

IV Tax Administration Under Growing Globalization

With the economic society becoming increasingly borderless, corporations and individuals conduct a variety of cross-border economic activities, which make tax administration more challenging than ever. Elimination of international tax avoidance and double taxation risks emerging from such an environmental change has become major issues for each tax authority. In this respect, the NTA fosters cooperative relations by sharing information and experience with other tax authorities and conducts mutual agreement procedures (MAP) to eliminate double taxation. Furthermore, from the standpoint of providing greater certainty to taxpayers with regard to transfer pricing taxation, the NTA endeavors to clarify its application standards and administrative policies and to properly and promptly process requests for advance pricing arrangements, while developing more robust governance structure to review transfer pricing taxation cases.

1 Addressing International Transactions

(1) Organization and officials for international taxation

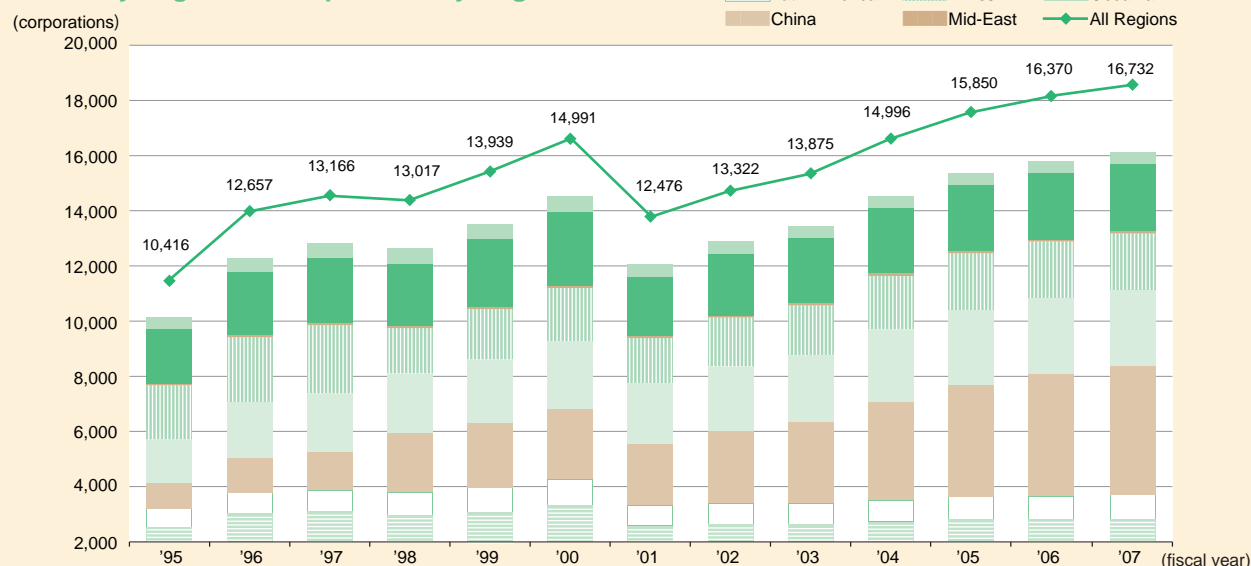
a. Environment involving the international taxation

Along with the progress in economic globalization, cross-border business and investment activities by individuals and corporations are becoming increasingly more active.

① Status of overseas advances by Japanese corporations

The following is the status of overseas advances by Japanese corporation. The number of locally organized corporations increased from 10,416 in 1995 to 16,732 in 2007, an increase of 1.6 times, with a particularly rapid growth of advance into China.

● Trend in the Number of the Locally Organized Corporation by Region



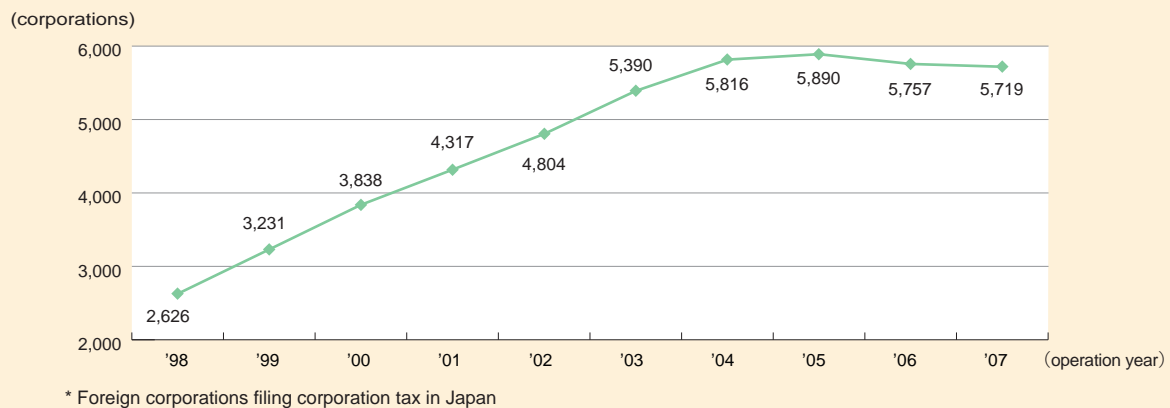
Note 1: "ASEAN4" representing Malaysia, Thailand, Indonesia, and the Philippines.
 Note 2: "NIEs3" representing Singapore, Taiwan, and South Korea.

(Source: Basic Research on Overseas Business Activities by the Ministry of Economy, Trade and Industry.)

② Trend in the Number of Foreign Corporations

The following is the trend in the number of the foreign corporations operating in Japan. Foreign corporations decreased by 38 on the year to 5,719 in fiscal 2007. The growth rate is 2.2 times greater than 10 years ago, although it slowed down.

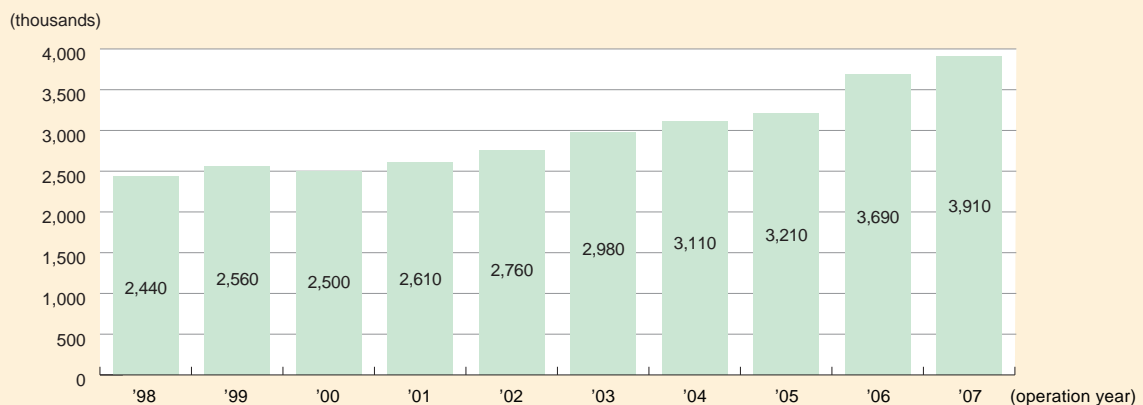
● Trend in the number of foreign corporations



③ Trend in the number of record of remittance and receipt related to foreign countries

The following is the number of record of remittance and receipt related to foreign countries.*¹ The number increased 220 thousand to 3,910 thousand in operation year 2007. It is increasing every year, up 70% from operation year 1998.

● Trend in the number of record of remittance and receipt related to foreign countries



b. Activities related to the international taxation

As the corporations and individuals step up their business activities, the tax examinations related to international taxation are gaining in importance. The NTA has increased the number of Senior Examiner (International Taxation), while organizing the International Examination of Large Enterprise Division and Project Team to Deal with Internationalization in the Regional Taxation Bureaus in Tokyo, Osaka, Nagoya, and Kanto-Shinetsu in order to improve and strengthen examination structures.

Since July 2007, the NTA has recruited experts specialized in legal and financial affairs with limited assignment terms to deal with complicated tax issues.

In addition, officials are improving examination skills and abilities related to international taxation at the National Tax College (NTC), a training institute in which personnel learn about legislation and tax treaty related to international taxation and financial transactions, as well as foreign languages.

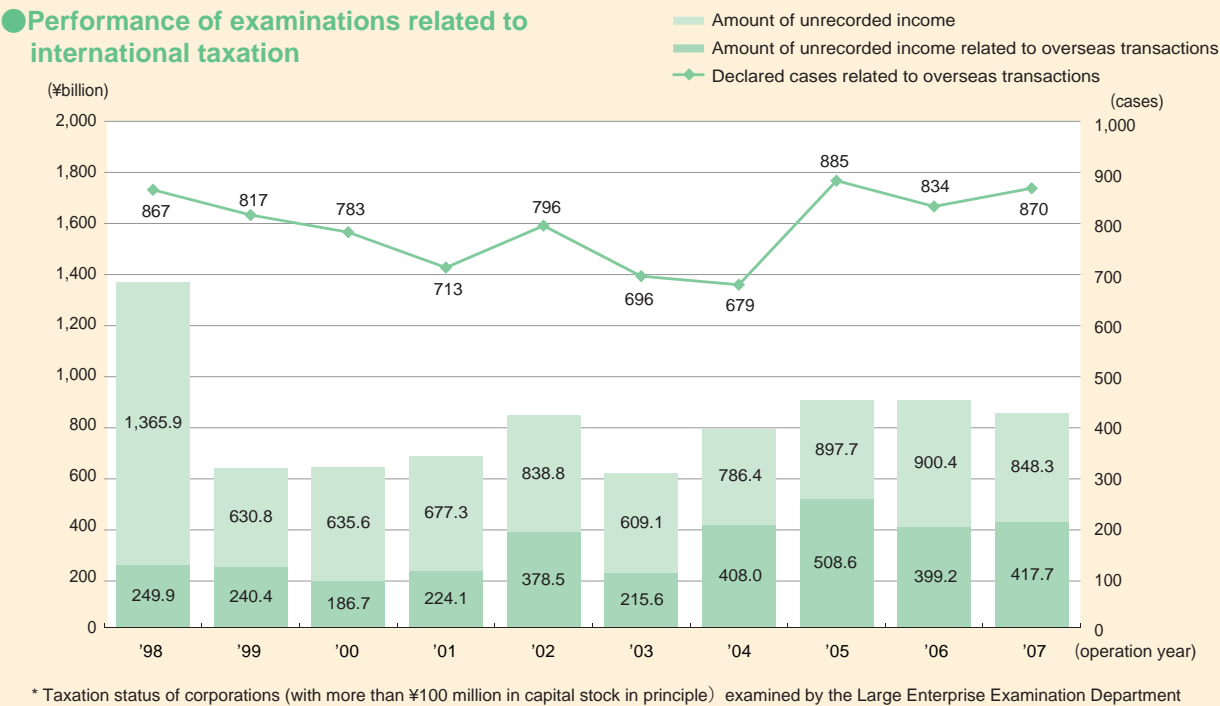
c. Performance of examinations related to international taxation

The NTA is actively working to examine taxpayers who conduct overseas transactions, and those

*¹ The record of remittance and receipt related to foreign countries is a report legally required to be submitted to the tax offices by financial institutions and which indicate the amount was remitted to or received from overseas nations exceeding more than ¥2 million (the amount was decreased from more than ¥2 million to more than ¥1 million in April 2009).

who own assets overseas. The performance of the examinations is showed on chart below.

In operation year 2004, the percentage of unrecorded income related to overseas transactions, which account for the majority of unrecorded income by large-scale corporations (handled by Large Enterprise Examination Department of the Regional Taxation Bureau), exceeded 50%. Thereafter the trend remains high in the amount of both unrecorded income and ratio of unrecorded overseas business transactions.



(2) International Tax Avoidance

International tax avoidance in an attempt to reduce the tax burden by taking advantage of differences in the individual countries' tax systems and tax treaty is becoming problematic on a global basis. Specialists in finance, law, and taxes are involved in international tax avoidance by organizing a variety of entities, such as the silent partnership (Tokumei Kumiai), contracts or partnerships, and using new and complicated financial techniques.

In recent years, this type of taxation problem has spread not only among major corporations with many overseas subsidiaries but also among wealthy individuals. As such, it is necessary for the NTA to keep track of international tax avoidance, conduct carefully planned examinations, and respond harshly to such acts with a view to ensuring fairness among taxpayers.

To this end, the NTA established project teams to counter international tax avoidance, while the specialist project teams and examination support teams in the major Regional Taxation Bureaus conducted in-depth tax examinations.

Meanwhile, we are finding transactions and related problems with new techniques by integrating and analyzing information collected in the course of tax examinations. The variety of information collected and methods of examinations are shared with other divisions to enhance the accuracy of tax examinations. When discovering any matters that require revision of tax laws, we request tax reform accordingly.

In recent years, the amount of investments through funds has increased as the capital market grew active. We are reacting to increasingly complicating economic transactions by establishing project teams that analyze the actual status of investment funds and develop methods for examinations to keep up with

them. Through the Joint International Tax Shelter Information Centre (JITSIC), Japan, the U.S.A., Canada, Australia, and the U.K., as members, are trying to share information on the mechanism of tax avoidance and ways that member nations can address the issue.

(3) Transfer Pricing Issues

The Transfer Pricing Taxation System requires that taxable income shall be calculated on the basis that transactions with a foreign affiliated company are deemed to be made at the “arm’s length price,” which means the price for transactions with the third party, when the prices of such transactions differ from those with a third party and make the taxable income of the corporation in Japan lower.

With the development of global business activities, transactions that may be subject to transfer pricing taxation have been increasing in terms of volume and have become more complicated as well. In order to respond to such changes, the NTA discloses information on the administration of the system and is trying to properly enforce transfer pricing taxation by strengthening the mechanism to review transfer pricing cases.

a. Clarification of administering the system and strengthening the structure of the review system

The NTA is trying to clarify application standards and administrative policies on transfer pricing taxation by updating and publishing the directives on interpretation of law and on the Operation for Transfer Pricing (the Administrative Guidelines), which ensure certainty for taxpayers. In October 2008, the NTA revised its administrative guidelines after inviting public comments, and the revision includes clarification of the treatment of provision of services, donations, and payments for price adjustments.

In the same operation year, the NTA updated its operating structure, making the divisions in charge of review or the mutual agreement procedure (MAP) (refer to Page 39) involved in matters related to the transfer pricing taxation cases early on implement proper taxation and promptly relieve double taxation.

Outline of the revised administrative guideline for operation

《clarification of treatments of the provision of services, donations, and payments for price adjustments》

- 1 Clarifying the criteria to determine whether intra-group activities fall under the provision of services subject to the transfer pricing taxation, based on the descriptions contained in the OECD Transfer Pricing Guidelines.
- 2 Explaining that the possibility of taxation of donations in a given situation, for example, when a corporation in Japan does not receive appropriate compensation for services provided by a foreign affiliated company.
- 3 Explaining that the possibility of taxation of donations in a given situation, for example, when the corporation in Japan retrospectively increased compensation related to transactions with a foreign affiliated company and the difference was paid to a foreign affiliated company in the name of a price adjustment, without reasonable grounds.

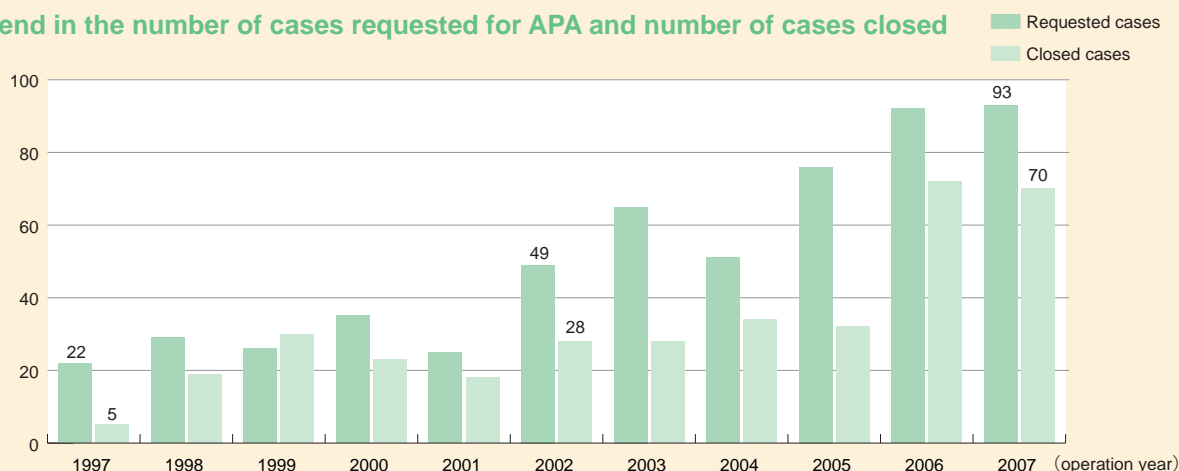
b. Advance Pricing Arrangement (APA)

APA on transfer pricing taxation is a procedure that when requested by taxpayers, the tax authorities confirm in advance the method of calculation of the arm’s length price for transactions with foreign affiliated companies. Reflecting the growth of global transactions, the number of APA requests is increasing. Office counters in charge of pre-filing consultations prior to filing a request for APA are placed at each of the

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Regional Taxation Bureaus to enable taxpayers to follow APA procedures. In July 2008, the division in charge of examining the APA requests was established within the Osaka Regional Taxation Bureau following the Tokyo, and the number of overall officials in charge was increased.

● Trend in the number of cases requested for APA and number of cases closed



* The number of cases requested for APA does not include the number of cases for which changes were made after the request. Meanwhile, the number of APA cases (refer to page 40) out of the cases subject to mutual agreement procedure (MAP) includes cases of changes acknowledged after being requested (because MAP is made again with regard to changes). Therefore, the figures do not match.

In relation to transfer pricing taxation cases, a system to provide a grace period for national tax payments has been established since fiscal 2007 (for local tax since fiscal 2008).

(4) Exchange of information under the tax treaty

There are cases that it is difficult for the NTA to clarify the global transactions by individuals and corporations only with the information gained within Japan. In such a case, the exchange of information under a bilateral tax treaty makes it possible to acquire the necessary information. The NTA is recently exchanging information on more than 200,000 cases a year.

2 Mutual agreement procedure (MAP)

As globalization progresses with individuals and corporations advancing into foreign markets, double taxation, where both Japan and a foreign country impose income tax, may arise. The transfer pricing taxation described above may also cause double taxation. The NTA is addressing the global issue of double taxation by making use of mutual agreement procedures (MAP^{*1}) with foreign tax authorities based on tax treaties.

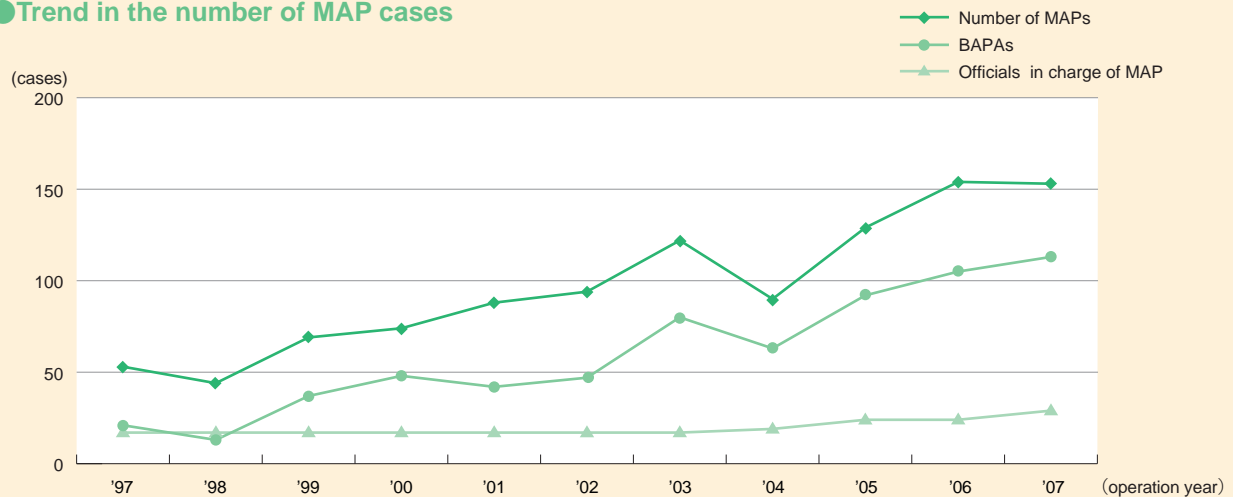
The number of MAP cases has increased in recent years, with more than 90% of MAP cases being related to transfer pricing. Among MAP cases, to assure predictability about transfer pricing, which has spread globally, the number of MAP cases related to APA is increasing. During operation year 2007, the NTA received 153 cases of MAP, of which 144 cases were related to transfer pricing and 113 cases were related to APA. Compared to 10 years ago, the number of MAP cases has increased by a factor of approximately three, and the number of Bilateral Advance Pricing Arrangements (BAPA; APA accompanied by MAP) cases has increased by a factor of approximately five.

^{*1} "Mutual Agreement Procedure (MAP)" means the negotiation procedure between the tax authorities of countries party to a tax treaty to relieve taxpayers from taxation that is not in accordance with the provisions of the treaty where the actions of one or both of the countries result in or will result in taxation that is not in accordance with the provisions of the tax treaty.

The number of countries with which the NTA was involved in MAP negotiations is increasing along with the increase in the number of MAP cases. While 14 countries were involved 10 years ago, it increased to 24 as of the end of June 2008. Likewise, BAPA cases have increased in recent years with Asian countries, which have little past experience in APA.

In an attempt to properly and promptly solve MAP cases, the NTA is strengthening its structure by increasing officials and putting an emphasis on APA, while deepening working relations with the foreign tax authorities for more efficient negotiations.

●Trend in the number of MAP cases



* The number of MAP cases represents where taxpayers claimed MAP or where the foreign tax authorities proposed MAP negotiation. The number of MAPs regarding change for agreed BAPA etc. is counted in the operation year in which re-negotiation was made.

●Tax treaty Network of Japan (45 treaties applied in 56 countries as of April 2009)

European Region (15 countries)

IRELAND
the U.K.
Italy
Austria
NETHERLANDS
SWITZERLAND
SWEDEN
SPAIN

DENMARK
GERMANY
Norway
Finland
FRANCE
BELGIUM
LUXEMBOURG

Middle East (3 countries)

Israel
Egypt
Turkey

South/Central Asia (4 countries)

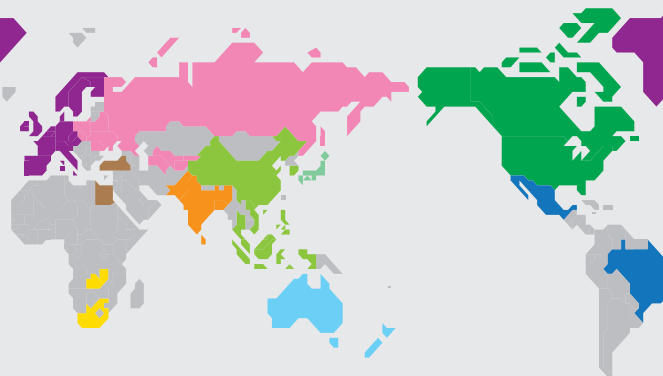
INDIA
Pakistan
Bangladesh
Sri Lanka

African Region (2 countries)

Zambia
South Africa

Pacific Region (3 countries)

AUSTRALIA
NEW ZEALAND
Fiji^{*4}



Capitalized are the names of countries (24) conducting MAP with the NTA as of the end of June 2008. Underlined are the names of countries (18) conducting BAPA.

East Europe / the Former Soviet Union (17 countries)

Azerbaijan^{*1}
Armenia^{*1}
Ukraine^{*1}
Uzbekistan^{*1}
Kyrgyz^{*1}
Georgia^{*1}
Slovakia^{*2}
Tajikistan^{*1}
Czech Republic^{*2}

Turkmenistan^{*1}
HUNGARY
Bulgaria
Belarus^{*1}
Poland
Moldova^{*1}
Romania
Russia^{*1}

North America (2 countries)

U.S.A.
CANADA

Latin America (2 countries)

Brazil
MEXICO

East/South East Asia (8 countries)

INDONESIA
Vietnam
SOUTH KOREA
SINGAPORE

THAILAND
CHINA^{*3}
Philippines
MALAYSIA

* 1 The treaty with the former Soviet Union is taken over.

* 3 The treaty does not apply to Hong Kong and Macao.

* 2 The treaty with former Czech/Slovakia is taken over.

* 4 Fiji takes over the former treaty with the U.K.

③ Cooperation and Coordination with Foreign Tax Authorities

(1) Cooperation for the developing countries

Under the framework of technical assistance by the Japan International Cooperation Agency (JICA), the NTA is actively involved in technical assistance primarily for Asian countries, in consideration of the economic ties between Japan and such countries.

Technical cooperation aims at improving tax administration in developing countries and the development of persons who understand Japanese tax administration. The program consists of two components: ① lectures in developing countries by dispatching NTA officials as instructors and ② training in Japan by inviting tax officials from the developing countries.



NTA Practical Training Course (Practicum)

Overview of Technical assistance

1 Dispatch of Tax officials to the developing countries

Considering the needs of tax authorities for training in the developing countries, tax officials are dispatched as instructors to give lectures on tax examinations, international taxation, staff training, and other tax subjects. In fiscal 2008, instructors were dispatched to lecture on the tax administration of Japan to Cambodia, Malaysia, Thailand, Vietnam and other countries.

With a view to giving continued advice on tax administration to developing countries, the NTA is dispatching tax officials in the capacity of long-term experts from JICA. In fiscal 2008, our tax officials remain in Malaysia, Indonesia, and Vietnam.

● Performance of Dispatched Personnel

Operation year		'04	'05	'06	'07	'08
Short-term expert	Countries dispatched	8	10	9	10	10
	Numbers dispatched	25	55	52	50	40
Long-term expert	Countries dispatched	2	4	4	3	3

2 Training in Japan

(1) International Seminar on Taxation (ISTAX)

ISTAX is a seminar for tax officials in developing countries on the tax system and tax administration of Japan. It has two courses: the general course for mid-career officials and the senior course for management-level officials. A total of 30 tax officials in the two courses combined participated in fiscal 2008.

(2) Country-Focused Training Courses in Tax Administration and Counterpart Training

The courses are given to tax officials in the specified developing countries at their request. Tax officials from China, Indonesia, Mongolia, Philippines, Thailand, Vietnam, and so on participated in the course in fiscal 2008.

(3) International Taxation for Asian Countries

Training is directed at tax official in Asian countries (China, Indonesia, Malaysia, Philippines, Thailand, and Vietnam) on the subject of international taxation. Twelve persons from six countries participated in fiscal 2008.

(4) NTA Practical Training Course (Practicum)

Training on the Japanese tax system and tax administration in general is provided for tax officials from developing countries who are studying in master courses at the graduate schools of Japanese universities on a

scholarship program from the World Bank. A total of 21 foreign students studying at graduate schools of Keio University, Yokohama National University, National Graduate Institute of Policy Studies, Hitotsubashi University, and Waseda University participated in fiscal 2008.

● Status of training conducted in Japan

Operation year		'04	'05	'06	'07	'08
International Seminar on Taxation (ISTAX) General Course	Countries accepted	18	22	17	18	18
	Persons accepted	19	22	20	19	20
International Seminar on Taxation (ISTAX) Senior Course	Countries accepted	10	11	11	10	10
	Persons accepted	11	11	11	10	10
Country-Focused Training Courses in Tax Administration	Countries accepted	3	3	3	3	4
	Persons accepted	25	23	30	32	60
Counterpart Training	Countries accepted	3	4	4	4	3
	Persons accepted	13	58	71	89	31
International Taxation for Asian Countries	Countries accepted	Newly launched	Newly launched	6	6	6
	Persons accepted	in 2008	in 2008	11	12	11
NTA Practical Training Course (Practicum)	Countries accepted	13	12	13	10	9
	Persons accepted	17	18	18	17	21

(2) Participation in international conferences among the tax authorities

New modes of business transactions are expanding with the progress of economic globalization and the advanced use of IT. Under such circumstances, the tax authorities of each country are faced with double taxation risk due to differences in the tax rules of the different countries and the problem of taxation loopholes of being untaxed by any country as a result of tax avoidance. For the purpose of promoting cooperation and sharing experiences among the tax authorities to deal with such risks and problems, the NTA participates in a variety of international conferences.

The OECD Committee on Fiscal Affairs (CFA) is a forum where OECD-member countries review the Model Tax Convention and Transfer Pricing Guidelines, and the tax authorities aim to share knowledge and experience. At the Forum on Tax Administration (FTA), which is a tax-administrator level meeting of the OECD-member countries with the inclusion of major non-OECD economies, the participants discussed the impact of the global financial crisis on tax administration, the responses to tax avoidance using tax havens, and measures to have financial institutions and high net worth individuals improve tax compliance. The NTA has been actively participating in such activities of the CFA. For further details, please visit the NTA website at <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, the U.S.A., Canada, Australia, the U.K., France, Germany, China, South Korea, and India, discusses urgent issues faced by each country, such as international tax avoidance. Its latest meeting was held in January 2009 in Kyoto hosted by Japan. Moreover, the Study Group on Asian Tax Administration and Research (SGATAR), consisting of tax administrations in 15 countries and regions, provides a forum for promoting cooperation and sharing the knowledge and experience in Asia.



[OECD Forum on Tax Administration] Held in May 2009