference call, meeting, stand-by, etc.
Benefits and relevancy	Strong – Contract and deliverable act as evidence	Weak – Hard to find the evidence on income generation and cost reduction
Documentation	Easy – Contract and deliverable can act as evidence	Difficult – Need to collect the evidences with separate efforts
Korean tax authority's position	Not challengeable (excluding arm's length price)	Challengeable on the deductibility itself

### Comparison of Direct-charge Method and Indirect-charge Method

The services from a third-party service provider are essentially based on the direct-charge method. However, most of intra-group services are based on the in-direct charge method. Hence, it is of importance to compare both methods for understanding the potential exposures of the in-direct charge method.

### Introduction of low Value-adding Intra-group Services under 2016 OECD TP Guideline

#### 1. Definition of low value-adding intra-group services

Under the OECD TP Guideline, low value-adding intra-group services i) are of a supportive nature, ii) are not part of the core business of the MNE group, iii) do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and iv) do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider.

#### 2. Simplified determination of arm's length charges for low value-adding intra-group services

Basically, the simplified approach means that a tax administration allows its tax payers to reduce the compliance effort of meeting the benefits test and in demonstrating arm's length charges for low value-adding intra-group services as long as they comply with the obligation on documentation and reporting.

- (1) Benefits test: It should be verified that the activities by the service provider provide the service recipients expected to pay for the services with economic or commercial value to enhance or maintain the service recipients' commercial position.
- (2) Arm's length charges: The same mark-up of 5% shall be utilized for all low value-adding intra-group services irrespective of the categories of services.

#### 3. Documentation and reporting

An MNE group electing for application of this simplified methodology shall prepare the following information and documentation: (1) A description of the categories of low value-adding intra-group services provided, etc.; (2) Written contracts or agreements for the provision of services, etc.; (3)

Documentation and calculations showing the determination of the cost pool as described in the paragraph above and of the mark-up applied thereon, etc.; (4) Calculations showing the application of the specified allocation key.

### Recommendations

#### Annual documentation on the service deliverables per service category

In addition to the documentation mentioned in the above paragraph, it is highly recommended that a Korean subsidiary having the intra-group service payments will document the service deliverables showing the service benefits per service category on an annual basis. For example, if the global legal counsel charges some intra-group service fees to a Korean subsidiary annually, such subsidiary shall collect and keep group legal consultation materials such as global legal policy update, legal review points of a certain contract, email advice, meeting material, training material, etc. on an annual basis. They shall be good supporting evidences for the deductibility of intra-group service fee for every fiscal year.

#### Utilization of the concept of low value-adding intra-group service fee in OECD TP Guideline

As low value-adding intra-group services are of a supportive and administrative nature, they have been challenged as weak relevancy items in connection with the benefits test in the past tax audit practice in Korea. However, as the OECD TP Guideline allows the tax payer to reduce the compliance effort of meeting the benefits test, the Korean taxpayers may argue that the Korean tax authority must not any more trigger the weak relevancy issue on the service categories having a supportive and administrative nature.

#### Utilization of a professional service firm for the documentation, etc.

If it is difficult for a Korean subsidiary to start the review, documentation and reporting of the deductibility issue of intra-group service fees, it is advisable that the subsidiary receives a professional firm's assistance on this issue.

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