

# IV Tax Administration Under Increasing Globalization

Cross-border economic activities by companies and individuals are becoming more complex and diverse. These changes have brought international tax avoidance, in which revenues received overseas are not declared, or which use complex international transactions to avoid paying tax to any country on earnings gained. On the other hand, there is the large problem of double taxation, in which more than one country have different views and impose taxes on the same income. In response to these problems, the NTA is working on internal improvements such as in its examination system, and is also building stronger cooperative relations by sharing information and experience with the tax authorities of foreign countries. The NTA is also in discussions with the authorities to resolve double taxation.

## 1 Addressing international transactions

### (1) Organization and officials for international taxation

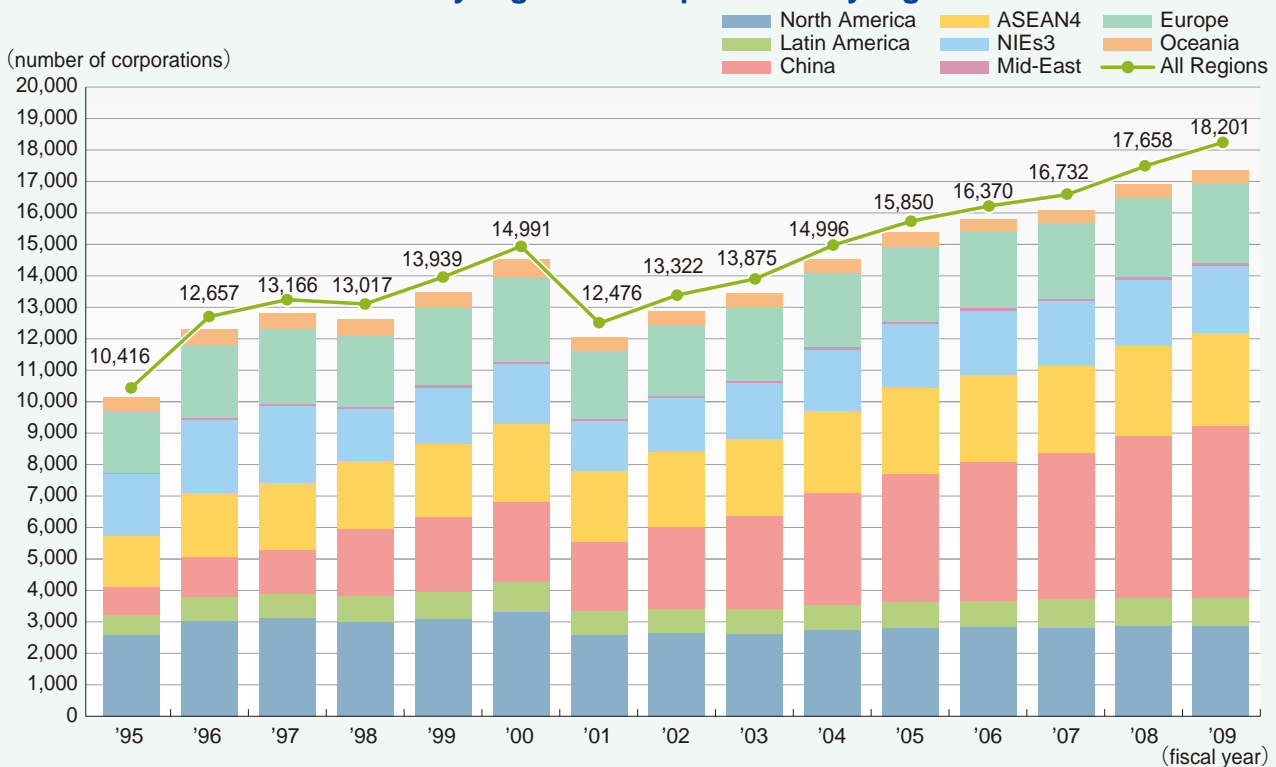
#### a. Environment involving international taxation

Along with the progress in globalization of business transactions, cross-border business and investment activities by companies and individuals are becoming increasingly active.

##### ① Status of overseas establishments by Japanese corporations

The following is the status of overseas establishments by Japanese corporations. The number of overseas locally organized corporations increased from 10,416 in FY1995 to 18,201 in FY2009, about a 70% increase, with a particularly rapid growth of establishments in China.

#### ● Trend in the number of locally organized corporations by region



\*1 "ASEAN4" signifies Malaysia, Thailand, Indonesia and the Philippines.

\*2 "NIEs3" signifies Singapore, Taiwan and South Korea.

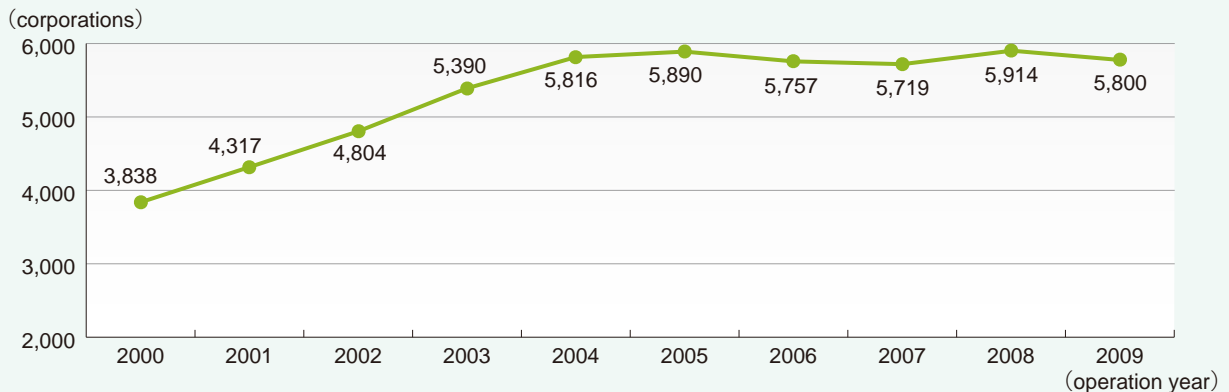
(Source: "Basic Research on Overseas Business Activities," by the Ministry of Economy, Trade and Industry)

##### ② Trend in the number of foreign corporations

The trend in the number of foreign corporations carrying out business activities in Japan is shown on the following page. There were 5,800 corporations in the 2009 operation year, which was 114 less than the previous year. The growth rate reversed, but this is still about 50% more than in the 2000 operation year.

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### ● Trend in the number of foreign corporations

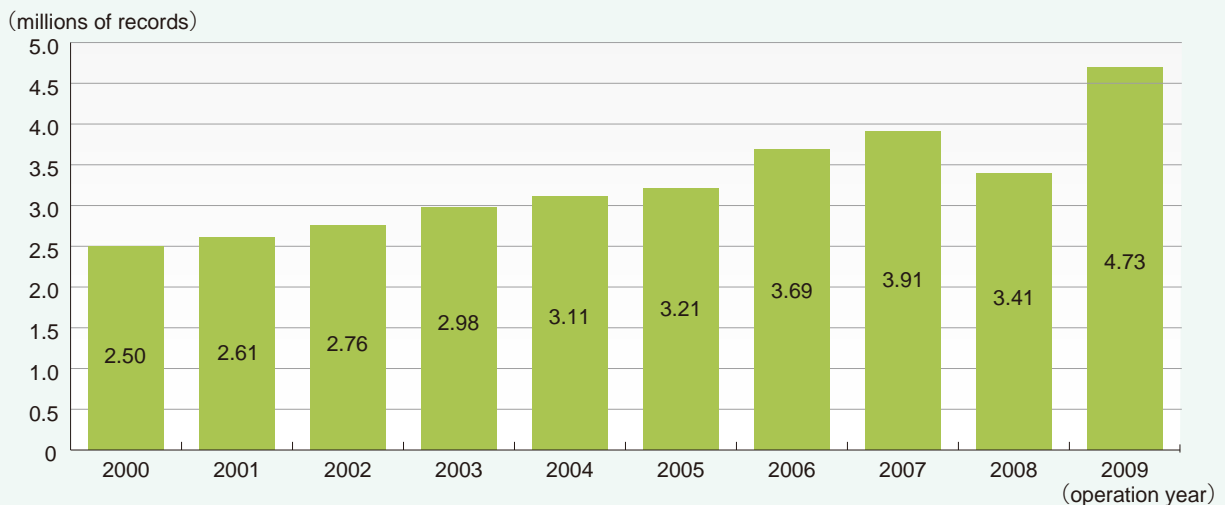


\* Foreign corporations filing corporation tax return in Japan

### ③ Trend in the number of records of remittances and receipts related to foreign countries

A record of remittance and receipt related to foreign countries<sup>1</sup> is submitted when a large remittance is sent to a foreign country. The figure below shows the number of these submitted. The criteria for requiring submission was reduced in the 2009 operation year, so 4.73 million records were submitted, which were 1.32 million more than in the previous year. The number of submissions is generally growing each year.

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



## b. Activities related to international taxation

As companies and individuals expand their cross-border business and investment activities, tax examinations related to international taxation are gaining in importance.

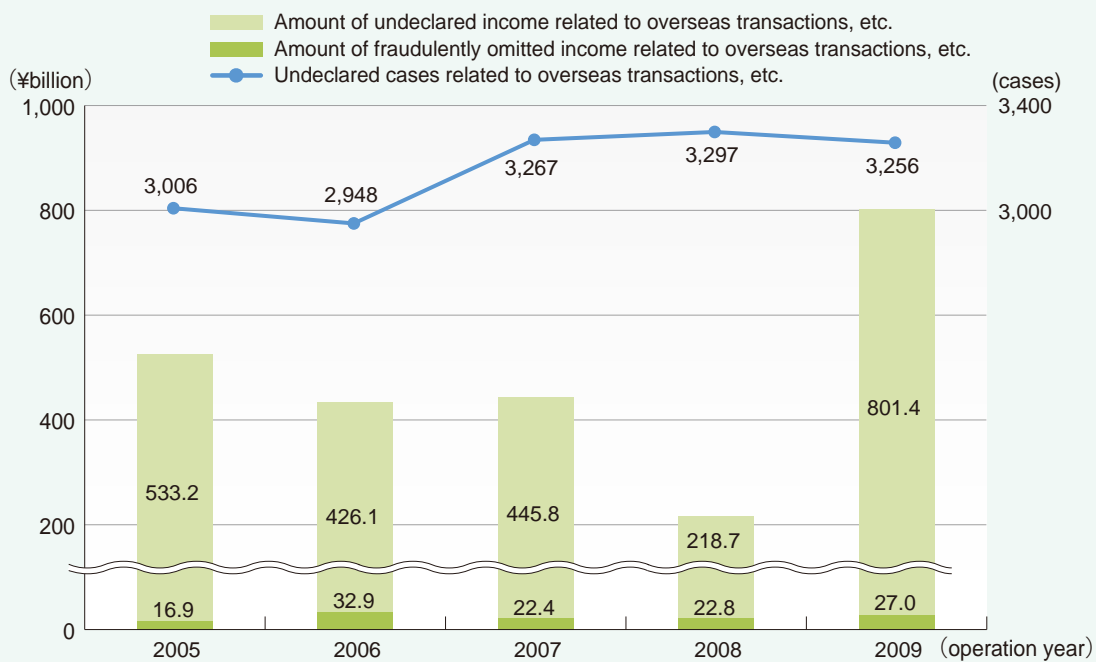
This is why the NTA emphasizes examinations of taxpayers who do overseas transactions and taxpayers who hold overseas assets. The NTA is performing deep examinations which effectively use the records of remittances and receipts related to foreign countries, and information exchange systems based on tax treaties and tax information exchange agreements.

The NTA is increasing the number of its Senior Examiners (International Taxation) who are dedicated to work on international taxation. We also established a department for specialized

<sup>1</sup> 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. These indicate the amount remitted to or received from overseas nations, if exceeding ¥2 million (the amount was decreased from more than ¥2 million to more than ¥1 million, starting April 2009).

handling of international tax avoidance cases. These are parts of our efforts to enhance and strengthen our examination system. The National Tax College is a training institution for staff, which provides training on international tax related laws and regulations, tax treaties, financial transactions, language study, etc. This works to enhance staff abilities for examinations concerning international taxation. The NTA also recruits lawyers and financial specialists to handle complex tax problems.

### ● Actual examinations related to international taxation (Corporation tax)



## (2) International tax avoidance

International tax avoidance problems are arising, as revenues gained overseas are hidden, and as people cleverly use differences between each country's tax system and tax treaties to avoid paying taxes to any country, despite gaining earnings. International tax avoidance, often prepared by financial, legal and tax specialists, often uses complex transactions which combine paper companies or cooperatives, derivatives (derivative financial instruments), etc., which makes it difficult to clarify the whole picture of the transactions. Recently, such problems are not only found among large companies, as it has also spread to small and medium companies and wealthy individuals.

When proper tax duty is not fulfilled due to such international tax avoidance conduct, this damages the sense of fairness among taxpayers. Tax authorities must learn about it and clarify the actual situation, and work to ensure that proper tax duty is performed. Therefore, the NTA uses tax examinations and various opportunities to collect information on international tax avoidance conduct, and if a tax problem is found, performs a thorough tax examination and clarifies the actual situation.

In order to strengthen our response to international tax avoidance conduct, a Chief Examiner was established in the Tokyo and Osaka Regional Taxation Bureaus, as a department in charge of information collection and analysis, and examination planning and proposals. This Chief Examiner and the International Examination of Large Enterprise Division etc. play central roles in collecting documents and information and clarifying facts on international tax avoidance conduct.

Furthermore, aiming to clarify international tax avoidance, Japan, the USA, Canada, Australia, the U.K., South Korea and China participate in the Joint International Tax Shelter Information Centre (JITSIC). JITSIC works to share information on international tax avoidance schemes and initiatives in member countries.

## (3) Transfer pricing issues

The transfer pricing system was introduced in the FY1986 tax reform. From the perspective of working to achieve proper international taxation, this prevents transferring income overseas by manipulating transaction prices with a foreign affiliated company. Specifically, if a Japanese company does a transaction with a foreign affiliated company, and that transaction price differs from the transaction price between third parties (this price is called an “arm’s length price”), resulting in lower taxable income for the Japanese company, then that transaction is deemed to have been done at an arm’s length price, and income is recalculated under this system.

As company activities become increasingly global, more transactions are becoming subject to the transfer pricing system, and transactions are becoming more complex, with growing importance of transactions involving intangible assets. It is necessary to appropriately handle such changes, increase predictability for taxpayers, and achieve proper and fair taxation.

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

In order to increase predictability for taxpayers, it is important that the NTA publishes and works to clarify its execution policy for the system’s operation, and its application criteria. In 2010, the NTA revised its administrative guidelines for operation, and its directives for interpretation of laws. These guidelines and directives clarify items which should be considered in its examinations when studying the process of determining prices of transactions with foreign affiliated companies, items to consider in studying documents deemed necessary to calculate arm’s length price, etc.

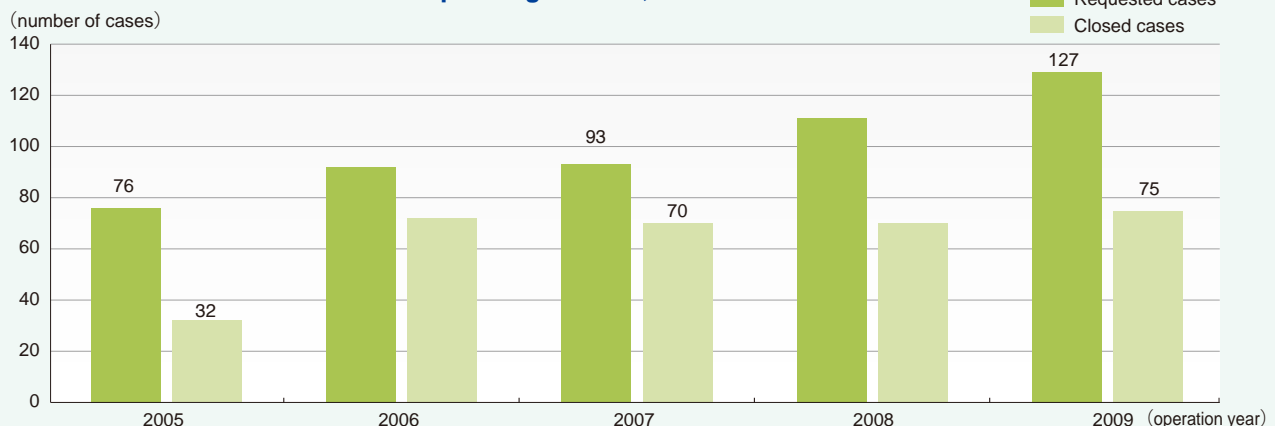
To also ensure proper and fair implementation, the NTA is working to enhance its examination system, for appropriate fact finding and interpretation and application of laws and regulations.

### b. Advance Pricing Arrangement (APA)

In an APA on transfer pricing taxation, based on the Japanese company’s request, the tax authority gives advance confirmation of the method for calculating the arm’s length price in transactions with a foreign affiliated company. The number of requests for APA is increasing, as a result of the increase in international transactions. This is why the NTA is working to improve its execution system and quickly process APAs. For example, a division dedicated to APA examinations was established in the Tokyo Regional Taxation Bureau and the Osaka Regional Taxation Bureau, where there are many companies which do international transactions. Also, a contact point is set up in each Regional Taxation Bureau, which handles advance consultations with national tax authorities before requesting an APA. This contributes to our development of an environment enabling taxpayers to smoothly use APAs.

APAs ensure predictability and legal stability for taxpayers. They also contribute to proper and smooth operation of the transfer pricing taxation. This is why the NTA will continue to provide them appropriately.

#### ● Trend in the number of cases requesting an APA, and number of cases closed



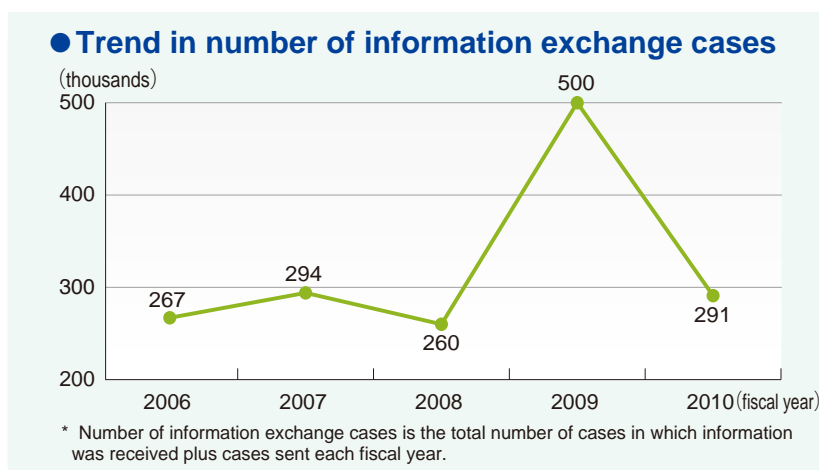
\* The number of cases requesting an APA does not include the number of cases for which changes were made after the request. On the other hand, the number of APA cases (refer to page 43) out of the cases subject to Mutual Agreement Procedure (MAP) includes cases of changes acknowledged after being requested (because MAP is made again with regard to changes). Therefore, the figures do not match.

## (4) Exchange of information under tax treaty and tax information exchange agreement

There are cases in which the NTA cannot sufficiently clarify international transactions by individuals and corporations only with the information obtained in Japan. In such a case, the exchange of information under a bilateral tax treaty and tax information exchange agreement makes it possible to acquire the necessary information.

Recently, the NTA has been exchanging information on several hundred thousand cases a year.

Japan is thus working to develop its framework for information exchange: adding new information exchange provisions to tax treaties in accordance with international standards<sup>1</sup>, changing existing provisions in accordance with international standards, etc. Japan now has 48 tax treaties in effect (covering 59 countries and regions). The treaty with Switzerland will be revised, after which all of Japan's tax treaties will have information exchange provisions. There are also provisions with some countries in which the examiner can meet directly with the person in charge in the other country, and exchange needed information. The NTA fully utilizes these to actively exchange information.



## 2 Mutual Agreement Procedure (MAP)

With the globalization of the Japanese economy, where the Japanese taxpayers move in on foreign markets or foreign taxpayers do the same on the Japanese market, they may encounter the international double tax situation, in which both Japan and the foreign country impose tax on the same income. Transfer pricing taxation mentioned in IV1(3) is one of the major areas of the international double taxation. We exert ourselves to resolve such double taxation problems, including transfer pricing, by negotiating with foreign tax authorities through so-called Mutual Agreement Procedures<sup>2</sup> prescribed in tax treaties.

The number of MAP cases, consisted of both cases in which the NTA received MAP requests from taxpayers in Japan, and cases in which the NTA received MAP requests from foreign tax authorities, has been increasing in recent years, with over 90% of them concerning transfer pricing. Among these, the number of the cases in Advanced Pricing Arrangement (APA) program, which provides taxpayers with predictability and legal stability in transfer pricing (see IV1(3)b), also shows the same trend as seen in MAP cases. For the 2009 operation year, we have received 183 MAP requests from either the taxpayers in Japan or foreign tax authorities, with 176 of these concerning transfer pricing. 149 out of the above 176 cases were concerning APA program. These numbers are showing drastic increase, compared to the ones of 10 years ago; by about 200% increase in the number of the MAP cases and by about 300% increase in those of APA cases.

With regard to the number of countries with which the NTA was involved in MAP negotiations, it also shows the same trend as above, along with the increase in the number of MAP cases. While 14 countries were involved 10 years ago, we are in negotiations with 21 countries as of the end of June 2010.

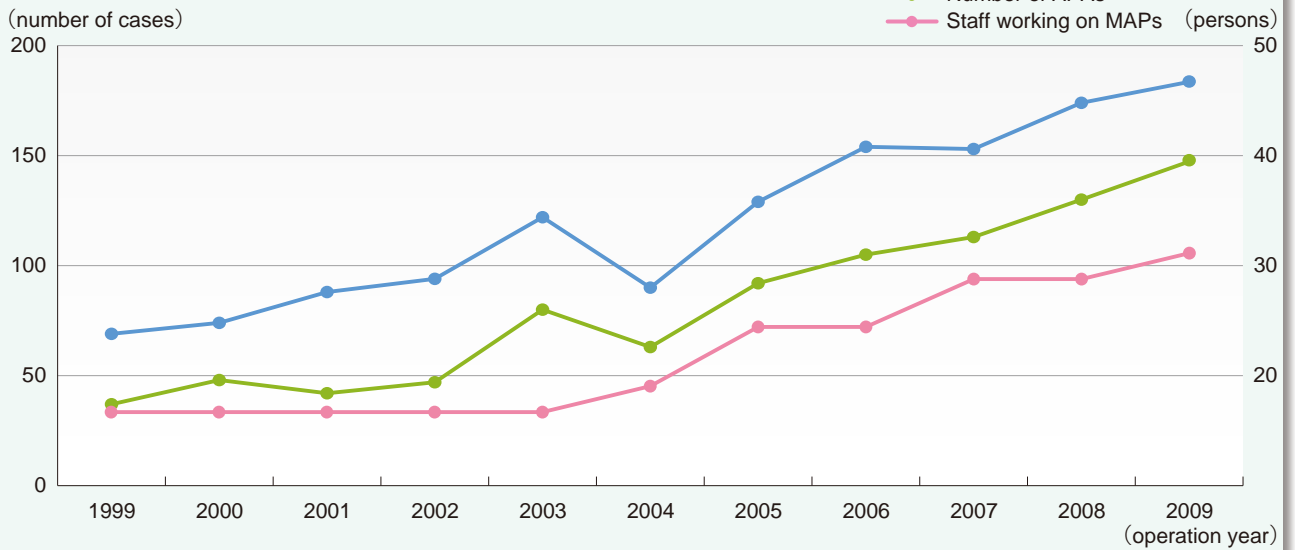
The NTA has been making every effort to resolve MAP cases as promptly and appropriately as possible by enhancing staffing and making operations more efficient and effective, as well as promoting cooperative relationship with foreign tax authorities.

1 Main items of international standards on information exchange: information held by financial institutions is also subject to information exchange, and information exchange is done even if there are no taxable earnings in one's own country.

2 "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.

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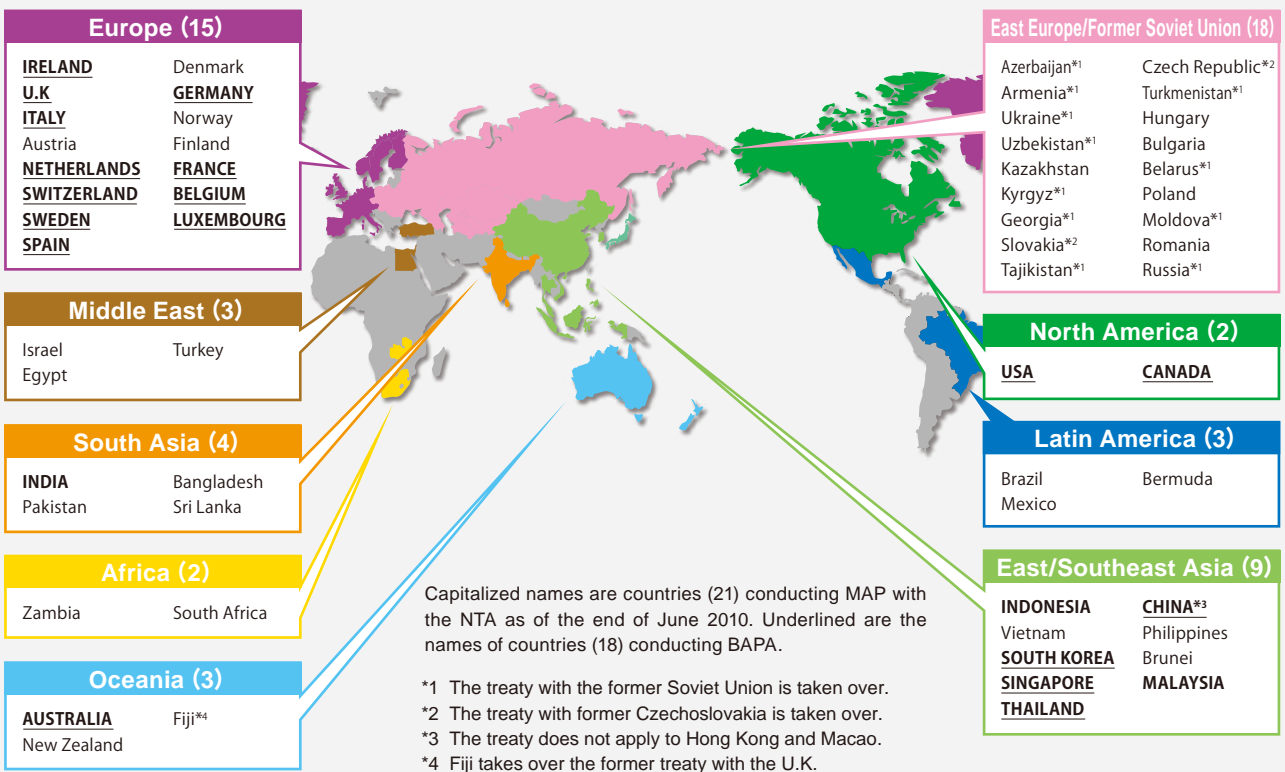
## ● The number of MAP cases and staff working on MAPs



\*1 The number of MAP cases consists of both cases in which the NTA received MAP requests from taxpayers in Japan, and cases in which the NTA received MAP requests from foreign tax authorities.

\*2 "Number of MAPs" includes the number of APAs.

## ● Tax treaty network of Japan (48 treaties applied in 59 countries & regions as of April 2011)



## 3 Cooperation and coordination with foreign tax authorities

### (1) Cooperation for developing countries

Under the framework of technical cooperation by the Japan International Cooperation Agency (JICA) etc., the NTA is actively providing technical cooperation to developing countries, focused on Asian countries. The aims are to improve tax administration of developing countries, and to foster people who understand Japan's tax administration.



International Seminar on Taxation

#### Overview of technical assistance

##### 1 Dispatch of tax officials to developing countries

Based on the requests of the foreign tax authorities, the NTA dispatches its officials as lecturers in fields such as taxpayer services, international taxation and staff training. In FY2010, officials were dispatched to provide lectures, etc. to China, Indonesia, Malaysia, Vietnam, etc.

With a view to giving continuous advice on tax administration to developing countries, the NTA is dispatching tax officials in the capacity of long-term experts from JICA. In FY2010, our tax officials remain in Indonesia, Malaysia, and Vietnam.

##### 2 Lectures and other 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, providing lectures, etc. It has two courses: the general course for mid-career officials, and the senior course for upper management-level officials. Counting both courses, a total of 32 tax officials participated in FY2010.

###### (2) Country-Focused Training Courses in Tax Administration

The courses are given to tax officials from specified developing countries at their request. 68 tax officials from China, Mongolia, Philippines and Uzbekistan participated in the course in FY2010.

###### (3) Training Course of International Taxation for Asian Countries

Training is directed at tax officials in Asian countries on the subject of international taxation. Nine persons from four countries (China, Malaysia, Philippines and Vietnam) participated in FY2010.

###### (4) NTA Practical Training Course (Practicum)

Training on the Japanese tax system and tax administration 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, etc. A total of 20 foreign students studying at graduate schools of Keio University, Yokohama National University, National Graduate Institute of Policy Studies, Waseda University and Hitotsubashi University participated in FY2010.

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### ● Status of training conducted in Japan

(number of countries, people)

Fiscal year		2006	2007	2008	2009	2010
International Seminar on Taxation (ISTAX) general course	Countries	17	18	18	19	18
	People	20	19	20	20	18
International Seminar on Taxation (ISTAX) senior course	Countries	11	10	10	11	14
	People	11	10	10	11	14
Country-Focused Training Courses in Tax Administration	Countries	7	6	8	8	4
	People	104	95	108	100	54
Training Course of International Taxation for Asian Countries	Countries	Newly launched in FY2007	6	6	6	4
	People		11	12	11	9
NTA Practical Training Course (Practicum)	Countries	12	13	10	9	12
	People	18	18	17	21	20

## (2) Participation by tax authorities in international conferences

As globalization and computerization of the economy brings an increase in new forms of transactions, there is the double taxation problem of more than one country imposing taxes on one income, and the taxation loophole problem of tax avoidance in which tax is not imposed in any country. These are becoming issues which should be addressed by each country's tax authorities. In order to solve such problems and to cooperate and share experience among each country's tax authorities, the NTA actively participates in various international conferences. The main conferences are described below: ① OECD Forum on Tax Administration (FTA), ② Study Group on Asian Tax Administration and Research (SGATAR), and ③ OECD Committee on Fiscal Affairs (CFA).

### ① OECD Forum on Tax Administration (FTA)

The OECD Forum on Tax Administration is a forum for sharing each country's knowledge and experience on a wide range of fields in tax administration, etc. It was held in Istanbul in the Republic of Turkey in September 2010, with discussions about each country's initiatives to enhance tax compliance concerning international transactions, and for enhanced corporate governance in tax fields.

### ② Study Group on Asian Tax Administration and Research (SGATAR)

The Study Group on Asian Tax Administration and Research is comprised of tax authorities of 16 countries and regions in Asia. This is a forum for discussions on cooperation and sharing of knowledge in the region. The 40th meeting was held in November 2010 in Fukuoka, where top tax officials of member countries and regions agreed to Japan's proposal on the importance of mutual cooperation on a practical level.

### ③ OECD Committee on Fiscal Affairs (CFA)

The OECD Committee on Fiscal Affairs is a forum where OECD member countries review the Model Tax Convention and Transfer Pricing Guidelines, and the tax authorities aim to share their knowledge and experience. Under the CFA, study groups are formed to discuss individual themes and exchange views. The NTA has been actively participating in such activities of CFA. For further details, please refer to the NTA website "OECD Committee on Fiscal Affairs (CFA)".

[www.nta.go.jp/sonota/kokusai/oecd/oecd.htm](http://www.nta.go.jp/sonota/kokusai/oecd/oecd.htm)