

**Commissioner’s Directive on the Operation of Transfer Pricing
(Administrative Guidelines)
National Tax Agency of Japan**

This document is a translation of the original Japanese-language Directive. The Japanese original is the official text.

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To: Regional Commissioners, Regional Taxation Bureaus
Regional Commissioner, Okinawa Regional Taxation Office
From: Commissioner, National Tax Agency

The following rules have been established in regard to the operation of transfer pricing and shall be followed from this date forward.

“Commissioner’s Directive on Procedure for Confirmation of Transfer Pricing Methodologies to Determine the Arm’s Length Price (Administrative Guidelines)” issued on October 25, 1999 [Document ID: Large Enterprise Examination Division 8-1] is hereby repealed.

(Purpose)

These procedures aim at the establishment of guidelines for operations related to Article 66-4 of the Act on Special Measures concerning Taxation “Special Taxation Measures of Transactions between Corporations and Foreign-related Persons” and the proper and smooth enforcement of transfer pricing taxation.

Chapter 1. Definitions and Basic Policies

(Definition of Terms)

1-1 In this Directive, the meaning of the terms listed below shall be as prescribed in the following respectively:

- (1) CTA: The Corporation Tax Act.
- (2) ASMT: Act on Special Measures concerning Taxation.

- (3) CTA Directive: Commissioner's Directive on Interpretation of the CTA.
- (4) ASMT Directive: Commissioner's Directive on Interpretation of the ASMT.
- (5) Transfer pricing taxation: The provisions of Article 66-4 of the ASMT (except Paragraph 3).
- (6) Consolidated corporation: A consolidated corporation prescribed in Item 12-7-4 of Article 2 of the CTA.
- (7) Consolidated parent corporation: A consolidated parent corporation prescribed in Item 12-7-2 of Article 2 of the CTA.
- (8) Final tax return: A final tax return prescribed in Item 31 of Article 2 of the CTA and attached documents.
- (9) Taxable year: Taxable year prescribed in Article 13 of the CTA.
- (10) Consolidated taxable year: Consolidated taxable year prescribed in Article 15-2 of the CTA.
- (11) Foreign-related person: A foreign-related person prescribed in Article 66-4(1) and Article 68-88(1) of the ASMT.
- (12) Foreign-related transaction: A foreign-related transaction prescribed in Article 66-4(1) and Article 68-88(1) of the ASMT.
- (13) Arm's length price: Arm's length price prescribed in Article 66-4(1) of the ASMT.
- (14) Method of calculation of arm's length price: The calculation method of arm's length price prescribed in Article 66-4(2) of the ASMT.
- (15) Unrelated persons: Persons who have no "special relations", as prescribed in Article 66-4(1) of the ASMT, with the subject corporation.
- (16) Comparable transactions: Comparable unrelated transactions prescribed in the ASMT Directive 66-4(2)-1.
- (17) Profit split method: The profit split method listed in Item 1 of Article 39-12(8) of the Cabinet Order of the ASMT.
- (18) Transactional net margin method: The transactional net margin method listed in Items 2, 3 and 4 of Article 39-12(8) of the Cabinet Order of the ASMT.
- (19) Intangible properties: The intangible properties prescribed in ASMT Directive 66-4 (2)-3-(8).
- (20) Tax treaties: The tax treaties that Japan concludes for the avoidance of double taxation and/or the prevention of fiscal evasion with respect to taxes on income.
- (21) Act on Special Provisions for the Enforcement of Income Tax Conventions: Act on Special Provisions of the Income Tax Act, Corporation Tax Act, and Local Tax Act for the Enforcement of Income Tax Conventions.
- (22) Mutual agreement procedure: A negotiation procedure between the competent authority of Japan and the competent authority of a foreign country pursuant to the provisions of a tax treaty.
- (23) APA: The confirmation made by a District Director of a Tax Office or a Regional Commissioner

of a Regional Taxation Bureau with regard to the methodologies of calculation of arm's length price and the specific details thereof (hereinafter referred to as "TPM") deemed to be the most reasonable to be adopted by a corporation.

- (24) APA review: The review of an APA request conducted by the RTB division-in-charge.
- (25) Pre-filing consultation: The consultation by the corporation intending to receive confirmation of the RTB division in charge (including, where necessary, the division in charge of the National Tax Agency and Office of Mutual Agreement Procedures) concerning the TPM for which an APA request is to be made (including anonymous consultations through an agent) prior to an APA request.
- (26) RTB division in charge: The Corporation Taxation Division of the Second Taxation Department of the Regional Taxation Bureau (Taxation Department in the cases of the Kanazawa, Takamatsu, and Kumamoto Regional Tax Bureaus) and Corporation Taxation Division of the Okinawa Regional Taxation Office (hereinafter referred to as "RTB Corporation Taxation Divisions") or Advance Pricing Arrangement Division of the First Large Enterprise Examination Department of the Tokyo Regional Tax Bureau, Transfer Pricing Division of the First Large Enterprise Examination Department of the Osaka Regional Tax Bureau, International Examination of Large Enterprise Division of the Large Enterprise Examination Department of the Nagoya Regional Tax Bureau, International Examination of Large Enterprise Division of the Large Enterprise Examination and Criminal Investigation Department of the Kanto-Shin-Etsu Regional Tax Bureau, Management Division (Large Enterprise Examination) of the Large Enterprise Examination and Criminal Investigation Department of the Sapporo, Sendai, Kanazawa, Hiroshima, Takamatsu, Fukuoka, and Kumamoto Regional Tax Bureaus, and the Large Enterprise Examination Division of the Okinawa Regional Taxation Office (hereinafter referred to as "RTB Large Enterprise Examination Divisions").
- (27) NTA division in charge: The Corporation Taxation Division of the Taxation Department of the National Tax Agency, or the Large Enterprise Examination Division of the Large Enterprise Examination and Criminal Investigation Department of the NTA.
- (28) NTA Office of Mutual Agreement Procedures: The Office of Mutual Agreement Procedures of the Commissioner's Secretariat of the National Tax Agency.
- (29) Commissioner's Directive on OTPCC: Commissioner's Directive on the Operation of Transfer Pricing with regard to Consolidated Corporations (Issued on Apr. 28, 2005) [Document ID: Large Enterprise Examination Division 7-4, etc.].

(Basic Policies)

1-2 Operations of transfer pricing taxation need to be properly managed, taking into consideration the fact that this taxation system is based on the arm's length principles. For this reason, it shall be

operated in accordance with the basic policies stated below:

- (1) It shall be closely examined whether the prices fixed for foreign-related transactions are equal to the prices normally fixed for uncontrolled transactions. In cases where any problem is found in the transactions, efforts shall be made to widely collect information regarding the market and the business for an appropriate examination as to the selection of the calculation method and comparable transaction, and adjustment for differences.
- (2) To ensure the predictability of the corporation and to realize proper and smooth enforcement of transfer pricing taxation, the APA process shall be conducted in cases where an APA request regarding the TPM is submitted by the corporation, based on the contents of mutual agreement related to the APA request if there is any such agreement.
- (3) To solve international double taxation caused by transfer pricing taxation, it is important for the tax authorities of each country to share an understanding of transfer pricing. Therefore, an examination or APA review shall be conducted in an appropriate manner by referring to the OECD Transfer Pricing Guidelines as necessary.

(Use of Reference Case Studies)

1-3 The “Reference Case Studies on Transfer Pricing Taxation” (supplement) describes the tax treatment of transfer pricing illustrated by examples based on certain preconditions. This shall be referred to in order to assist the proper administration of transfer pricing taxation while being mindful that there exist other cases as well as those described in the Case Studies that, though similar, may be treated differently for the purposes of transfer pricing due to being based on different preconditions.

Chapter 2. Examination

(Examination Policies)

2-1 When examining foreign-related transactions, the following points shall be taken into account, in order to correctly ascertain whether any problem exists in the transaction under transfer pricing taxation. In the examination process, each case shall be examined not perfunctorily but carefully, bearing in mind the circumstances of each transaction.

- (1) Whether or not the gross profit margin or operating profit margin (hereinafter referred to as “profit margin and so on”) arising from foreign-related transactions of the corporation is excessively low compared with other transactions, which are conducted by the corporation with unrelated persons in a similar market and which are similar in quantity, market level, and other respects.
- (2) Whether or not the profit margin and so on arising from foreign-related transactions of the

corporation is excessively low compared with the profit margin and so on of other unrelated persons engaged in the same category of business similar in quantity, market level, and other respects with the corporation.

- (3) Whether or not the corporation's profit arising from foreign-related transactions is relatively low compared with the foreign-related person's profit arising from the same transactions, in the light of the function performed or risks assumed by the corporation or the foreign-related person with respect to such foreign-related transactions.

(Points to Consider when Conducting Examinations)

2-2 Foreign-related transactions shall be examined on the basis of final tax returns and other materials or data collected through examinations.

Prior to calculation of arm's length prices, examinations shall be conducted from various angles, including by the following methods, in order to determine whether there exist any problems regarding transfer pricing taxation and to ensure that the examinations are conducted effectively.

- (1) Verification whether or not the profit margin of foreign-related transactions under the examination are within the range of the profit margin of uncontrolled transactions (hereinafter referred to as "transactions deemed comparable with the foreign-related transaction") in the same business category and substantially similar to the foreign-related transactions in terms of quantity, market level, and other respects.
- (2) Use of the average value of the consideration or profit margin for foreign-related transactions or transactions deemed comparable with the foreign-related transactions during a reasonable length of time before and after such a taxable year or consolidated taxable year, if it is considered to be inappropriate to examine the price of inventory and so on of the foreign-related transactions based only on the information for each relevant taxable year or consolidated taxable year due to considerable changes in prices reflecting changes in public demand, product lifecycle, or other such factors.

(Examination of Attachment of Form 17-(3))

2-3 In cases where a corporation that conducts any foreign-related transaction fails to attach "Information on Foreign Related Persons" (Form 17-(3)) to its final tax return or to provide sufficient information in Form 17-(3), the corporation shall be urged to submit the Form or to revise the information provided, and endeavors to obtain more accurate information on the particulars of the transactions shall be made.

(Documents to Be Inspected at the Time of Examination)

2-4 In examinations, it shall be ascertained whether any problem under transfer pricing taxation

exists by obtaining information on the actual circumstances of the foreign-related transaction from documents, books and records, and other materials (hereinafter in 2-4 referred to as “documents”), such as:

- (1) Documents that describe the capital relationship and details of business of the corporation and each foreign-related person:
 - (a) Documents containing the capital and business relationship between the corporation and its affiliate(s);
 - (b) Documents containing the history and any changes in major shareholders of the corporation and the foreign-related person;
 - (c) Financial documents or financial statements and reports on the details of business with respect to the corporation, and corresponding reports for the foreign-related person;
 - (d) Documents listing the major product lines of the corporation and the foreign-related person, and the transaction price, selling markets, and market size of each product;
 - (e) Documents containing the results and characteristics of each business, the special circumstances of each taxable year, and other details of business of the corporation and the foreign-related person.
- (2) Documents used by the corporation for the calculation of arm’s length prices:
 - (a) Documents containing the selection process of comparable transactions adopted by the corporation and the details of the comparable transactions;
 - (b) In cases where the corporation calculates arm’s length prices regarding more than one transaction as a single transaction, documents reporting the details of each original transaction on the basis of which the calculation is made;
 - (c) Documents containing the reasons for adoption of the calculation method of the arm’s length prices and any other document prepared by the corporation for calculating the arm’s length prices;
 - (d) Documents containing the adjustment method and reasons for adjustments, if differences are adjusted with respect to comparable transactions.
- (3) Documents containing the details of foreign-related transactions:
 - (a) Contracts or documents containing the content of contracts;
 - (b) Pricing policy and documents containing the details of price negotiations between the corporation and the foreign-related person;
 - (c) Documents containing the details of the business strategies of the corporation or the foreign-related person with regard to the foreign-related transactions;
 - (d) Documents containing the statement of profits and losses of the corporation and the foreign-related person with regard to the foreign-related transactions;
 - (e) Documents containing the functions performed or risks assumed by the corporation and the

- foreign-related person with respect to the foreign-related transactions;
 - (f) Documents containing the details of the intangible properties used by the corporation or the foreign-related person for conducting the foreign-related transactions;
 - (g) Documents regarding the analysis of the market of the inventory and so on related to the foreign-related transactions;
 - (h) Documents containing the details of inventory and so on related to the foreign-related transactions;
 - (i) If there are any other transactions closely connected with the foreign-related transactions, documents containing the details of such transactions.
- (4) Other documents
- (a) Manuals and so on containing the details of the accounting standards of the corporation and the foreign-related person;
 - (b) Documents containing the details of the transfer pricing examinations or APA conducted with regard to the foreign-related person by foreign tax authorities;
 - (c) If the foreign-related person, under the system of a foreign country corresponding to transfer pricing taxation, has prepared any document pursuant to the rules that require the preparation of appropriate documents for supporting the effectiveness of the system (referred to as “Documentation Rules”), then the documents so prepared;
 - (d) Other documents as deemed necessary.

(Points to Note in Applying the Estimation Clause or the Rules of Inquiry and Inspection to Third Parties in the Same Trade)

2-5 In cases where a corporation is requested to present or submit documents, books, and records or copies (hereinafter referred to in 2-5 as “documents prescribed in Paragraph 7”), and the corporation fails to present such documents prescribed in Paragraph 7 without delay, the provisions of Paragraph 7 (“Estimation Clause”) or Paragraph 9 (“Rules of Inquiry and Inspection to Third Parties in the Same Trade”) of Article 66-4 of the ASMT is applicable. In applying these rules, the following points shall be noted:

- (1) When requesting the corporation to present or submit the documents prescribed in Paragraph 7, explanation shall be given to the corporation that if it fails to present or submit these documents without delay, Paragraph 7 or Paragraph 9 of Article 66-4 of the ASMT is applicable; also, the fact that the explanation has been given and how the documents are presented or submitted by the corporation after such explanation shall be recorded.
- (2) Whether the corporation has presented or submitted the documents prescribed in Paragraph 7 without delay shall be judged in light of the period normally required for submission or presentation of such documents.

(3) In cases where any uncontrolled transaction (uncontrolled transaction prescribed in ASMT Directive 66-4(2)-1; hereinafter the same) recognized by applying the provisions of Article 66-4(9) of the ASMT is selected as a comparable transaction, explanation shall be given to the corporation about the conditions of such selection, the content of the comparable transaction, and the method of adjustment for difference. When the explanation is made, attention shall be paid to the provisions of Article 163 (Confidentiality of Staff) of the CTA and the fact that such an explanation has been given shall be recorded.

(Loans)

2-6 The following points shall be noted when examining loans:

- (1) Loans to which the CTA Directive 9-4-2 (Regarding Loans Without Interest for Reconstructing a Subsidiary and so on) is applicable shall also be treated as legitimate transactions under transfer pricing taxation.
- (2) In cases where the maturity date of a foreign-related transaction is unknown, the period of the loan shall be reasonably calculated in light of the purpose of the loan.

(Corporations Not in the Financial Business)

2-7 In conducting examinations on lending and borrowing activities between a corporation and a foreign-related person, in cases where neither party is engaged in lending or investment activities as a core business and also where the ASMT Directive 66-4(6)-4 is not applicable, the appropriateness of the interest rate applied to the lending or borrowing shall be examined by regarding the interest rate, calculated as follows, as the arm's length interest rate:

- (1) The interest rate that would normally be applied to a loan, assuming that the lender involved in the foreign-related transaction made the loan from an unrelated bank under similar conditions in terms of currency, borrowing date, and borrowing period.
- (2) The interest rate that would normally be earned on the funds involved in the foreign-related transaction, assuming that they were invested in government securities or the like under similar conditions in terms of currency, transaction date, and transaction period (exclusive of cases where the interest rate set forth in (1) is applicable).

(Note) In cases where the interest rate set forth in (1) is applicable, and the loan actually made from a bank and so on to the lender in the foreign-related transaction is a loan made under similar conditions as set forth in (1), whether the loan has a conditional relationship with the foreign-related transaction is of no relevance.

(Provision of Services)

2-8 The following points shall be noted when examining the provision of services:

(1) In some cases, the consideration for use of intangible properties is not included in the price for the provision of services, even though the intangible properties are used for rendering services.

(Note) In the case where it is examined whether any intangible properties are used when services are rendered, it shall be noted that the provision of services and use of intangible properties are conceptually distinct. Consideration therefore needs to be given to such matters as whether the intangible properties used by the service provider when rendering services correspond to the intangible properties set forth in ASMT Directive 66-4(2)-3-(8), and what impact the provision of services has on the activities and functions of the service recipient.

(2) In some cases, the services are rendered in conjunction with the transfer and so on of tangible assets or intangible properties, and the value of the consideration related to the provision of services is included in the price of such transfers and so on of such properties.

(Provision of Services Incidental to the Original Business Activities)

2-9 In the case where the ASMT Directive 66-4(6)-5 is not applicable to the provision of services incidental to the original business activities conducted by the corporation with the foreign-related person, whether or not the consideration for rendering such services is appropriate shall be examined, assuming that the gross cost for rendering such services is an arm's length price.

In this case, the services incidental to the original business activities mean the services rendered incidentally or related to the original business activities of a corporation or a foreign-related person not mainly engaged in the provision of the services; e.g., a corporation that imports products from its foreign subsidiary provides technical guidance regarding the manufacturing facilities of the foreign subsidiary. The gross cost for the provision of services includes, as a rule, not only direct expenses related to the services but also indirect expenses, such as the general and administrative expenses of the department in charge or any assisting department, calculated in accordance with reasonable distribution standards.

(Note) As a rule, whether the provision of services is incidental to the original business is judged on the basis of the purpose of such rendering of services. Nevertheless, the gross cost incurred for the provision of services shall not be treated as an arm's length price if:

- (a) The cost incurred for the provision of the services accounts for a considerable portion of the amount of costs or expenses of the corporation or the foreign-related person for the taxable year during which such services are rendered.
- (b) It is deemed inappropriate to treat the gross cost for the provision of the services as a consideration of the service; this is because the intangible properties are used for the provision of such services, or for other similar reasons.

(Treatment of Intra-group Services)

(1) All transactions having commercial value between a corporation and its foreign-related persons fall under foreign-related transactions.

Thus, transfer pricing examinations shall be conducted bearing in mind that the following services have commercial value: services regarding management, finance, business, and administration (see list below), which are performed by the corporation for its foreign-related persons (or vice versa) and which are services that the foreign-related persons would need to acquire from unrelated persons by paying the consideration or would perform for themselves if they were not rendered by the corporation.

- (a) Planning and/or coordination
- (b) Budgeting and/or budgetary control
- (c) Accounting, tax, and/or legal services
- (d) Management of credit and/or factoring
- (e) Operation, maintenance, and/or management of computer networks
- (f) Supervision of cash flow and/or solvency
- (g) Investing and/or raising of funds
- (h) Management of interest and/or exchange rate risks
- (i) Assistance in the fields of production, purchase, distribution, and/or marketing
- (j) Recruitment and/or training of staff

In cases where the corporation continuously maintains staff and equipment that are ready to perform services for the foreign-related persons upon request at any time, maintaining this state of readiness is itself a service, thus transfer pricing examinations of these services shall be conducted depending on the respective conditions.

In cases where foreign-related persons acquire some services from unrelated persons or perform such services for themselves, services which the corporation duplicates for the foreign-related persons do not have commercial value and are not included in foreign-related transactions. Exceptions are where the duplication of services is only temporary or where the duplication is undertaken to reduce the risk of a wrong business decision.

On the other hand, even if the activities performed by the corporation as the parent company for the foreign-related person are related to intra-group services, activities such as meetings of shareholders of the parent company or reporting requirements based on legislation, which the parent company performs in its capacity as a shareholder, do not have commercial value and are not included in foreign-related transactions; this is because they are not the type of activities that the foreign-related persons would acquire from unrelated persons by payment or would perform

for themselves if they were not performed by the corporation. Whether these activities are included in activities which the parent company performs in its capacity as a shareholder, or monitoring and so on which are included in intra-group services, shall be determined based on whether the activities have commercial value or not.

(Intangible Properties to Consider in Examinations)

2-11 When determining, in examinations, how intangible properties contribute to the income of the corporation or foreign-related persons, properties such as the following that have material value and serve as a source of income shall be comprehensively considered:

- (a) Patents and trade secrets derived from technical innovation.
- (b) Know-how derived from experience by employees and other human resources through business activities such as management, front-office operations, production, research and development, and sales promotion.
- (c) Production process, negotiation procedures, and development, distribution, and financing networks.

When determining whether the intangible property of the corporation or foreign-related person serve as a source of income, in the case, for instance, where it is possible to identify a corporation without intangible properties serving as a source of income from among corporations engaging in the same category of business as the foreign-related transaction and having similar markets and scales of operation, it shall be noted that a comparison is made between the profit margin (or similar indices) of the foreign-related transaction of the corporation or foreign-related person and the profit margin of the corporation without such intangible properties, as well as analyzing the activities, functions, and so forth in relation to the creation of the intangible properties of the corporation or foreign-related person.

(Note) Regarding the relationship between the provision of services and intangible properties in cases where intangible properties are used when providing services, 2-8(1) Note shall be noted

(Contribution to the Formation, Maintenance or Development of Intangible Properties)

2-12 When examining licensing transactions of intangible properties, it shall be noted that not only the legal ownership of the intangible properties but also the degree of contribution of a corporation or a foreign-related person to the activities for the formation, maintenance or development of the intangible property (hereafter "the formation and so on") need to be taken into account.

In assessing the degree of the contribution to the said formation and so on, the functions that the corporation or the foreign-related person performed, such as decision making, rendering of services, bearing of costs, and risk management, shall be taken into account comprehensively. In this case, it is to be noted that the degree of contribution shall be assessed as low when the corporation or the

foreign-related person merely bears the cost of the formation and so on of the intangible properties that are expected to be the source of income.

(Transaction for the Licensing of Intangible Property)

2-13 In cases where either a corporation or a foreign-related person is using the intangible property owned by either of them without an agreement concerning its use, it is to be noted that the arm's length price of this transaction shall be calculated as a transaction for licensing, except when it is recognized as a transfer transaction.

The commencement date of the licensing shall be determined properly from among the dates when the intangible property concerned was provided, the use started or profit was recorded through the use, by considering examples of transactions between non-related persons.

(Cost Contribution Arrangement)

2-14 A Cost Contribution Arrangement (hereinafter referred to as "CCA") means a contract to share the cost required for the activities necessary for the achievement of a common purpose, such as development of a specific intangible property (hereinafter referred to as "Activities such as Research and Development,") between contracting parties (hereinafter referred to as "the Participant"), and to obtain the interest of the outcome yielded from Activities such as Research and Development in accordance with the proportion of the total amount of expected benefit (hereinafter referred to as "the Expected Proportion of Benefit") of the earning that is expected to increase or the cost that is expected to decrease (hereinafter referred to as "the Expected Benefit") for each participant by the new outcome yielded from Activities such as Research and Development.

For instance, the following falls under a CCA: a contract to share the cost required for the development of the manufacturing technology between the corporation and foreign-related person, using the Expected Proportion of Benefit calculated on the basis of the Expected Benefit that would be enjoyed through the sale of new products to be manufactured by each of the corporation and foreign-related persons, and using the manufacturing technology concerned to obtain the interest of the new intangible property yielded from the development of the manufacturing technology in accordance with the cost to be shared by each of them.

(Treatment of CCA)

2-15 The cost contribution (including the adjustment of the amount of cost contribution) and acquisition of the interest based on a CCA concluded between the corporation and foreign-related person fall under foreign-related transactions, and in cases where the Expected Proportion of Benefit of a corporation in the CCA is recognized to be excessive compared with an appropriate proportion (the proportion calculated based on 2-16 and 2-18), it shall be noted that the amount for the part

corresponding to the proportion that became excessive out of the total cost borne by the corporation concerned may not be deducted from the taxable income as it exceeds the arm's length price.

(Note) The cost shared by a corporation shall be treated in accordance with prescriptions of the laws and regulations concerning corporation tax. Therefore, for instance, in cases where there are entertainment expenses and so forth in the cost required for Activities such as Research and Development which are provided in the provision of Articles 61-4(3) of the ASMT, the amount of entertainment expenses and so forth shared by the corporation based on a proper Expected Proportion of Benefit shall be treated in accordance with the provision of ASMT Directive 61-4(1)-23(1) ("Method of the Expenditure of Entertainment Expenses and So Forth"). Therefore, it is to be noted that entertainment expenses and so forth in the cost shall be subject to the calculation of non-deductible expenses under the provision of Paragraph 1 of the said Article.

(Points to Consider in Relation to CCA)

2-16 In cases where a corporation concluded a CAA with a foreign-related person, it shall be examined whether or not the amount of cost contribution of the corporation is appropriate, taking the following points into consideration.

- (a) Whether the range of the Activities such as Research and Development is clearly defined and the content is provided for concretely and in detail.
- (b) Whether all participants are expected to enjoy the benefit directly by using the outcome yielded from the Activities such as Research and Development for themselves.
- (c) Whether the amount of cost to be shared by each participant has been determined by allocating the total amount of cost required for the Activities such as Research and Development, based on the Expected Proportion of Benefit which has been properly estimated.
- (d) In cases where it is difficult to estimate the Expected Benefit directly, whether the standard (sales amount, gross margin, operating profit, volume of production or sales and so forth) used for the calculation of the Expected Benefit is reasonable enough for assuming the degree of Benefit obtained from the outcome yielded from the Activities such as Research and Development.
- (e) Whether the Expected Proportion of Benefit is reviewed in accordance with the fluctuation of the standard used to calculate it.
- (f) Whether it has been examined if the estimation of each participant's Expected Benefit was appropriate when there was a remarkable difference between the Expected Proportion of Benefit and the realized proportion of benefit (which means the proportion of increased earning or decreased costs for each participant (hereinafter referred to as "the Realized Benefit") based on the outcome yielded from Activities such as Research and Development,

to the total of the Realized Benefit for each participant).

- (g) In cases where there is a new entry in an active CCA or a withdrawal and there is intangible property and so forth, developed through Activities such as Research and Development, whether the intangible property and so forth are evaluated at the time of the new entry or a withdrawal, and whether the appropriate consideration of the intangible property and so forth is paid or received among the participants in proportion to the share of the intangible property and so forth.

(Use of Existing Intangible Property in CCA)

2-17 In cases where an existing intangible property owned by a participant (any properties other than intangible property acquired / developed through the CCA, hereafter the same) is used for Activities such as Research and Development in the CCA, it shall be noted that it is required to examine whether the participant who owns the existing intangible property has received the arm's length royalty or the cost shared has been calculated assuming that such an amount has been shared by the participant, except when such an intangible property is recognized to have been transferred to the other participants.

(Note) In cases where a corporation conducts development activities and so forth by itself in relation to Activities such as Research and Development, within the framework of the CCA, or the realized benefit of the foreign-related participant markedly exceeds its Expected Benefit, it is required to examine whether the existing intangible property owned by the corporation is used for Activities such as Research and Development concerned; in the case where it is recognized as being used, it is to be noted that the points in this main clause shall be taken into account in the examination.

(Documents to be Inspected at the Time of Examination on CCA)

2-18 While information on the actual circumstance of the foreign-related transaction is to be accurately obtained from the documents and other items listed in 2-4 above in examinations, when examining on CCA, it shall be determined whether or not there is any problem under transfer pricing taxation by requesting the submission of documents of CCA (including the attached documents describing the scope / content of the activities of research and development) and mainly the following documents, such as:

- (1) Documents prepared at the time of concluding a CCA:
 - (a) Documents describing the name, address, capital relations, description of business and other information of the participants,
 - (b) Documents describing the details of negotiation / consultation leading to the conclusion of an agreement made by participants,
 - (c) Documents describing the method of calculating the Expected Proportion of Benefit and the

- reason to use such a method,
- (d) Documents describing the accounting standard used for calculating the amount of the cost shared and Expected Benefit,
 - (e) Documents describing the details of adjusting the amount of cost shared in the case where there is the difference between the realized proportion of benefit and Expected Proportion of Benefit,
 - (f) Documents describing the details of valuation of the intangible property and so on in cases where any new participation or withdrawal takes place,
 - (g) Documents describing the details in relation to the modification of contractual terms and conditions, the revision, or termination of the CCA.
- (2) Documents prepared after the conclusion of a CCA:
- (a) Documents describing the total amount of the cost and its breakdown required for Activities such as Research and Development, as well as the amount of the cost shared by each participant and the process of its calculation,
 - (b) Documents describing the extent of the difference between the Expected and realized Proportions of Benefit in relation to Activities such as Research and Development,
 - (c) Documents describing the change of the share of each participant in the intangible property and so forth, formed through Activities such as Research and Development (including the method of valuation of intangible property and so forth, formed through Activities such as Research and Development),
 - (d) Documents describing the details of any new participation or withdrawal.
- (3) Other documents:
- (a) Documents describing the content of the intangible property and details of calculating the royalty in cases where an existing intangible property concerned is used in Activities such as Research and Development,
 - (b) Documents describing the name, address and other particulars of those who are scheduled to make use of the outcome yielded from Activities such as Research and Development, but who will not participate in the CCA

(Transfer of Money for Price Adjustment and So Forth)

2-19 In cases where a corporation transfers money back and forth with a foreign-related person nominally for the purpose of price adjustment, whether or not the transfer of money is made in fact for the adjustment of transaction prices shall be closely examined.

(Consideration Calculated by Foreign Tax Authority)

2-20 It shall be noted that since arm's length prices are calculated in accordance with the laws of

Japan, the consideration for a foreign-related transaction calculated for the purpose of taxation corresponding to transfer pricing taxation on a foreign-related person by a foreign tax authority is not necessarily an arm's length price (except for the cases where a mutual agreement has been reached).

(Relationship with Request for APA)

2-21

- (1) It shall be noted that an examination is not interrupted by an APA request.
- (2) Documents (except those as to facts) received from the corporation for the APA review (hereinafter referred to as the "applicant for APA") may not be used for the examination unless the corporation gives consent to the use of such materials.

(Transfer Pricing Taxation and Classification of Domestic/Foreign Source Income)

2-22 In cases where the provision of Article 69(1) (Foreign Tax Credit) of the CTA is applied together with transfer pricing taxation in examinations, it shall be noted that calculation of the creditable amount of foreign tax is made after the judgment of whether the increased income through the application of transfer pricing taxation is of domestic source or foreign source by applying the provisions of Article 138 (Domestic Source Income) to Article 140 (Details of the Scope of Domestic Source Income) of the CTA inclusive.

(Relationship with Thin Capitalization)

2-23 In cases where the provision of Article 66-5 (Special Rules of Interest on Indebtedness Pertaining to Foreign Control Stockholders) of the ASMT is applied together with transfer pricing taxation in examinations, it shall be noted that the portion of the "interest on borrowed funds" that exceeds the arm's length price may not be included when calculating the "interest on borrowed funds" prescribed in Paragraph 1 of the preceding article.

(Relationship with Withholding Tax)

2-24 In cases where, as a result of an examination, any difference is identified for the purpose of levying of the corporation tax between the amount of interest or royalty paid by the corporation to the foreign-related person and the arm's length price, it shall be noted that such difference does not affect the interest or the amount of royalty subject to withholding tax. Also it shall be noted that, under some tax treaties, the reduced tax rate is not applicable to such differences.

(Relationship with Consumption Tax)

2-25 Transfer pricing taxation covers the application of the CTA and other laws related to

Corporation Tax. Therefore, it shall be noted that the calculation of consumption tax is not affected by the application of such taxation in examinations.

Chapter 3. Points to Note in Calculating Arm's Length Prices

(Method for Adjusting Differences)

3-1 In adjusting the differences between a foreign-related transaction and a comparable transaction, the adjustment may be made by applying the method described below according to the circumstances of each case.

It shall be noted that an adjustment is made for differences if it is objectively clear that the differences would have an impact on the calculation of the consideration prescribed in Item 1(a) of Article 66-4(2) of the ASMT or the normal profit margin prescribed in Item 1(b) and (c) of preceding article, or on the calculation of the percentage prescribed in Item 2 and Item 3 of Article 39-12(8) of the Cabinet Order of the ASMT (by the same method as that given in Item 2(a) of Article 66-4(2) of the ASMT).

- (1) In cases where the trade terms of one transaction is FOB (free on board)-based and the other transaction is CIF (cost, insurance & freight)-based, the amount equal to freight and insurance is added to or deducted from the consideration of the comparable transaction.
- (2) In cases where there is a difference between the foreign-related transaction and a comparable transaction with respect to the period after sight of the bill, the amount equal to the interest that accrues during the period between the sight and settlement is added to or deducted from the consideration of the comparable transaction.
- (3) In cases where any discount or rebate according to the quantity of the transaction is specified in the trade terms for the comparable transaction, the consideration resulting from application of the terms such as discount or rebate of the comparable transaction to the quantity of the foreign-related transaction is used.
- (4) In cases where there is any difference as to function or risk, and the extent of such function or risk is considered measurable by the amount of expenses incurred by the parties with respect to the foreign-related transaction and the comparable transaction, such difference is adjusted using the percentage of the amount of the above-mentioned expenses to the total sales or sales cost related to such foreign-related transaction and the comparable transaction.

(Selection of Comparable Transactions for Foreign-Related Transactions with Use of Intangible Properties)

3-2 In cases where, when applying the provisions of ASMT Directive 66-4(2)-3, a corporation or foreign-related person engages in foreign-related transactions involving use of intangible properties,

it is to be noted that the similarity of intangible properties in terms of type, scope, mode of use, and so forth shall be considered when selecting comparable transactions.

(Calculating Arm's Length Prices for Some Comparable Transactions)

3-3 In calculating arm's length prices, where some comparable transactions are so similar to the foreign-related transaction in reference to factors which are prescribed in ASMT Directive 66-4(2)-3, it shall be noted that a mean of prices or margin profits arising from those comparable transactions may be used.

(Treatment of Common Expenses in the Profit Split Method)

3-4 When applying the profit split method, in cases where any cost of sales, and general, administrative and selling expenses incurred in connection both with the foreign-related transaction and other transactions (referred to in 3-4 as "Common Expenses") are included in such cost and expenses of the corporation or its foreign-related person, the profit to be split (as prescribed in ASMT Directive 66-4(4)-1: hereinafter the same) arising from the foreign-related transaction is calculated by dividing the cost and expenses in accordance with the proportion of reasonable factors. The reasonableness of these factors, such as sales, cost of sales, value of assets used for the transactions, number of employees involved in the transaction and so forth, shall be regarded in light of the content of both transactions and the nature of such expenses.

Also, it shall be noted that the common expenses are calculated based on the above method when calculating the factors to be used for attribution of profit to be split based on the amount of expenses.

(Treatment of Residual Profit Split Method)

3-5 When applying the residual profit split method prescribed in ASMT Directive 66 4(4)-5, "ordinarily gained profit out of the profit to be split that unrelated persons who do not possess material intangibles may obtain" shall be calculated based on profit indices, such as the ratio of operating profit to the value of business assets, or to the sales of a corporation (excluding a corporation that owns any material intangible asset) that is engaged in the same category of business as the foreign-related person and is similar in market size or scale of operation to the foreign-related person.

(Selling and General Administrative Expenses in Applying the Transactional Net Margin Method)

3-6 In calculating arm's length prices using the transactional net margin method, "selling and general administrative expenses for selling the inventory concerning the foreign-related transaction" shall contain the direct and/or indirect costs of selling. In cases where there are costs arising from both foreign-related transactions and other transactions, the costs shall be divided according to a rational

ratio of factors in light of the content of both transactions and the nature of such expenses, for example, sales, cost of sales, value of assets, and number of employees, according to the format of the individual transaction.

(Points to Note Concerning the Treatment of Taxation by Estimation)

3-7

(1) When applying the method set forth in Item 1 of Article 39-12(12) of the Cabinet Order of the ASMT, it shall be noted that the provisions of ASMT Directive 66-4(4)-1 to 66-4(4)-5 inclusive shall apply *mutatis mutandis*, and that the operating profit or corresponding sum (hereinafter referred to as “operating profit”) arising from business involving foreign-related transactions according to the financial documents describing the consolidated assets and profit and loss situation of the business group to which the corporation and foreign-related persons belong, (hereinafter referred to as “consolidated financial statements”) shall in principle be allocated to the corporation and foreign-related persons by splitting it according to the factors provided for in the said item.

(Note) In cases where the operating profit arising from business involving foreign-related transactions according to consolidated financial statements is not separated from operating profit arising from other business, the amount calculated by multiplying the operating profit arising from business including business involving foreign-related transactions by the proportion of (b) to (a) below may be allocated to the corporation.

(a) Factors sufficient to estimate the degree of the contribution of the business group to the generation of operating profit from business including business involving foreign-related transactions.

(b) Factors among those specified in (a) that are sufficient to estimate the degree of the contribution by the corporation through business involving foreign-related transactions.

(2) It shall be noted that when applying the method set forth in Item 4 of Article 39-12(12) of the Cabinet Order of the ASMT, ASMT Directive 66-4(5)-1 shall apply *mutatis mutandis*.

Chapter 4. Treatment of Foreign Transferred Income

(Treatment of Refund of Foreign Transferred Income)

4-1 In cases where a corporation that submitted the document prescribed in ASMT Directive 66-4(8)-2 has not received all or part of the refund stated in the document by the scheduled date, it shall be judged as to whether the application of the provision referred to above is appropriate after examining if there is any reasonable reason for there not having been a refund.

(Note) In the case where a corporation inquires about the form of the document prescribed in ASMT

Directive 66-4(8)-2, the corporation shall be informed that it may use “Application for Refund of Foreign Transferred Income” (appended Form 1).

(Treatment of Refund of Foreign Transferred Income with Corresponding Adjustment)

4-2 In cases where a foreign tax authority has imposed tax on a foreign-related person under a system corresponding to transfer pricing taxation, it shall be noted that if a corporation whose taxable income has been reduced by reason of a corresponding adjustment based on a mutual agreement has remitted the entire amount or part of the amount so reduced to the foreign-related person, the remitted amount may not be deducted from the taxable income.

(Treatment of Amounts Refunded to Foreign-Related Persons with Corresponding Adjustment)

4-3 In cases where taxable income has been reduced by reason of corresponding adjustment based on a mutual agreement, when the corporation shall remit the entire amount or part of the amount so reduced to the foreign-related person within a reasonable period, a request for correction to a tax return is made pursuant to the provisions of Article 7(1) of the Act on Special Provisions for the Enforcement of Income Tax Conventions (“Special Measures for Correction in the Case of Agreement Based on an Income Tax Convention Concerning the Amount of Compensation for Transactions”) and the following particulars are reported in writing (using “Notification Regarding Refund of Foreign Transferred Income with Corresponding Adjustment” (appended Form 7)) to the District Director (Regional Commissioner in the cases of a corporation handled by the RTB Large Enterprise Examination Division), it shall be noted that the amount to be refunded is treated as an account payable to the foreign-related person.

- (a) Corporation name
- (b) Place of tax payment
- (c) Name of representative
- (d) Name and location of foreign-related person
- (e) Scheduled date of refund
- (f) Amount of refund (together with amount in foreign currency in the case of transactions in foreign currencies)
- (g) Method of refund

(Note) The amount reported as being refunded in respect of a transaction in a foreign currency shall be the yen equivalent calculated in accordance with the provisions of Corporation Tax Act Directive 13-2-1-2 (“Transactions in Foreign Currencies and Yen Conversions by the Accrual Calculation Method”). The difference between this amount and the yen equivalent converted by using the foreign exchange buying and selling rate on the day of the refund shall be included in gross revenue or loss in the taxable year in which the day of the refund falls.

Chapter 5. Advance Pricing Arrangements (APA)

(APA Policies)

5-1 In light of the fact that APA is intended to ensure the predictability of transfer pricing taxation for corporations and to assist proper and smooth enforcement of transfer pricing taxation, APA reviews shall be conducted in a balanced, accurate, and swift manner according to the complexity and importance of each case while paying full consideration to ensuring the taxation rights of Japan. Corporations shall also be eligible for appropriate pre-filing consultations in order to improve the convenience of and expedite the APA procedure.

(Filing Requests for APA)

5-2

- (1) Corporations are eligible to file requests for APA relating to some or all foreign-related transactions with the District Director (or the Regional Commissioner of the Regional Taxation Bureaus [hereinafter referred to as “RTB Commissioner”] in cases where the corporations are those under the jurisdiction of the RTB Large Enterprise Examination Division under the Ministry of Finance Ordinance No.49 of 1949; hereinafter the same) who has the responsibility for the corporation’s returns.
- (2) Upon request for APA, an applicant shall file a “Request for APA of the TPM” (appended Form 2) (hereinafter referred to as “APA request”) for each address in their country with the District Director of the precinct RTB. This will be done by the prescribed due date for the filing of final tax returns (the extended due date in cases where the due date is extended pursuant to the provisions of Article 75-2 (Special Rules for Extension of Due Date of Filing Final Returns) of the CTA pertaining to the first taxable year of the taxable years that the applicant is requesting to be confirmed (hereinafter referred to as “taxable years to be confirmed”).
- (3) The APA request shall be filed in duplicate (in triplicate when mutual consultations are requested) in cases of a corporation handled by the RTB Large Enterprise Examination Division, or in triplicate (in quadruplicate when mutual consultations are requested) in cases of all other corporations (The same shall apply to the cases of 5-3, 5-8, and 5-9)

(Documents to Be Attached)

5-3 The District Director shall ask an applicant for APA to submit the following documents with the APA request:

- (a) Documents describing the outline of transactions to be confirmed and organizations conducting the transactions to be confirmed;
- (b) Documents describing the TPM to be confirmed and specific details thereof, and an explanation as to why it is the most reasonable;
- (c) Documents describing business and economic conditions essential to the APA and its continuation (hereinafter referred to as “critical assumptions”);

- (d) Documents providing a detailed explanation of transactions to be confirmed, including cash flow and currencies involved;
- (e) Documents regarding direct or indirect capital relations or relations under substantial control between the foreign-related person pertaining to transactions to be confirmed (hereafter the “applicable foreign-related person”) and the applicant for APA;
- (f) Documents regarding the functions performed by the applicant for APA and the applicable foreign-related person in transactions to be confirmed;
- (g) Operational and accounting information for the prior three (3) taxable years of the applicant for APA and the applicable foreign-related person (or alternate information, such as future business plans, business projections if the transactions to be confirmed relate to a new product or business and data for the prior three (3) taxable years is not available);
- (h) Documents describing any transfer pricing examinations, appeals, lawsuits, and so forth pertaining to applicable foreign-related persons, and details of past taxation in their country;
- (i) Documents required in order to explain concretely the TPM applied for by the applicant for APA, such as the results of application of the TPM for which the APA is requested to the three (3) taxable years prior to the taxable year to be confirmed;
- (j) Other reference documents required for APA.

(Note) In addition to the documents set forth in (g) and (i), the RTB division in charge shall require the applicant for APA to submit documents for the two previous taxable years if it is deemed not possible to conduct a proper APA review using the documents for three (3) taxable years considering factors such as the lifecycle of the products involved in the transactions to be confirmed.

(Translation of Attached Documents)

5-4 Applicants for APA shall be requested to submit Japanese translations if any of the attached documents are written in foreign languages.

(Revision of APA Requests)

5-5 The Examination Group (Corporation) of the Tax Office (group in charge of corporation tax; hereinafter the same) or the RTB Large Enterprise Examination Division shall check the content of the APA request and documents as prescribed in 5-3. In the case where there are any misstatements or deficiencies, the applicant for APA shall be asked to revise the APA request.

(Forwarding of APA Requests and so on)

5-6 The Examination Group (Corporation) of the Tax Office shall promptly forward two (2) sets of the APA request received (or three (3) sets if the applicant for APA requests a mutual agreement procedure) to the RTB Corporation Taxation Division, and the RTB Corporation Taxation Division

shall promptly forward one (1) set of these (or two (2) sets if the applicant for APA requests a mutual agreement procedure) to the NTA Corporation Taxation Division. The RTB Large Enterprise Examination Division shall promptly forward one (1) set of the APA request received (or two (2) sets if the applicant for APA requests a mutual agreement procedure) to the Large Enterprise Examination Division of the Examination and Criminal Investigation Department of the NTA. If the applicant for APA requests a mutual agreement procedure, the NTA division in charge shall forward one (1) set of the APA request to the Office of Mutual Agreement Procedures of the NTA.

(Taxable Years to be Confirmed)

5-7 Taxable years to be confirmed are in principle from three (3) to five (5) taxable years.

(Amendments to APA Requests)

5-8 In cases where an applicant for APA submits documents pertaining to amendments to the filed request, the Examination Group (Corporation) of the Tax Office or the RTB Large Enterprise Examination Division shall process the request in accordance with the provisions of 5-5 and 5-6.

(Withdrawal of APA Requests)

5-9 In cases where an applicant for APA submits statements pertaining to the withdrawal of the APA request, the Examination Group (Corporation) of the Tax Office or the RTB Large Enterprise Examination Division shall process such statements in accordance with the provisions of 5-5 and 5-6.

(Pre-filing Consultations)

5-10

- (1) The RTB division in charge shall accede to requests from corporations for a pre-filing consultation. On receiving notice from the RTB division-in-charge, the NTA division-in-charge (including the Office of Mutual Agreement Procedures in the cases of consultations regarding an APA with mutual agreement; the same in (2)) shall in principle attend such consultations.
- (2) Mindful that pre-filing consultations are intended to help make APA procedures more convenient for corporations and to expedite APA procedures, the RTB division in charge (including the NTA division in charge involved in pre-filing consultations) shall pay attention to the following points when meeting with corporations for pre-filing consultations in order to streamline the processing of APA requests by applicants for APA and to facilitate APA reviews after their request:
 - (a) Matters necessary to APA procedures, including guidelines on the preparation of the

attached documents submitted with APA requests and deadlines for submission, shall be properly explained at the time of pre-filing consultations.

- (b) Efforts shall be made to provide the information required in order to correctly ascertain the details of the foreign-related transactions that are the subject of the consultation, and to enable the corporation concerned to make an appropriate judgment as to whether to apply for an APA and what kind of application to make.
- (3) At pre-filing consultations, the RTB division in charge shall discuss issues and information that fall within the scope of the documents presented or submitted by the corporation requesting the consultation.

In the case where documents required due to the content of the pre-filing consultation are not presented or submitted, it shall be explained to the corporation why a proper pre-filing consultation cannot be held.

- (4) In the case where an applicant for APA fails to attach the documents prescribed in 5-3 to an APA request, the applicant shall be informed that an APA request cannot be conformed pursuant to the provisions of 5-15(4) and 5-15(5), unless there are found to exist adequate grounds for being unable to submit some of the documents by the deadline for submission of the APA request at a pre-filing consultation that concerns the attachment of the documents prescribed in 5-3. In this instance, the RTB division in charge shall not be required to apply the provisions of 5-15(4) and 5-15(5) for a period deemed ordinarily necessary for the preparation of such documents (except where an extended period is required; hereinafter referred to as the “submission grace period”).

In such a case, the RTB division in charge shall specify the submission grace period to the corporation requesting the pre-filing consultation, and explain that the APA review is in principle deferred for the duration of this period.

(Review of APA Requests)

5-11 The RTB division in charge shall evaluate the APA request in the following manner:

- (1) The RTB division in charge shall commence the APA review promptly upon receipt of an APA request, and shall conduct the review in a balanced manner appropriate to the complexity and difficulty of the case while endeavoring to process the request correctly and swiftly. The NTA division in charge shall additionally be involved in APA review as necessary.

As the cooperation of the applicant for APA is essential to process an APA review swiftly, a better understanding of the applicant for APA on the importance of such cooperation shall be promoted.

- (2) The RTB division in charge shall in principle perform APA reviews in accordance with the provisions of 2-1 and 2-2, and as otherwise prescribed in Chapter 2 and Chapter 3.

It shall be noted that APA reviews do not constitute an examination or inspection of the taxpayer's books and records regarding Corporation Tax.

- (3) In cases where documents other than those prescribed in 5-3 are found to be required for an APA review, the RTB division in charge shall explain this to the applicant for APA and request that the applicant for APA submit such documents.

In order to expedite the APA review process, the RTB division in charge shall set a deadline for the submission of such documents that is deemed reasonable in view of the circumstances of the applicant for APA in light of the period ordinarily required to prepare such documents.

- (4) The RTB division in charge may request the applicant for APA to amend their requests in the case where the division concludes that the TPM requested is not the most reasonable.
- (5) The NTA division in charge shall request the RTB division in charge to report on the status of the APA review process as necessary.

(Mutual Consultations Relating to APA)

5-12

- (1) In cases where an applicant for APA has not filed a request for a mutual agreement procedure for the APA, the RTB division in charge shall provide information required by the applicant for APA to appropriately decide what kind of request to make; if it is confirmed that the applicant intends to request an APA with a mutual agreement procedure, it shall recommend that the applicant request for mutual consultation in order to avoid double taxation and ensure predictability.
- (2) The RTB division in charge shall recommend the prompt requesting of a pre-filing consultation or filing of an APA request by a corporation in the case where it is identified that the corporation or foreign-related person held a pre-filing consultation or filed an APA request with a foreign tax authority.
- (3) In cases where a mutual agreement procedure is requested, the RTB division in charge shall request the applicant for APA to file, in addition to APA requests, an Application for Mutual Consultation prescribed in the "Commissioner's Directive on Mutual Agreement Procedures (Administrative Guidelines)" issued on June 25, 2001 [Document ID: Office of Mutual Agreement Procedures 1-39].

(Coordination among the RTB division in charge and the NTA and the Office of Mutual Agreement Procedures)

5-13 In cases where an applicant for APA requests a mutual agreement procedure pertaining to the APA, the RTB division in charge, the NTA division in charge and the Office of Mutual Agreement Procedures shall consult with each other as necessary.

In this case, after completing its APA review, the RTB division in charge shall present its opinions on

the APA request to the Office of Mutual Agreement Procedures via the NTA division in charge. The Office of Mutual Agreement Procedures shall forward the contents of the mutual agreement to the RTB division in charge via the NTA division in charge.

(In the case where APA and Performance of APA Process Are Not Appropriate)

5-14 When conducting APA reviews, cases shall be appropriately handled as prescribed in (1) or (2) respectively in order to ensure the proper and smooth enforcement of transfer pricing taxation.

(1) In cases such as the following where an APA is deemed inappropriate, the RTB division in charge shall, after consultation with the NTA division in charge (including the Office of Mutual Agreement Procedures in the cases of an APA with mutual agreement), request the applicant for APA to correct the APA request. In the case where the applicant fails to make such a correction, an explanation shall be given to the applicant that the APA is not possible.

In the case where the content of a pre-filing consultation falls under (a) below, the following details shall be explained to the corporation requesting the pre-filing consultation.

(a) In cases where it is found that the burden of tax in Japan would be reduced without reasonable economic grounds as a result of the transaction to be confirmed being of a form not ordinarily undertaken between unrelated parties.

(b) In cases where the failure of the applicant for APA to submit information necessary for APA review or otherwise provide necessary cooperation would hinder an APA.

(2) In cases such as the following where commencement or continuation of APA review is deemed inappropriate, the RTB division in charge shall, after consultation with the NTA division in charge (including the Office of Mutual Agreement Procedures in the cases of an APA with mutual agreement), explanation shall be given to the applicant for APA that the APA process will be deferred until such time that the commencement or recommencement of APA review is possible.

(a) In cases where an applicant for APA files an APA request for transactions similar to those involving reassessment based on transfer pricing taxation, it is deemed necessary to conduct an APA review following adjudication on an appeal or finalization of a decision or judgment regarding such reassessment.

(b) In cases where an applicant for APA files an APA request and a request for a mutual agreement procedure in respect of foreign-related transactions other than transactions to be confirmed, it is deemed necessary to conduct an APA review for such transactions to be confirmed following a mutual agreement.

(c) In cases where it is deemed necessary to conduct an APA review after having obtained actual results of transactions to be confirmed due to it not being possible to ascertain the actual circumstances of business activities only from the documents, such as future business plans

and business projections, prescribed in the parenthesized clause to 5-3(g).

(Notification of Results of APA Review)

5-15

- (1) In cases where the RTB division in charge receives notification of a mutual agreement from the Office of Mutual Agreement Procedures via the NTA division in charge, the RTB division in charge shall promptly notify the District Director that the APA confirmation is made based on the results of agreement after the request has been suitably processed, including requesting the applicant for APA to correct the application according to the results of the agreement.
- (2) In cases where the RTB division in charge has received a notification that a mutual agreement had not been reached from the Office of Mutual Agreement Procedures via the NTA division in charge, the RTB division in charge shall ask the opinion of the applicant for APA regarding whether to withdraw its request for APA or to seek APA without a mutual agreement, and then promptly process the request in accordance with the provisions of 5-9, 5-15(3), or 5-15(4).
- (3) In cases where the RTB division in charge concludes after APA review that the TPM applied by the corporation is the most reasonable and no request has been filed for a mutual agreement procedure, the division shall promptly forward an APA notice to the District Director
- (4) In cases where the RTB division in charge concludes after APA review that the TPM applied by the corporation is not the most reasonable, the applicant for APA fails to submit the attaching documents prescribed in 5-3, the applicant does not submit the documents set forth in 5-11(3), or it is judged that an APA review can not be conducted in accordance with the provisions of 5-14(1), the division shall, after consultation with the NTA division in charge (including the Office of Mutual Agreement Procedures in the cases of an APA request with mutual agreement), promptly inform the District Director that the APA confirmation is not possible.
- (5) The District Director shall, upon receipt of the notice set forth in 5-15(1), 5-15(3), or 5-15(4) from the RTB division in charge, promptly send a notice for or against the APA using appended Form 3 (“Notification of Confirmation of Method of Calculation of Arm’s Length Prices”) or Form 4 (“Notification That Method of Calculation of Arm’s Length Prices Cannot Be Confirmed”), as applicable, to the applicant for APA.

(Effect of the APA)

5-16 In cases where a corporation that has received a notice of APA confirmation set forth in 5-15(5) (hereinafter referred to as a “confirmed corporation”) files tax returns complying with the content of the APA for the confirmed taxable years, the District Director shall treat the confirmed foreign-related transactions (hereinafter referred to as “confirmed transactions”) as having been conducted at the arm’s length price.

In cases where a taxable year to be confirmed has already elapsed at the time of confirmation, it shall be noted that an amended return submitted by the confirmed corporation to make the return filed for the taxable year to be confirmed comply with the content of the APA is not treated as corresponding to a “return filed foreknowing that corrections should be made” prescribed in Article 65(5) (Additional Tax for Deficient Returns) of the Act on General Rules for National Taxes.

(Submission of Reports)

5-17 Confirmed corporations shall be requested to submit reports with the following information no later than the prescribed due date for filing final tax returns concerning the confirmed transactions pertaining to each taxable year confirmed (hereinafter referred to as “confirmed taxable year”) or within the period specified by the District Director.

The report shall be filed in duplicate in the cases of corporations handled by the RTB Large Enterprise Examination Division, and in triplicate in the cases of all other corporations.

- (a) Statement that the confirmed corporation filed tax returns complying with the contents of the APA;
- (b) Profit or loss data of the confirmed corporation and the applicable foreign-related person relating to confirmed transactions (in the case where it is necessary, taking the content of APA into account);
- (c) Statement of fluctuations, if any, of material business and economic conditions based on which the APA was given;
- (d) Statement of adjustments made by the confirmed corporation provided in 5-19 in cases where the results of the confirmed transaction do not comply with the contents of the APA;
- (e) Financial and accounting data for the confirmed corporation and the applicable foreign-related person for the confirmed taxable years;
- (f) Other relevant information that helps the tax authorities determine whether the confirmed corporation filed tax returns complying with the contents of the APA.

(Treatment of Reports)

5-18

- (1) In cases where the report prescribed in 5-17 was filed by a confirmed corporation, the report shall be processed by the Examination Group (Corporation) of the Tax Office or the RTB Large Enterprise Examination Division in accordance with 5-5 or 5-6.
- (2) The RTB division in charge shall evaluate the report submitted and determine whether the confirmed corporation complies with the content of the APA.

It shall be noted that report reviews correspond to examinations for corporation tax, and this shall be explained to the confirmed corporation by the RTB division in charge at the time of the report

review. In cases where it is found as a result of the report review that a return complying with the content of the APA has not been filed and the amount of income has been understated, the RTB division in charge shall explain to the confirmed corporation the result of review and that it is necessary to submit an amended return.

(Note) In cases where the confirmed corporation voluntarily files an amended return pursuant to the provisions of 5-19(2)(b) due to detection of such an understatement before it is deemed that the corporation knew of the report review by the RTB division in charge on account of visitation of the corporation by officials of the RTB division in charge for the purpose of report review or indication of such an understatement, the amended return is not treated as corresponding to a “return filed foreknowing that corrections should be made” prescribed in Article 65(5) (Additional Tax for Deficient Returns) of the Act on General Rules for National Taxes.

The judgment as to whether a return corresponds to a “return filed foreknowing that corrections should be made” is made on the basis of “Treatment of Additional Tax for Understatement and for Return After the Due Date (Administrative Guidelines)” issued on July 3, 2000 [Document ID: Corporation Taxation Division 2-9, etc.].

- (3) The RTB division in charge shall report the results of report review to the NTA division in charge as required, and forward the results to the Office of Mutual Agreement Procedures via the NTA division in charge in cases where a mutual agreement was reached.

(Compensating adjustments)

5-19

- (1) In cases where the confirmed corporation makes any adjustments required to comply with the contents of the APA in its financial statements, the District Director shall regard them as legitimate transactions for the purpose of transfer pricing.
- (2) The RTB division in charge shall request the confirmed corporation to make compensating adjustments relating to the APA (hereinafter referred to as “compensating adjustments”) as follows:
 - (a) The confirmed corporation shall correct the taxable income on its final return in the case where it turns out that income is understated pertaining to the confirmed taxable years due to an inconsistency between the actual transaction and the results of applying the confirmed TPM before filing final tax returns.
 - (b) The confirmed corporation shall promptly file amended tax returns in the case where it turns out that income was understated in the tax returns pertaining to the confirmed taxable years due to an inconsistency between the actual transaction and the results of applying the confirmed TPM after filing final tax returns.
 - (c) In cases where a mutual agreement covers the APA (bilateral APA), the confirmed

corporation may correct the taxable income on the final returns based on the mutual agreement concerning compensating adjustments if it turns out that income in the financial statements pertaining to the confirmed taxable years is overstated due to a difference between the actual transaction and the results of applying the confirmed TPM after the closing date for financial statements and before filing final tax returns.

- (d) In cases where a mutual agreement covers the APA (bilateral APA), the confirmed corporation may file a request for correction for the tax return as prescribed in Article 7(1) of the Act on Special Provisions for the Enforcement of Income Tax Conventions based on the mutual agreement concerning compensating adjustments if it turns out that income was overstated due to a difference between the actual transaction and the results of applying the confirmed TPM in the tax returns after filing final tax returns pertaining to the confirmed taxable years.

(Revisions to APA)

5-20 In cases where a request for revision is filed by the confirmed corporation because there arises a situation that causes material differences to business and economic conditions essential to the continuation of the APA in each of the confirmed taxable years, the District Director shall receive and process it in accordance with the relevant provisions of 5-1 to 5-19 inclusive.

(Cancellation of APA)

5-21

- (1) In cases where the occurrence of any of the conditions below, the RTB division in charge shall forward a notice to the District Director that the APA, when conditions (a) through (c) below apply, relating to taxable years (consolidated taxable years in cases where they are applicable) subsequent to the year in which the applicable incident occurred, and when condition (d) applies, retroactively, is cancelled.
- (a) A confirmed corporation does not submit the request for revision prescribed in 5-20 even when material differences arise.
 - (b) A confirmed corporation fails to comply with the contents of the APA in its tax returns.
 - (c) A confirmed corporation fails to submit the report prescribed in 5-17, or the report contains material errors.
 - (d) Any of the facts based on which the APA was given are revealed to be false, or the APA request contains material errors.
- (2) Before forwarding a notice relating to cancellation under Subparagraph (1), the RTB division in charge shall consult with the NTA division in charge where necessary.
- (3) In cases where Subparagraph (1) applies to an APA covered by a mutual agreement, the RTB

division in charge shall consult with the Office of Mutual Agreement Procedures via the NTA division in charge, and forward a notice to cancel the APA after receiving a notification of another mutual agreement which cancels the former mutual agreement.

- (4) The District Director shall, upon receipt of a notice from the RTB division in charge, cancel the APA by sending the “Notification of Cancellation of Confirmation of Method of Calculation of Arm’s Length Prices (appended Form 5)” to the confirmed corporation.

(Renewal of APAs)

5-22 In cases where a confirmed corporation files a request for renewal of its APA, the request shall be processed in accordance with the provisions of 5-1 to 5-21 inclusive, and the confirmed corporation shall file a request for renewal of its APA with the precinct District Director by the day before of the commencement of the taxable years to be confirmed, in principle.

(Applying the TPM to Tax Years Prior to the Confirmed Years)

5-23 In cases where an applicant for APA has the intention to apply the requesting TPM for years prior to the taxable years (consolidated taxable years if they are applicable; hereinafter the same in 5-23) to be confirmed, its APA request is accompanied by a request for a mutual agreement, and the confirmed TPM is regarded as the most reasonable even for years prior to the confirmed taxable years, the request shall be processed in accordance with the provisions of 5-15, 5-16, 5-19, and 5-21.

(Application to Transactions between the Head Office and Branches)

5-24 In cases where a foreign tax authority in the country where the head office of the corporation is located requests the commencement of a mutual agreement based on a request corresponding to the APA with respect to transactions between the head office or branch offices in foreign countries and the branch office in Japan that conducts businesses as set forth in Item 7 of Article 176(1) of the Cabinet Order of the CTA, and the branch office in Japan makes a request similar to a request for APA, necessary measures shall be taken in accordance with the provisions of 5-1 to 5-23 inclusive.

(Treatment of Corporation’s Entry into Consolidated-Corporation Group)

5-25

- (1) In cases where an applicant for APA becomes a member of a consolidated-corporation group and the concerned corporation files a request for APA, the precinct District Director shall request the consolidated parent corporation to promptly submit the “Application of Continuation of APA after Entry into Consolidated-Corporation Group (appended Form 6)”.

The application shall be filed in duplicate (in triplicate if the consolidated parent corporation requests a mutual agreement) with the RTB Commissioner, or in triplicate (in quadruplicate if the

consolidated parent corporation requests a mutual agreement) with the District Director.

- (2) In cases where the consolidated parent corporation as set forth in Subparagraph (1) submits Form 6 to the precinct District Director, the precinct District Director shall send a copy of the Form to the District Director who governs the district where the concerned corporation's head office or main office is located. The Examination Group (Corporation) of the Tax Office or the RTB Large Enterprise Examination Division shall handle the case in accordance with the provisions of 5-5 and 5-6. In cases where the concerned corporation requests a mutual agreement, the NTA divisions in charge shall send a copy of the Form to the Office of Mutual Agreement Procedures.
- (3) In cases where the consolidated parent corporation submits Form 6, the Commissioner's Directive on OTPCC 5-1 to 5-25 inclusive shall apply to the APA concerning the concerned corporation, assuming that the request prescribed in Commissioner's Directive on OTPCC 5-2 has been made from the consolidated parent corporation to the precinct District Director.