

Transfer Pricing News

Update on audit procedures

February 2013



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The revision of the Act on General Rules for National Taxes (clarification of audit procedures) and its impact on transfer pricing audits.
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The Act on General Rules for National Taxes ("AGNT") was revised in 2011 to include a new chapter "7-2 Examinations of National Taxes" to clarify procedures to be taken during a tax examination effective January 1, 2013. Most notably, these procedures include the following:

- When commencing a tax examination, the tax authorities should, in principle, provide the taxpayer with a formal notice of examination. The notice should include information on the purpose of the examination, the tax type (e.g., corporate tax, consumption tax or income tax, otherwise known as "tax units"), and the taxable period to be covered by the examination (Article 74-9);
- When concluding a tax examination, if the tax authorities do not consider that an assessment should be made, the authorities should notify the taxpayer accordingly in writing (Article 74-11, paragraph 1). If the tax authorities consider that an assessment should be made, they shall provide the taxpayer with information on the results of the examination (Article 74-11, paragraph 2); and

- The tax authorities may conduct a re-examination only “when it is regarded that there is an error in light of newly-available information” with respect to a taxable period on which the tax authorities have already concluded an examination (Article 74-11, paragraph 6). In other words, once an audit is complete, those years are closed to further review so long as no new information comes to light that would have otherwise affected the result of that audit.

In accordance with Article 74-9 of the AGNT, as noted above, both the taxable period and type of tax to be covered by a tax examination are required to be defined in a formal notice of examination. While transfer pricing has until now typically been examined separately to general corporate tax, as transfer pricing falls under the corporate tax umbrella (i.e., corporate tax and transfer pricing are considered to be part of the same “tax type”), transfer pricing is now covered by, and thus can be reviewed during, a single corporate tax examination.

In this respect the National Tax Authority (“NTA”) has issued a Commissioner’s Directive on Interpretation of the AGNT in relation to Chapter 7-2 “Examinations of National Taxes” (the “Directive”), which provides that a transfer pricing examination may be separated from a general examination so as to “lighten the burden of a taxpayer when the taxpayer’s prior consent is available” (Article 3-1, paragraph (4)(a) of the Directive). While the specific mechanism for consent is yet unclear, the tax authorities may request prior approval from a taxpayer to separate transfer pricing and general corporate tax examinations, with each examination being treated as separate examination for the purposes of the Act. Effectively, by obtaining a taxpayer’s prior consent, transfer pricing and general corporate tax examinations will be conducted as they have been to date.

The Directive raises the question as to whether a taxpayer should or should not provide consent to separate transfer pricing and general corporate tax examinations. The choice to include or exclude transfer pricing as a tax item subject to examination may depend on the taxpayer’s resources to support both a corporate tax and transfer pricing audit, and the taxpayer’s own assessment of transfer pricing risk and the likelihood of a separate transfer pricing audit. It remains to be seen how tax examiners may react to the taxpayer’s election to include or exclude transfer pricing in the corporate tax audit.

There is still some degree of uncertainty how the new audit procedures and the Directive will be implemented in practice. While this uncertainty still remains, the revisions may be generally viewed as positive step forward since it may provide taxpayers greater clarity and transparency on the tax examination process.

For more detailed information, please consult your international tax representative or contact any of the following members listed below:

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