

# IV Tax Administration in the Era of Globalization

The NTA promotes tax administration, including cooperation with foreign tax authorities to meet the era of globalization.

As multinational enterprises conduct various cross-border economic activities amid growing economic and social globalization, one country's taxation system and tax administration can have a great impact on other countries' taxation systems and enforcement. The environment surrounding tax administration has thus changed dramatically. The elimination of international tax avoidance and double taxation risks emerging from such environmental change has become a major issue for tax authorities worldwide. In this respect, it is necessary to develop common rules on international transactions, promote cooperation among tax authorities, and share experiences between them. In this situation, the NTA actively responds to the globalization of tax administration by enhancing mutual trust and cooperation with other countries. Furthermore, in order to tackle the problems of international tax avoidance and transfer pricing, the NTA is enhancing and strengthening its examination framework.

## 1 Addressing International Transactions

Concerning tax evasion and tax avoidance through the exploitation of cross-border transactions, the NTA implements proper taxation from the viewpoint of securing the taxing rights of our country, after properly grasping the facts through examinations. To this end, the NTA has enhanced the examination framework, such as increasing the number of senior examiners (international taxation), setting up a project team, and taking every opportunity available to collect information helpful to taxation through means such as grasping the flow of funds to foreign countries and making the best use of the exchange of information under the tax treaties. Furthermore, the NTA is properly handling transfer pricing issues arising from transactions between corporations and overseas affiliates through examinations.

### (1) Organization and staff for International Taxation

As cross-border business and investment activities of corporations and individuals expand, the importance of examination in relation to international taxation is increasing.

To this end, the NTA has increased the number of senior examiners (international taxation) and has endeavored to enhance and strengthen the examination framework, such as setting up international examination divisions in the Tokyo, Osaka, Nagoya, and Kanto-Shinetsu Taxation Bureaus. In recent years, international taxation problems have begun to extend not only from large enterprises and corporations that have many overseas subsidiaries but also to wealthy individuals as well. In order to deal with such circumstances, the NTA established the

“Project Team to Deal with Internationalization” in the four regional taxation bureaus referred to above and is endeavoring to grasp or elucidate such tax avoidance schemes and collect information on financial assets held overseas by tax evaders.

Furthermore, from July 2007, the NTA has employed legal and financial specialists as senior examiners (international taxation) under fixed-term contracts to deal with complicated taxation problems.

In addition, the National Tax College, which is the organization for training staff, provides training courses on international tax law, tax treaties, financial transactions, and foreign languages with the aim of improving the capability of tax officials to examine international taxation.

## (2) International Tax Avoidance

International tax avoidance involving reducing tax liability by cleverly exploiting differences between national tax systems and tax treaties is developing into a major issue. Finance specialists, legal counsels, and tax experts have possibly become involved in international tax avoidance, and various entities such as sleeping partnership (Tokumei Kumiai) contracts, partnerships, LLC (limited liability companies) and similar, or complicated schemes making use of new financial technology, are used for international tax avoidance.

From the viewpoint of realizing proper and fair taxation, the NTA is endeavoring to grasp and elucidate the actual state of transactions, taking every opportunity available. If there are recognizable problems for taxation purposes, the NTA conducts close examinations and deals strictly with tax evaders, so that no partiality is generated for taxpayers. If any tax avoidance scheme arises that is difficult to deal with under the existing laws, the department in charge is to be requested to improve the system concerned.

## (3) Transfer Pricing Issues

If a company sets a price for a transaction with an overseas affiliated company different from the normal price for transaction with a third party (transfer price), it becomes possible to transfer the domestic profit to a foreign country. Under the transfer pricing taxation system, the profit is taxed after such a transfer price is changed to a normal price (this is called an “arm’s length price”) in calculation to prevent income from escaping abroad through transactions with overseas affiliated companies.

As the globalization of business activities develops, increasing numbers of transactions are subject to transfer

pricing taxation and the transactions have become more complicated. The NTA is striving to realize proper international taxation through the accurate implementation of the transfer pricing taxation system in order to deal with such changes in economic conditions and prevent the taxable income of our country from escaping abroad. At the same time, the NTA is endeavoring to clarify the operation of the system and improve the environment for using APA with the purpose of ensuring operational transparency and predictability for the taxpayer.

## (1) Improvement in Operational Transparency

While the NTA has endeavored to clarify application standards and operational policy for the transfer pricing taxation system through setting up and revising the directives concerning the interpretation of the laws and administrative guidelines for operation, the criteria for judgment were newly presented in June 2007 in relation to transactions for intangible assets and rendering of service in the “Commissioner’s Directive on the Operation of Transfer Pricing (Administrative Guidelines)” from the viewpoint of enhancing predictability for the taxpayer. At the same time, “Reference Case Studies on Application of Transfer Pricing Taxation” was newly prepared as its supplementary volume and made public after the procedures for solicitation of public comments were completed. This supplement describes the treatment for transfer pricing taxation purposes of a number of cases under certain preconditions.

### (2) APA

Based on the application from the taxpayer, the tax authority confirms in advance the method of calculating the arm’s length price for a transaction with an overseas affiliated company. Reflecting the increase in international transactions in recent years, the number of applications for APA is increasing. The NTA provides pre-filing consultation before the application for APA so that the taxpayer can smoothly use the APA process. The NTA has set up a counter in charge of pre-filing consultation in each of the regional taxation bureaus, and is endeavoring to improve the environment for the use of APA, such as posting an outline of the APA process and procedure for pre-filing consultation on the NTA website.

Considering the characteristics of transfer pricing taxation, the NTA introduced a system of grace of tax payment to mitigate double taxation burdens until an agreement is formed at bilateral consultations in the MAP.

### Reference Case Studies on Application of Transfer Pricing Taxation

In the Reference Case Studies on Application of Transfer Pricing Taxation, 26 examples mainly in relation to transactions involving intangible assets such as patent and know-how are taken up, using examples from recent taxation practices. After presenting a schematic of business relations, a summary of business and a summary of the foreign-related transactions, functions and activities of corporations and overseas affiliates for each example as preconditions, not only treatment for the purpose of transfer pricing taxation but also points aimed at and checked by the staff in charge of examination and APA review, are presented.

## (4) Exchange of Information under Tax Treaties

In international transactions, not only the risk of double taxation but also “taxation loopholes,” in which no tax is levied by any country, has been an issue. The tax authorities of each country have been enhancing their actions regarding international taxation in order to address various tax avoidance schemes, but proper information collection from outside the country is essential for proper and fair taxation. With this in mind, each country is reinforcing the exchange of information under the tax treaties.

Through the 2003 and 2006 tax reforms, Japan also developed legislation concerning the exchange of information,

including investigation on tax violations. In July 2007, a new Information Exchange Section was established in the International Operations Division of the NTA. Thus, the NTA has set up a system to respond to requests from foreign countries promptly and also proactively request their cooperation.

In addition, at the Joint International Tax Shelter Information Centre (JITSIC), of which Japan, U.S., Canada, Australia, and U.K. are members, efforts are actively made to elucidate tax avoidance schemes, consistent with the provisions of exchange of information under the bilateral tax treaties.

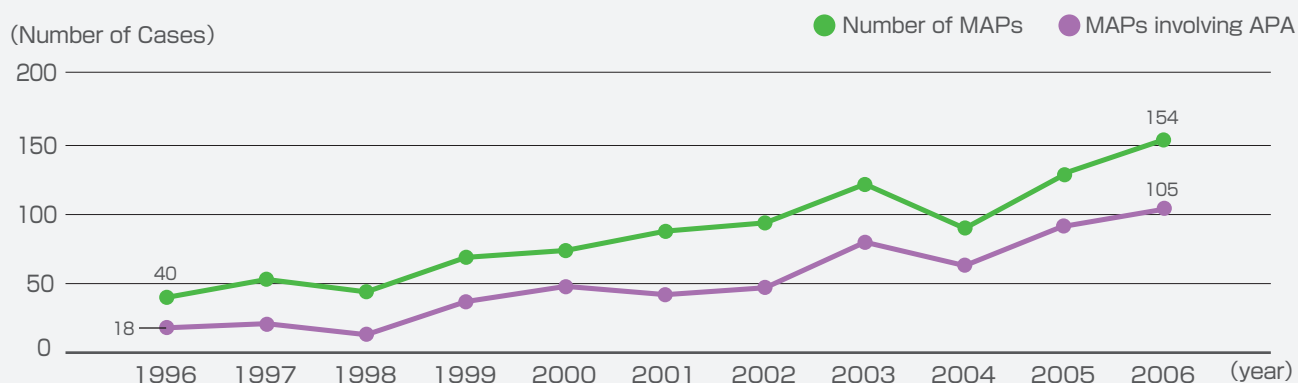
## 2 Mutual Agreement Procedure (MAP)

Using a system of mutual agreement procedures\* based on tax treaties, the NTA is striving to smoothly handle taxation issues, such as the prevention of international double taxation.

The number of cases of MAP is tending to increase in recent years, and more than 90% of cases are related to transfer pricing. As for cases of transfer pricing, an increasing number of cases involve APA. In the year from July 2006 to June 2007, 154 cases of MAP occurred, of which 140 cases were related to transfer pricing and 105 involving APA for transfer pricing. Compared to statistics of 10 years ago, the number of cases of MAP has increased approximately fourfold, while cases of MAP involving APA have also increased, approximately sixfold. The number of countries with which the NTA was under negotiation for MAP was 12 at the end of June 1997 and it increased to 25 at the end of June 2007.

Likewise, APAs with MAP have been recently increasing in relation with Asian countries, which have little experience in APAs. In order to resolve MAP-related cases properly and promptly, the NTA is enhancing cooperative relations with foreign tax authorities and engaging in discussion more effectively.

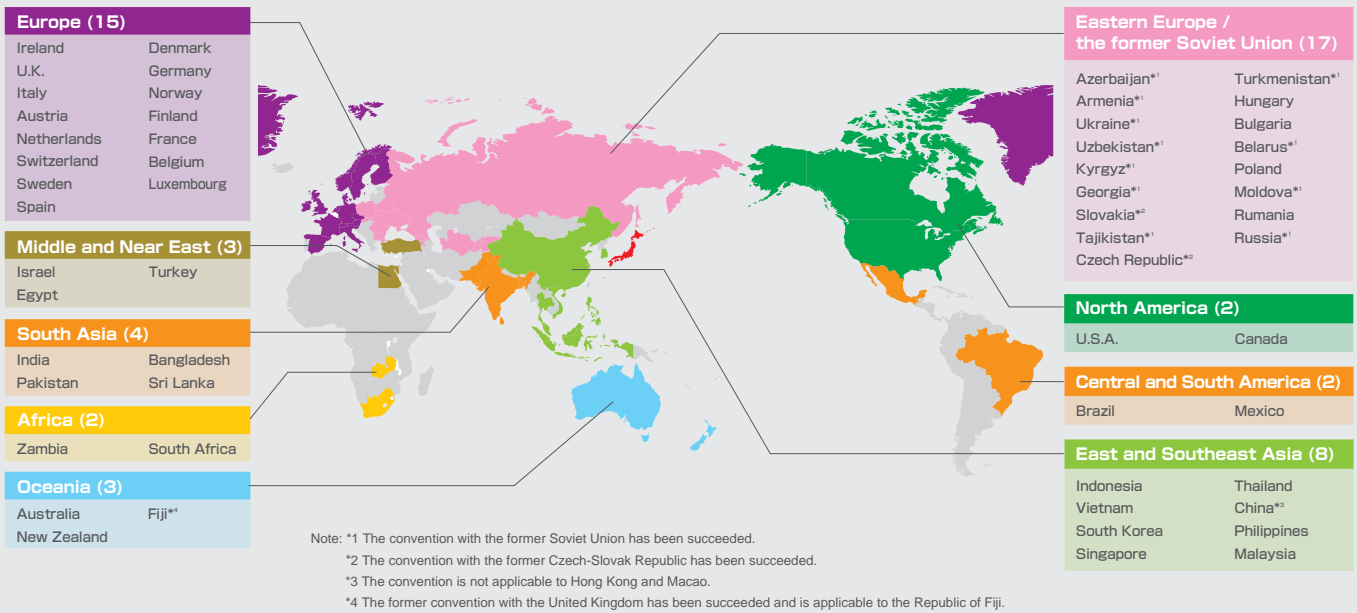
### ● Trends in the Number of Cases of MAP



Note: The figure represents the number of MAPs that occurred in a year from July to the following June.

\* “Mutual agreement procedure (MAP)” refers to a negotiation procedure between the tax authorities of contracting parties on a tax treaty to eliminate taxation incompatible with the applicable tax treaty when a taxpayer is or is likely to be subject to tax incompatible with provisions in the tax treaty. All of the 45 tax treaties that Japan has concluded (applicable to 56 nations) provide for the MAP.

## ● Japan's Tax Convention Network (45 conventions applied in 56 countries, as of April 2008)



# 3 Cooperation and Coordination with Foreign Tax Authorities

## (1) Technical Assistance to Developing Countries

The NTA is positively engaging in technical cooperation with developing countries. In cooperation with the Japan International Cooperation Agency (JICA), the NTA holds the International Seminar on Taxation (ISTAX) and has conducted country-specific projects. Especially in the fields of tax examination, taxpayer services, organizational management, and so forth, the NTA is sending its tax officials as experts to ASEAN countries and others, and providing training sessions in Japan by inviting the staff of foreign tax authorities. The NTA is also actively contributing to technical cooperation in seminars held by OECD or the Asian Development Bank (ADB). Through these technical cooperation activities, Japanese tax administrative experiences and know-how will improve tax administration in developing countries and these activities will also

contribute to improving region-wide tax administration and enhancing regional cooperative relationships.



Practicum at the NTA

## Outline of Technical Cooperation

### 1 Dispatch of Tax Officials as Experts

#### (1) Long-term Dispatch

Based on the practice and experience in the NTA, its tax officials are dispatched to foreign tax authorities as experts to be stationed for an extended period in order to provide continuous advice that will contribute to improvement in the tax administration of the country concerned. In fiscal 2007, they were dispatched to Indonesia, Malaysia, and Vietnam.

#### (2) Short-term Dispatch

In consideration of the needs of the tax authorities of developing countries, our tax officials are dispatched as experts in fields such as tax examination, international taxation, and staff training for a short period. In fiscal 2007, they were dispatched to Cambodia, Indonesia, Laos, Malaysia, Thailand, Vietnam, and so forth.

## 2 Implementation of Training within Japan

### (1) International Seminar on Taxation (ISTAX)

ISTAX is a seminar for training tax officials mainly from Asia and also from Africa and Central and South America on expertise in the Japanese tax system and administration as a part of official development assistance (ODA), in cooperation with JICA. The seminar includes a general course for middle-level tax officials (number of participants: about 20; training period: about two months) and a senior course for management-level tax officials (number of participants: about 10; training period: about 1 month).

### (2) Short-term Seminar for Foreign Tax Officials

With respect to Asian countries who have a close relationship with Japan, short-term training courses (training 1-3 weeks) are provided in line with requests from their tax authorities in order to respond to their specific needs. In fiscal 2007, training was implemented for each of Cambodia, Indonesia, Mongolia, Thailand, Vietnam, and so forth, and, in addition, Asian international taxation training was also implemented, in which multiple countries in the Asian region participated jointly.

### (3) Training of Foreign Tax Officials during Their Study in Japan (NTA Practicum)

Training is provided to tax officials of developing countries who are studying for a master's degree at a graduate school in Japan, under World Bank and other scholarships. This training is designed to meet the needs of practical knowledge, and is for learning expertise in the Japanese tax system and administration and improving the tax administration in each of the participating countries. In fiscal 2007, this training was provided to 17 students studying in the graduate schools of Keio University, Yokohama National University, National Graduate Institute for Policy Studies, and Hitotsubashi University.

## (2) International Conferences

Adaptation to the environmental change surrounding tax administration, including economic globalization and highly networked information, has been a common issue for tax authorities worldwide, despite gaps in their taxation systems. In this context, the tax authorities of different countries are endeavoring to study measures and share their experiences in dealing with various common issues, such as reinforcement of compliance (observance of laws) and improvement of taxpayers' services.

The OECD Committee on Fiscal Affairs provides a forum where OECD member countries engage in discussions to set international common taxation rules, such as the Model Tax Convention and the Transfer Pricing Guidelines, and the tax authorities of OECD member countries share their knowledge and experiences. The NTA has been actively participating in such activities of the OECD Committee on Fiscal Affairs. For further information, please access the website of the NTA.

<http://www.nta.go.jp/sonota/kokusai/oecd/oecd.htm>  
-- Japanese only

The Leeds Castle Group (Tax Administrators Meeting), consisting of 10 major nations, namely Japan, U.S., Canada, Australia, U.K., France, Germany, China, South Korea, and India, discusses how they should address abusive tax planning. Moreover, the Study Group on Asian

Tax Administration and Research (SGATAR), consisting of tax authorities in 15 countries and regions in Asia, is holding a forum that contributes to regional cooperation.

In addition, the NTA holds tax administrator-level meetings every year with the tax authorities of China and South Korea, who have close historical and economic relationships with Japan, in order to promote cooperation.



The Leeds Castle Group (Tax Administrators Meeting)  
held in January 2008

## (3) Cooperation with Foreign Tax Authorities, Information Collection, and Research Activities

To properly collect information outside Japan and enhance linkage with foreign tax authorities, the NTA has placed NTA liaison officers in the U.S. and some other countries and regions with close economic relations with Japan since 1985. At the end of March 2008, the NTA has

liaison officers in 13 countries (18 regions) to collect information on the tax systems and tax administration in the country in which they are placed. They also serve as an important pipeline when cooperation with foreign tax authorities is needed.