

# APA Program Report 2006

October 2006

National Tax Agency

# Contents

1	Introduction	1
2	What Are Advance Pricing Arrangements (APAs)?	2
3	History of APAs in Japan and the World	3
4	Address at PATA	4
5	Overview of APA in Japan	5
	(1) Definition of APA	
	(2) Relationship between APA and MAP	
	(3) Relationship between APA and Transfer Pricing Examinations	
	(4) Request and Review Procedures	
	(5) Review of APA Requests	
	(6) Effects of APA	
	(7) Examination of Compliance Conditions	
	(8) Compensating Adjustments	
	(9) Revisions, Cancellations, and Renewals	
	(10) Rollbacks	
	(11) Procedures for Consolidated Corporations	
6	APA Process	11
	(1) Submission of APA Request	
	(2) Case Review by the Regional Taxation Bureau (RTB) APA Review Group	
	(3) MAP Negotiations and Agreement	
	(4) Review of Annual Compliance Reports, etc.	
	<b>【Chart】</b> Flowchart of BAPA Procedure	
7	Staff in Charge of BAPA Cases	14
	(1) MAP Staff	
	(2) APA Review Groups	
8	Taxpayer Cooperation in APA	15
9	Recent Development	16
	(1) Recent Development of Mutual Agreement Procedures (MAP)	
	(2) Recent Development of BAPA	

- a. The Number of Disposed BAPAs –by Industry
  - b. The Number of Disposed BAPAs –by Transaction Type
  - c. The Number of Disposed BAPAs –by Transfer Pricing Methods
  - d. The Number of Disposed BAPAs –by Region
  - e. Time Required per BAPA Case
- (3) Recent Discussions

Attachment 1 Partner Countries of Mutual Agreement Procedure

Attachment 2 Summary of MAP Statistics

Reference Japan's Tax Convention Network

## 1. Introduction

In Japan, transfer pricing taxation was introduced in 1986. In 1987, Advance Pricing Arrangement (APA) started in Japan, making Japan the first country in the world to implement such procedures.

Basic framework of transfer pricing taxation is to compute taxation income as its transactions are deemed to be conducted by arms' length price in case that taxation income of a corporation is decreased since transaction between a corporation and its related parties differs from arms' length price.

An APA is a framework for a tax administration to indicate their administrative commitment to refraining from transfer pricing taxation if the taxpayer files its tax return in accordance with the agreed APA conditions for the APA covered years.

APAs may involve either one country only (unilateral APA), or two or more countries (bilateral APA or multilateral APA accompanied by the Mutual Agreement Procedures (MAP), hereinafter referred to as "BAPA").

The National Tax Agency (NTA) is promoting BAPAs to facilitate the enforcement of transfer pricing taxation, to mitigate the administrative burden on companies, and to ensure taxation predictability for company management. The number of BAPAs is also increasing with the globalization of the economy and as APAs become more widely known among taxpayers.

APA cases make up the majority of MAP cases today. This indicates that the need to prevent double taxation before it occurs by using APA is increasing.

The usefulness of APAs is largely known among taxpayers, and the number of cases of second or third APA has recently increased. Moreover, cases with nations without any experience in BAPA have occurred, and BAPA has been expanded geographically.

This report outlines APA and the data concerning APA and MAP from 1 July 2005 to 30 June 2006. Although APAs may involve one country only (unilateral APA), this report mainly focuses on BAPAs which make up the majority of APAs in Japan. We hope that this report will deepen taxpayers' understanding of APA administration and further promote APA.

## 2. What Are Advance Pricing Arrangements (APAs)?

As noted above, an APA is a framework for a tax administration to indicate their administrative commitment to refraining from transfer pricing taxation if the taxpayer files its tax return in accordance with the agreed APA conditions for the APA covered years.

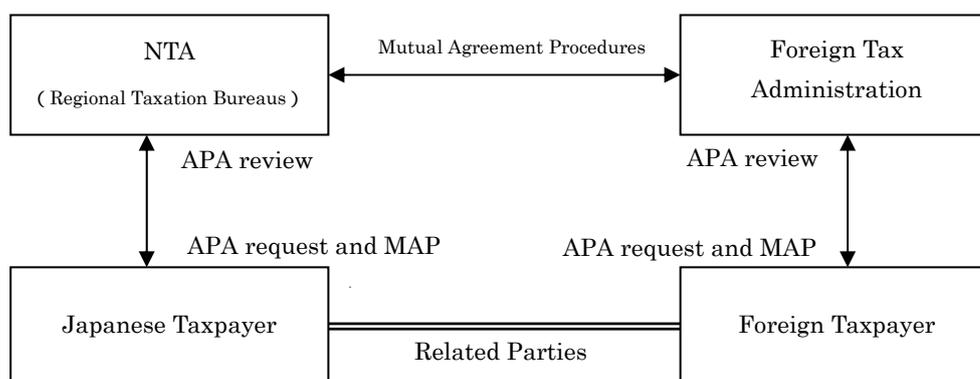
The objective of APA is to ensure the predictability of transfer pricing taxation for the taxpayer by confirming in advance the method of calculating arm's length prices between the tax administration and the taxpayer. This ensures the proper and smooth enforcement of transfer pricing taxation. Transfer pricing taxation may often result in a large amount of additional taxes, and the examinations often require a great deal of time and MAPs to resolve the double taxation. Thus, the risks involved in transfer pricing taxation for the taxpayer are generally quite high. APAs help taxpayers involved in foreign-related transactions to prevent the risk of such transfer pricing taxation in advance.

APAs may involve either one country only (unilateral APAs), or two or more countries (BAPAs).

Unilateral APAs confirm the method to be used to calculate arm's length prices by the NTA for the taxpayer in Japan. Unilateral APAs do not ensure that associated taxpayers in other countries will avoid the risk of taxation by foreign tax administrations.

BAPAs, on the other hand, include consultations regarding the method of calculation of arm's length prices between the two or more tax administrations that have jurisdiction over the related taxpayers. Its objective is to ensure the predictability of transfer pricing taxation and to prevent double taxation. With a BAPA, the taxpayer is ensured the legal stability of both tax administrations (or all tax administrations, in multilateral cases). This is the reason that many countries including Japan conduct BAPAs.

### Diagram of the BAPA Process



### 3. History of APAs in Japan and the World

In the nineteen eighties, because of development of globalization of business activities, the need to address income shifting through transactions between a corporation and its related parties increased. Some foreign countries had already prepared to address such income shifting. Therefore, Japan introduced transfer pricing taxation in March 1986 to realize proper international taxation in common framework with foreign countries.

APAs were first created in Japan in 1987. APAs were developed to ensure the proper and smooth enforcement of transfer pricing legislation by giving administrative confirmation as to the most rational method of calculating arm's length prices for corporations.

The United States Internal Revenue Service (IRS) also formally adopted APAs (known as "Advance Pricing Agreements" in the U.S.) in 1991 with Procedure 91-22. Subsequently, Canada (1994), New Zealand (1994), Australia (1995), and Mexico (1995) among other countries, all participated in APAs. After a 1995 OECD report on transfer pricing further promoted APAs, Korea (1996), China (1998), the U.K. (1999), France (1999), the Netherlands (1999), and Germany (2000) all joined the system, and APAs truly became a focus of global interest<sup>1</sup>.

With this increase in global recognition, the number of APA requests has risen, and since 1994, BAPA requests in Japan have also increased. Due to this increase in requests for BAPA, Japan's 1987 Directive was revised in 1999, and Japan's *Commissioner's Directive on Methods of Calculation of Arm's Length Prices (Administrative Guidelines)* endorsing BAPA was released in June 1, 2001. This document was superseded by the *Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines)*<sup>2</sup> (hereafter referred to as Transfer Pricing Administrative Guidelines) and is still in effect.

Comprehensive guidelines for MAP on which BAPA cases are based were released as the *Commissioner's Directive on Mutual Agreement Procedures (Administrative Guidelines)* (hereafter referred to as "MAP Administrative Guidelines") on 25 June 2001<sup>3</sup>. The MAP Administrative Guidelines (English version) are available on the NTA website ([www.nta.go.jp](http://www.nta.go.jp)).

The United States, Canada and Australia also publicize APA reports every year in its website.

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<sup>1</sup> The OECD issued the OECD/APA Guidelines in 1999, thereby committing to promoting BAPA.

<sup>2</sup> Document ID: Examination Division 7-1 etc. dated 1 June 2001

<sup>3</sup> Document ID: Office of Mutual Agreement Procedures 1-39 etc. dated 25 June 2001  
MAP related to APA is regulated in the MAP Administrative Guidelines.

#### 4. Address at PATA<sup>4</sup>

The Pacific Association of Tax Administrators (PATA) is comprised of representatives from the tax administrations of Japan, Australia, Canada, and the United States. Committee meetings based on the Exchange of Information articles of the applicable Convention provide a forum for the administrations to exchange opinions about fiscal matters of common interest. PATA has committed itself to executing MAP and BAPA. In June 2004, PATA released an amendment to both guidance documents to handle the dramatically increased use of MAP and BAPA and subsequently, to respond to the growing demand from taxpayers for international guidance. Both guidance documents concern the execution of MAP and BAPA, but are not binding on PATA members.

Each guidance document establishes a deadline of two years for settling MAP and BAPA cases. This two-year timeframe does not apply to certain cases, such as cases where a taxpayer does not cooperate. Moreover, although MAP negotiations are a government-level process, the taxpayers in question are also permitted to participate at some sessions to provide factual information.

Guidance for MAP also applies to all mutual agreement procedures, including transfer pricing adjustments.

Guidance for BAPA encourages and facilitates the use of BAPA among PATA members which is considered more desirable than a unilateral APA. Both guidance documents are also available on the NTA website ([www.nta.go.jp](http://www.nta.go.jp)).

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<sup>4</sup> In January 2006 at the commissioners' meeting including Japan, the United States, Canada, Australia, the United Kingdom, France, China, and India held at Leeds Castle in London suburb, it was agreed to set up the commissioners' meeting ("Leeds Castle Group") including above countries and Germany and Korea, and PATA was dissolved.

## 5. Overview of APA in Japan

Japan's APA procedures are regulated by the aforementioned Transfer Pricing Administrative Guidelines and the MAP Administrative Guidelines. An overview of the procedures is as follows.

### (1) Definition of APA<sup>5</sup>

APA is defined as the confirmation made by a District Director of a Tax Office or a Regional Commissioner of an Regional Taxation Bureau (RTB) with regard to the method of calculation of arm's length prices and the specific details thereof deemed to be the most reasonable to be adopted by a corporation.

### (2) Relationship between APA and MAP

#### a. Elimination of double taxation

BAPA is a means to eliminate double taxation before transactions take place by conducting Competent Authority (CA) negotiations and reaching an agreement between the countries concerned regarding suitable transfer pricing methods.

#### b. Endorsement of MAP requests when an APA is filed<sup>6</sup>

To prevent double taxation and to ensure predictability of taxation, the division in charge at the RTBs shall recommend the APA applicant to file a MAP request in the case that the corporation has not filed one.

#### c. Collaboration between RTB APA review teams and the MAP section<sup>7</sup>

The APA review teams (divisions in charge at the RTBs) and the MAP section (Office of Mutual Agreement Procedures at the NTA) collaborate together and exchange ideas from the pre-filing conference stage to the conclusion of the MAP, in order to resolve the APA case as quickly as possible.

### (3) Relationship between APA and Transfer Pricing Examinations

#### a. Confirmation of future years' transfer pricing

APA examines the suitability of the methods used to calculate arm's length prices and the profit rate based on past financial data. This is in order to grant confirmation for future transactions, In contrast, transfer pricing examinations deal with past years' transactions.

#### b. Use of range

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<sup>5</sup> Transfer Pricing Administrative Guidelines 1-1. Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups (Document ID: Examination Division 7-4 etc. dated 28 April 2005) 1-1

<sup>6</sup> Transfer Pricing Administrative Guidelines 5-11

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-11

<sup>7</sup> Transfer Pricing Administrative Guidelines 5-12

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-12

In transfer pricing examinations, arm's length prices are calculated as a particular level or point. In contrast, APA often set a range that indicates that there is no income transfer.

c. Comparable transactions

APA recognize the calculation methods suggested by the taxpayer himself, and so the selection of comparable transactions is based only on information the taxpayer is able to gather (public data, internal data, etc.).

d. Relationship between APA requests and examinations<sup>8</sup>

- Filing an APA request does not put into abeyance any examination of the same taxpayer and transactions.
- In order to ensure confidence in the system, information obtained from the taxpayer in the APA review process is not used in the examination, except for factual information, such as financial statements, capital relationship diagrams, and summary statements of business.

#### **(4) Request and Review Procedures**

a. Deadline for filing APA requests<sup>9</sup>

A Special Application Form ("Request for APA of the Transfer Pricing Methodology") must be filed with the necessary documents no later than the deadline<sup>10</sup> for filing the taxpayer's final tax return for the first business year to be covered by the APA. When MAP is requested, a MAP Request Form must also be submitted separately. Although there is no deadline for requesting MAP regarding APA cases, the MAP Request Form is usually submitted together with the APA request.

b. Documents to be attached with APA request<sup>11</sup>

- Outline of organization engaged in foreign-related transaction for confirmation and/or details of the transaction
- Transfer pricing method to be confirmed and the specific details thereof, and explanation of why this method is the most rational
- Material business and economic conditions essential to the APA
- Cash flow and currency types of the transaction to be confirmed
- Capital relations and substantial control relationships with foreign-related persons
- Functions performed by transaction parties
- Operational and accounting information for the prior three taxable years
- Outline of transfer pricing examinations, appeals, lawsuits, and similar procedures

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<sup>8</sup> Transfer Pricing Administrative Guidelines 2–21

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 2-21

<sup>9</sup> Transfer Pricing Administrative Guidelines 5–1

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–1

<sup>10</sup> The deadline for filing a request for APA renewal is the day before the first day of the business year to be covered by the APA. (Transfer Pricing Administrative Guidelines 5–20. Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–20.)

<sup>11</sup> Transfer Pricing Administrative Guidelines 5–2, 5–3

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–2, 5–3

pertaining to applicable foreign-related persons, and details of past taxation in their country

- Results determined by applying the requested transfer pricing methods to the prior three taxable years

c. Terms to be confirmed<sup>12</sup>

Under the Transfer Pricing Administrative Guidelines, APA in principle are applicable to three to five taxable years.

### **(5) Review of APA Requests**

The review is carried out based on the following items:

- a. Information about the business conditions of the APA-requesting taxpayer and the foreign-related company and the particulars of the foreign-related transactions
- b. Analysis of probability of past years' income transfer, which constitute the basic data for review
- c. Analysis of the adequacy of the methods used to calculate the arm's length prices
- d. Analysis of the comparability of the comparable transactions
  - Types of inventories and service rendered, etc.
  - Stage of transaction
  - Volume of transactions
  - Terms and conditions for the transaction
  - Functions performed and risks to be assumed by the parties concerned
  - Intangible assets
  - Business strategy
  - Timing of entry into the market
  - Market conditions

### **(6) Effects of APA<sup>13</sup>**

When the taxpayer files tax returns in accordance with the APA, the confirmed transaction is treated as having been conducted based on arm's length prices.

### **(7) Examination of Compliance Conditions<sup>14</sup>**

A taxpayer who has received an APA confirmation (hereafter referred to as "confirmed corporation") must submit reports (annual compliance reports) explaining that the filed income is in accordance with the APA confirmation, by the deadline for the taxpayer's final tax return for each year covered

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<sup>12</sup> Transfer Pricing Administrative Guidelines 5-7

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-7

<sup>13</sup> Transfer Pricing Administrative Guidelines 5-16

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-16

<sup>14</sup> Transfer Pricing Administrative Guidelines 5-14

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-14

by the APA or the deadline predetermined by the District Director of the Tax Office. The division in charge at the RTB in question will examine the content of those reports.

#### **(8) Compensating Adjustments<sup>15</sup>**

In case incomes (actual figures) derived from the confirmed transactions during the APA-covered year do not comply with the conditions of the confirmed APA, the taxpayer must make necessary adjustments for the year (Compensating Adjustments). If the confirmed corporation makes any adjustments to comply with the APA in its financial statements, the adjustments are treated as legitimate transactions for the purpose of transfer pricing.

If it is found that the incomes of the confirmed corporation are less than the appropriate figures, the corporation must take one of the two following procedures:

a. Adjustment of figures on the final returns

The confirmed corporation must correct the taxable income on the final returns if it turns out that income was understated in the financial statements pertaining to the confirmed taxable years due to an inconsistency between the actual transaction and the results of applying the confirmed transfer pricing method after the closing date for the financial statements, and before the deadline for final tax returns.

b. Amended returns

The confirmed corporation must promptly file amended tax returns if 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 transfer pricing method after filing the tax returns.

If it is found that the incomes of the confirmed corporations are more than the appropriate figures, when BAPA is applied, the confirmed corporation may adjust its income by one of the following two ways:

a. Adjustment of figures on the final returns

The confirmed corporation may correct the taxable income on the final returns based on the mutual agreement related to compensating adjustments if it turns out that income in the financial statements pertaining to the confirmed taxable years was overstated due to a difference between the actual transaction and the results of applying the confirmed transfer pricing method after the closing date for the financial statements, and before the deadline for final tax returns.

b. Request for correction of tax return

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<sup>15</sup> Transfer Pricing Administrative Guidelines 5–17  
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–17

The confirmed corporation may file a request for correction of the tax return based on the mutual agreement related to 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 transfer pricing method in the tax returns after filing its final tax returns pertaining to the confirmed taxable years.

## **(9) Revisions, Cancellations, and Renewals**

### **a. Revisions<sup>16</sup>**

In the event that there arises a situation that causes material differences to business and economic conditions essential to the continuation of the APA and critical assumptions differ drastically from those at the time of the confirmation, the taxpayer must file a request for APA revision.

### **b. Cancellations<sup>17</sup>**

An APA shall be cancelled under any of the following circumstances:

- The confirmed corporation did not submit the request for revision even when material differences to critical assumptions necessary to continue APA arose.
- The confirmed corporation failed to comply with the contents of the APA in its tax returns.
- The confirmed corporation failed to submit the annual compliance report.
- Any of the facts based on the APA request are revealed to be false.

### **c. Renewals<sup>18</sup>**

Request for APA renewal for business years following the confirmed years shall be processed in accordance with the procedures for new APA requests.

## **(10) Rollbacks<sup>19</sup>**

When the taxpayer proposes to roll back the transfer pricing method to years prior to the confirmed years and the confirmed transfer pricing method in BAPA is regarded as the most suitable even for the years prior to the confirmed years, the rollback shall be approved.

## **(11) Procedures for Consolidated Corporations**

The NTA established the Commissioner's Directive on the Operation of Transfer Pricing Related to Consolidated Corporate Groups in April 2005.<sup>20</sup> The parent corporation shall file the request for

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<sup>16</sup> Transfer Pricing Administrative Guidelines 5–18

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–18

<sup>17</sup> Transfer Pricing Administrative Guidelines 5–19

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–19

<sup>18</sup> Transfer Pricing Administrative Guidelines 5–20

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–20

<sup>19</sup> Transfer Pricing Administrative Guidelines 5–21

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–21

<sup>20</sup> See footnote 5.

APA concerning its own transactions with foreign related entities in the name of the parent corporation to the District Director of the Tax Office with jurisdiction over the place of tax payment. The parent corporation, instead of a subsidiary, shall also file requests for APA on the foreign related transactions of consolidated subsidiaries to the District Director of the Tax Office with jurisdiction over the place of tax payment<sup>21</sup>.

The Commissioner's Directive on Mutual Agreement Procedures (Administrative Guidelines) was revised to make the consolidated parent corporation the entity to request a MAP on behalf of its subsidiaries.<sup>22</sup>

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<sup>21</sup> Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-1

<sup>22</sup> Document ID: Office of Mutual Agreement Procedures 1-18 etc. dated 8 June 2005 (amended)

## 6. APA Process

In Japan, APA commence at the request of the taxpayer. The NTA does not charge any fee for APA proceedings. BAPA procedures, as a rule, can be divided into the following four steps: (1) submission of APA request, (2) case review by the Regional Taxation Bureau (RTB) APA review group, (3) MAP negotiations and agreement, and (4) review of annual compliance reports, etc.

### (1) Submission of APA Request

The taxpayer may have a pre-filing conference with the tax authority before deciding whether to apply for an APA.<sup>23</sup> Where MAP proceedings are likely to be requested at a later date, the relevant divisions of the Regional Taxation Bureau (RTB) and the NTA Head Office in charge of the APA program may attend the meeting, and the NTA's Office of Mutual Agreement Procedures may participate in the consultations. Further, there may be cases where the taxpayer applies for an APA after a transfer pricing examination in order to avoid future risk of taxation and to ensure tax predictability for his or her business. In such cases, if a MAP is underway regarding a former transfer pricing taxation case, the taxpayer can submit a request for APA to the CA analysts and then arrange for a pre-filing conference.

The NTA encourages taxpayers who submit an APA request to file a request for MAP in the case where the taxpayer has not filed one<sup>24</sup>.

APA requests are submitted to the Tax Office or RTB depending on the size of the applicant corporation. To the request form, the taxpayer is required to attach necessary documents which sufficiently illustrate the transactions (see 5(4)b). The APA review group of the RTB facilitates the review of APA requests.

### (2) Case Review by the Regional Taxation Bureau (RTB) APA Review Group

When the APA request is submitted, the relevant division of the RTB designates a person to be responsible for the request and commence the review immediately. The APA review staff requests documents necessary for the review in addition to the documents attached to the APA request. The APA review group of the RTB then reports the results of its review to the division in charge at the NTA Head Office. That NTA division reviews the report internally and sends it to the NTA's Office of Mutual Agreement Procedures.

The RTB APA review group conducts its review in accordance with the Transfer Pricing Administrative Guidelines 5-10 (Evaluation of APA Requests).

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<sup>23</sup> Transfer Pricing Administrative Guidelines 5-6  
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-6

<sup>24</sup> Transfer Pricing Administrative Guidelines 5-11  
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-11

### **(3) MAP Negotiations and Agreement<sup>25</sup>**

In the case of BAPA, the CA analysts draft a position paper based on the conclusion reached by the APA review staff of the RTB in question. Face-to-face negotiations between the CA staff of the countries involved are generally held several times a year. In addition, communication between CAs by telephone, fax, and other means is encouraged, and opinions are exchanged on specific cases where necessary. The CA staff and APA review staff keep in regular contact and exchange views on the material facts.

When the APA agreement reached is the same as the content of the APA request, the APA review group within the RTB, then sends a notice of APA confirmation to the taxpayer. When the APA agreement reached differs from the content of the APA application, the taxpayer is required to submit a modified APA request. The RTB APA review group then sends a notice of APA confirmation to the taxpayer.<sup>26</sup>

### **(4) Review of Annual Compliance Reports, etc.<sup>27</sup>**

After the APA confirmation notice is received, the taxpayer is required to submit, by the deadline for its final tax return or by a newly designated date, an annual compliance report which explains whether the business results reported in the year's tax return meet with the agreement. The division of the RTB in charge may request an explanation from the taxpayer if necessary. Further, it may visit the taxpayer's premises for a review. In the case that income figures are under-reported compared with the figures agreed, they must be adjusted upward in the modified APA request. Conversely, when income figures are over-reported, MAP negotiations must be held. The taxpayer must submit a MAP request and conduct a compensating adjustment (request for correction of tax return) based on the new MAP agreement.

Further, when the conditions provided in critical assumptions are changed, the taxpayer must submit a request for new MAP consultations.

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<sup>25</sup> Transfer Pricing Administrative Guidelines 5–13

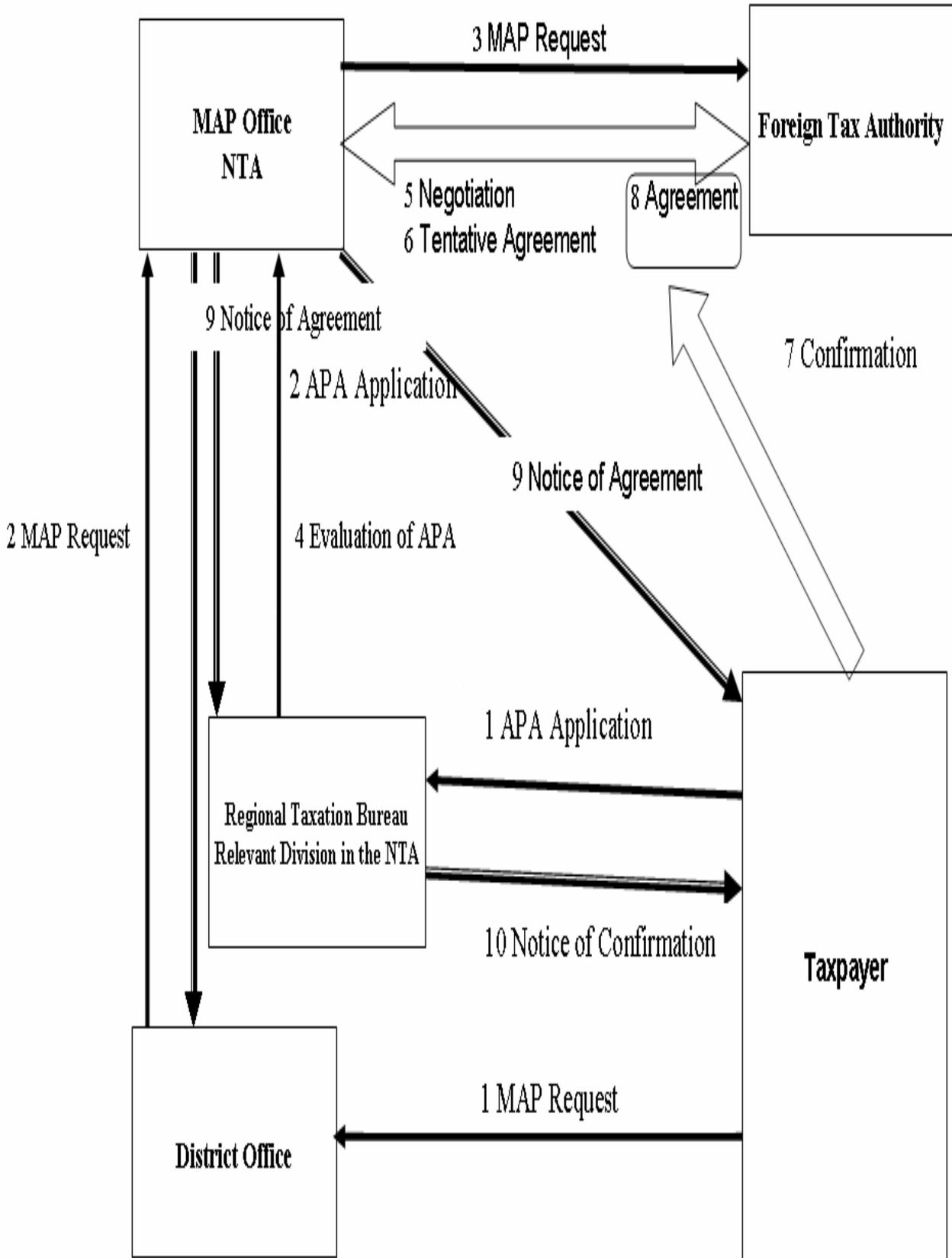
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–13

<sup>26</sup> In the case of a unilateral APA, a modified APA request may be requested when the RTB APA review group judges the original APA request to be unreasonable. If the taxpayer does not accept the request for modification from the APA review group, the APA review group sends a notice of non-confirmation. When the content of the APA request is approved, or when the taxpayer accepts the required modification, the RTB APA review group sends a notice of confirmation to the taxpayer.

<sup>27</sup> Transfer Pricing Administrative Guidelines 5–14, 5–15

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–14, 5–15

Flowchart of BAPA Procedure



## 7. Staff in Charge of BAPA Cases

### (1) MAP Staff

A section in charge of MAP was created in June 1982 and initially placed under the Councilor of the Minister's Secretariat (Deputy Commissioner [International Affairs]) and the Director (Head of the Office for the Deputy Commissioner [International Affairs]). The Deputy Commissioner and the Director handle international conferences. The Office of International Operations was established in 1986. Subsequently, the positions of the Director overseeing MAP (1995) were created. The Office of Mutual Agreement Procedures was established in July 1999.

The staff of the Office of Mutual Agreement Procedures is responsible for all MAP cases so they handle the Mutual Agreement Procedures related to double taxation cases including not only BAPA cases, but also transfer pricing taxation cases, withholding cases, and permanent establishment cases. However, APA cases have comprised more than half of all cases handled by the Office of Mutual Agreement Procedures in recent years. The table below describes the Office of Mutual Agreement Procedures.

Deputy Commissioner (International Affairs)	Director, Office of Mutual Agreement Procedures	Group	Jurisdiction
		1	Mainly North America and Oceania
2			
5			
6			
Director (Mutual Agreement Procedures)		3	Mainly Western Europe and Asia
		4	

### (2) APA Review Groups

The Examination Division of the Examination and Criminal Investigation Department in the NTA established the Director (International Examination), Research and Information Section No. 1-3 (Currently renamed "International Information Section No. 1-3") in 1987. They supervise and guide the RTBs in transfer pricing taxation and implementation of the APA program.

National Tax Agency			
Assistant Commissioner (Examination and Criminal Investigation)	Director, Examination Division	Director (International Examination)	International Information Section No. 1-3

The divisions in charge of APA within the Examination Division in the RTBs are as follows. In 2005,

Second Transfer Pricing Division was established to handle reviews of APA requests.

Regional Taxation Bureau (Office)			
Tokyo RTB	First Examination Department	Deputy Assistant Regional Commissioner (International)	Second Transfer Pricing Division
Osaka RTB	First Examination Department		Transfer Pricing Division
Nagoya RTB	Examination Department		International Examination Division
Kanto-Shinetsu RTB	Examination and Criminal Investigation Department		International Examination Division
Other RTBs	Examination and Criminal Investigation Department		Management Division (Examination)
Okinawa Regional Taxation Office			Examination Division

## 8. Taxpayer Cooperation in APA

The APA system is based on taxpayer initiative. The cooperation of the taxpayer is therefore indispensable for APA to proceed smoothly. In particular, timely submission of the relevant documents and other information contribute greatly to efficient case reviews and CA discussions. Prompt submission is thus essential.

Further, when an APA request is submitted to a foreign tax administration, an application should be submitted simultaneously to the NTA in order to enable more effective case review and CA discussions.

Moreover, the CA analysts quite often request additional information for the purpose of, for example, verifying facts. On such occasions, the taxpayer's prompt response is highly appreciated.

If it is found that the main purpose of the APA request is to decrease the tax burden in an inappropriate way, the APA/MAP procedures may stop or end in non-confirmation.

## 9. Recent Development

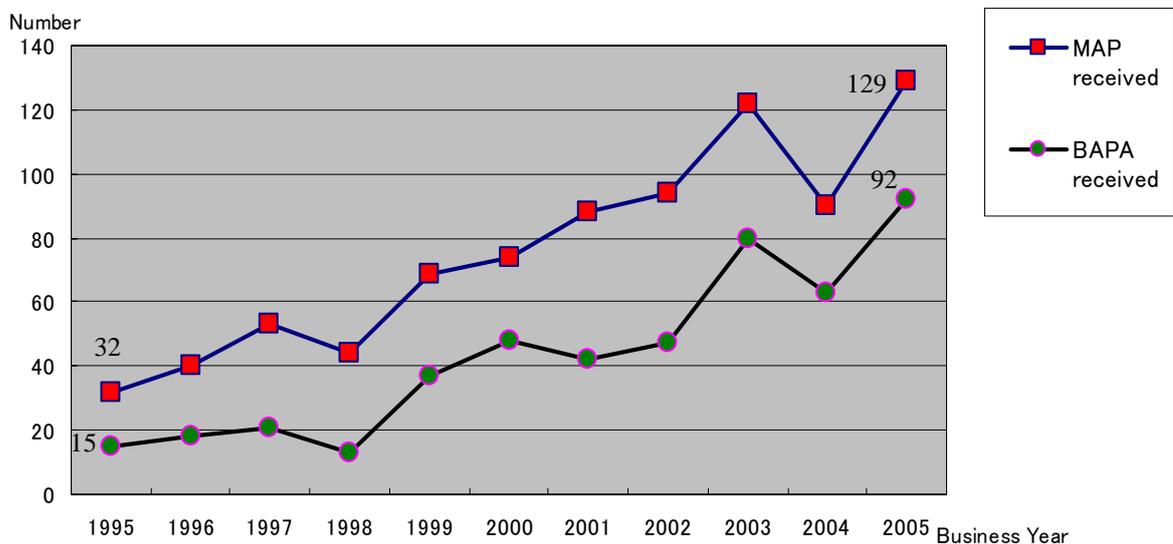
### (1) Recent Development of Mutual Agreement Procedures (MAP)

The number of map cases received tends to increase, and 90% and more of these cases relate to transfer pricing taxation. Among those, the number of bilateral advance pricing arrangement cases accompanied by the Mutual Agreement Procedures (BAPA) has been increasing.

During the 2005 business year (which started July 2005 and finished at the end of June 2006), the number of cases received is 129. Among those, the number of transfer pricing cases is 119 and the number of BAPA cases is 92. Comparing the 1995 business year with that of ten years ago, the number of map cases received increased approximately four times and the number of BAPA cases increased approximately six times.

Chart 1 below indicates trend in the number of MAP received, and the number of BAPA received for the past ten (10) years.

Chart 1 Trend in the number of MAP received and BAPA received



(Note)

- 1 Business year is from July 2005 through the end of June 2006.
- 2 The number of MAP cases received is the cases either which we received request for mutual agreement procedures from the taxpayers, or which we received request for mutual agreement procedures from foreign taxpayer authorities.
- 3 MAP cases with regard to compensating adjustment and revision of the agreement are counted as the number of MAP received as of the re-negotiation year.

### (2) Recent Development of BAPA

The number of disposed BAPAs is 65 and Charts 2 through 5 below indicate the detail.

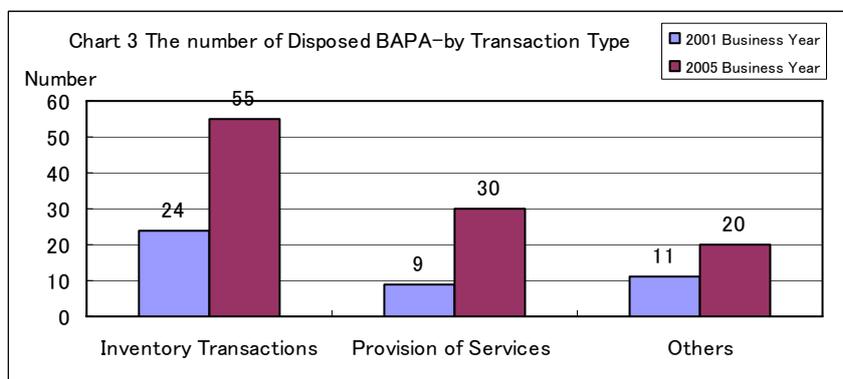
a. The Number of Disposed BAPAs – by Industry

The number of BAPA cases disposed is categorized by industry of taxpayers in Chart 2 below. While in business year 2001, the number of manufacturing companies is 20 and the number of wholesale and retail is 4, in business year 2005 the number of manufacturing companies is 31 and the number of wholesale and retail is 27. The number of wholesale and retail substantially increased.



b. The Number of Disposed BAPAs– by Transaction Type

The number of disposed BAPAs is categorized by transaction type in Chart 3<sup>28</sup> below. While in business year 2001, the number of Inventory Transactions is 24 and the number of Provision of Services is 9, in business year 2005 the number of Inventory Transactions is 55 and the number of Provision of Services is 30. The ratio of the number of Provision of Services relatively increased.

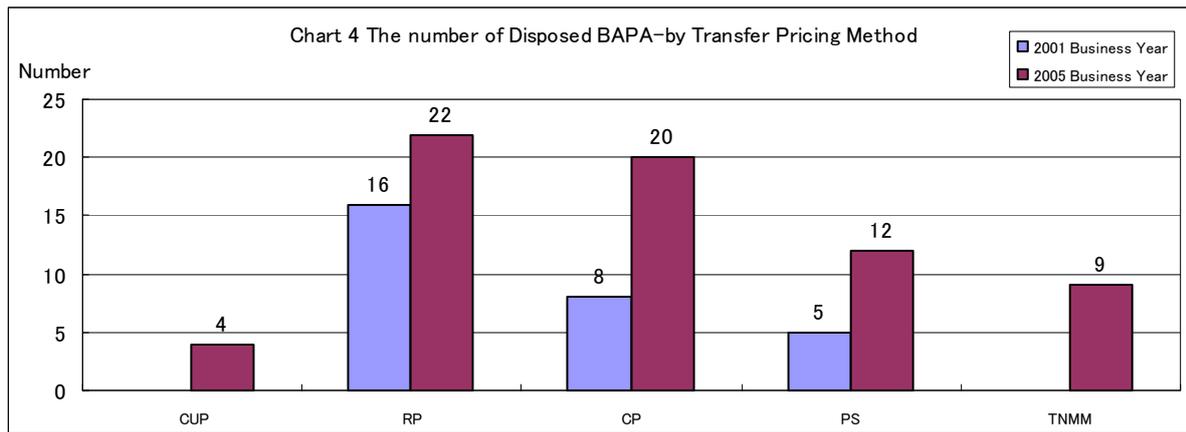


c. The Number of Disposed BAPAs– by Transfer Pricing Methods

The number of disposed BAPAs is categorized by transfer pricing methods in Chart 4<sup>29</sup> below. In business year 2005, the number of CP method and profit split method substantially increased. The number of TNMM, which was introduced in March 2004, is increasing. In light of the recent trend of increase of intangible transactions in BAPAs, profit split method will be further expected to increase.

<sup>28</sup> Some cases include more than one transaction. “Others” refers to royalty and global trading-related transactions.

<sup>29</sup> In some cases, several transfer pricing methods are applied.

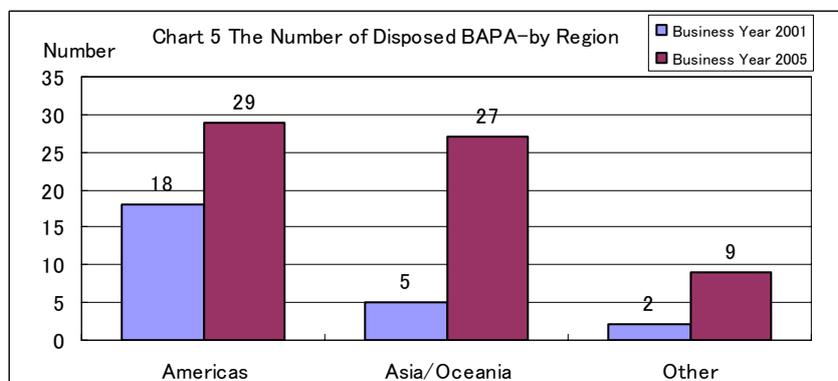


#### d. The Number of Disposed BAPAs – by Region

The number of disposed BAPAs is categorized by transfer pricing methods in the chart 5 below. Although the number of BAPA cases with USA, Australia, and Canada has made up a large share of BAPAs, the number of BAPA cases with Asian countries with little experience in BAPA is increasing. In light of the change of BAPA response in such countries, the number of BAPAs with such countries will be expected to increase.

While the number of countries with which we negotiated BAPA was eleven countries in business year 1995 or ten years ago, it increased to become twenty-three countries in business year 2005.

The number of countries with which we have negotiated at the end of business year 2005 is shown in the attachment “Partner Countries of Mutual Agreement Procedure.



#### e. Time Required per BAPA Case

The average time spent on a BAPA case is around two years, though it varies according to whether, for example, a case is a new case, whether it merely involves the renewal of a former APA, or whether it is a compensating adjustment case.

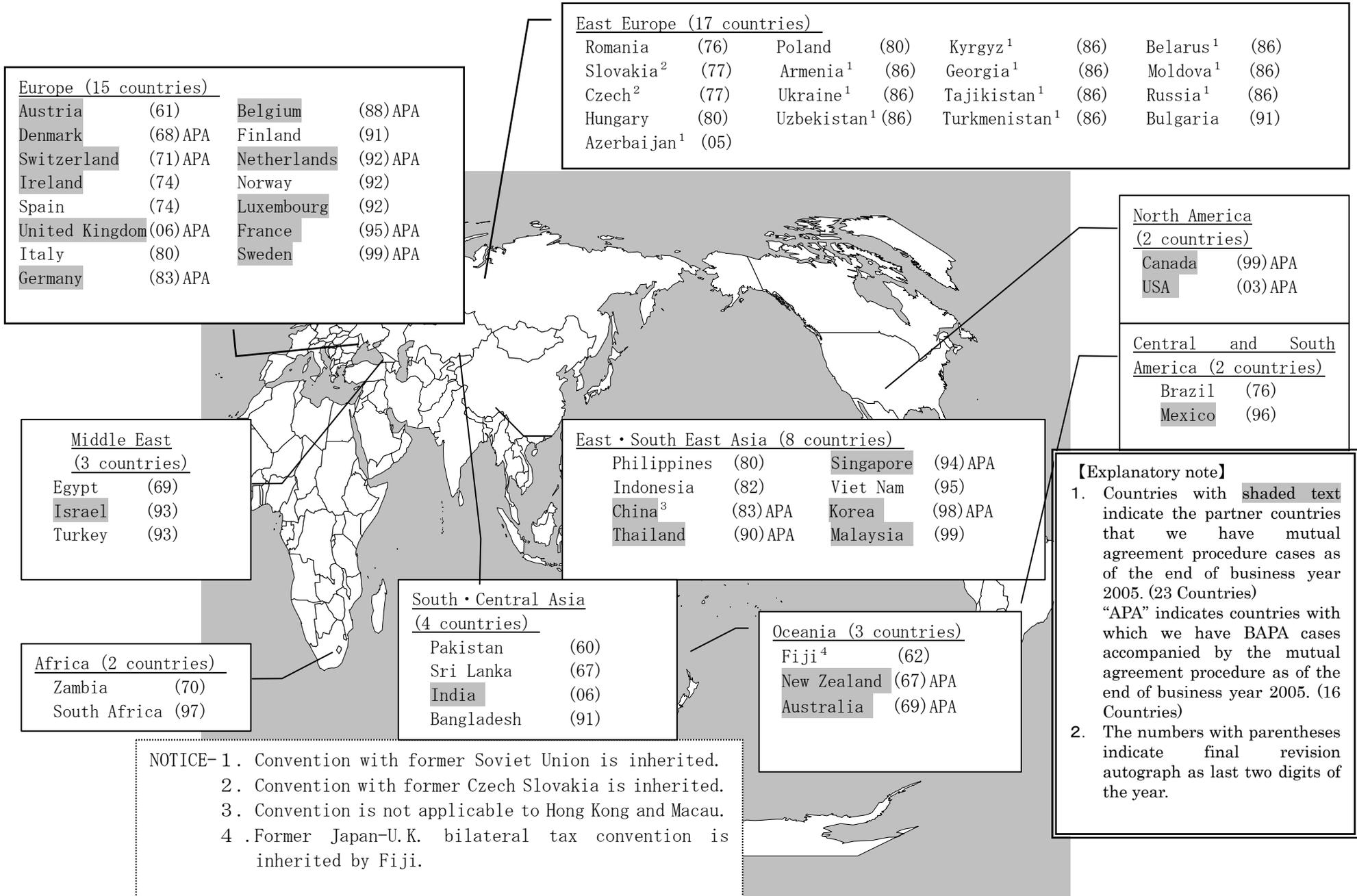
### (3) Recent Discussions

Resolution of dispute with regard to international taxation including mutual agreement procedures are currently discussed at the OECD. At the OECD, implementation of mutual agreement

procedure, policy issues, and complementary resolution of dispute are discussed with reference to “MAP Operational Guidance for Member Countries of the Pacific Association of Tax Administrators” and “BAPA Operational Guidance for Member Countries of the Pacific Association of Tax Administrators,” publicized by PATA in June 2004. In early 2006, in light of OECD discussions and comments from the business community through public comment procedures, public discussion draft which compiled draft revision of OECD model convention and its commentary, and draft of effective mutual agreement procedure manual were publicized. In March 2006, public consultation of the draft above was held in Tokyo and we heard opinions from the business community. Hereinafter, the discussion will be finalized considering these opinions.

# Partner Countries of Mutual Agreement Procedure

(Attachment 1)



### Summary of MAP Statistics

Business Year		BAPA	Transfer Pricing Taxation	Others	Total
2003	Cases Received	80	30	12	122
	Cases Disposed	39	19	25	83
	Cases Carried Over	129	48	26	203
2004	Cases Received	63	8	19	90
	Cases Disposed	49	27	16	92
	Cases Carried Over	143	29	29	201
2005	Cases Received	92	27	10	129
	Cases Disposed	65	16	12	93
	Cases Carried Over	170	40	27	237

(Note)

- 1 Business year is from July through the end of June.
- 2 The number of MAP cases received is the cases either which we received request for mutual agreement procedures from the taxpayers, or which we received request for mutual agreement procedures from foreign taxpayer authorities.
- 3 MAP cases with regard to compensating adjustment and revision of the agreement are counted as the number of MAP received as of the re-negotiation year.

# Japan's Tax Convention Network

( Reference )

Europe ( 15 countries )

<b>Austria</b> (61)	<b>Belgium</b> (88)
<b>Denmark</b> (68)	<b>Finland</b> (91)
<b>Switzerland</b> (71)	<b>Netherlands</b> (92)
<b>Ireland</b> (74)	<b>Norway</b> (92)CA
<b>Spain</b> (74)	<b>Luxembourg</b> (92)CA
<b>United Kingdom</b> (06)CA	<b>France</b> (95)CA
<b>Italy</b> (80)	<b>Sweden</b> (99)CA
<b>Germany</b> (83)	

East Europe ( 17 countries )

Romania (76)	<b>Poland</b> (80)	Kyrgyz <sup>1</sup> (86)	Belarus <sup>1</sup> (86)
<b>Slovakia</b> <sup>2</sup> (77)	Armenia <sup>1</sup> (86)	Georgia <sup>1</sup> (86)	Moldova <sup>1</sup> (86)
<b>Czech</b> <sup>2</sup> (77)	Ukraine <sup>1</sup> (86)	Tajikistan <sup>1</sup> (86)	Russia <sup>1</sup> (86)
<b>Hungary</b> (80)	Uzbekistan <sup>1</sup> (86)	Turkmenistan <sup>1</sup> (86)	Bulgaria (91)CA
Azerbaijan <sup>1</sup> (05)			

North America (2 countries)

<b>Canada</b> (99)CA
<b>USA</b> (03)CA

Central and South America (2 countries)

<b>Brazil</b> (76)
<b>Mexico</b> (96)CA

Middle East (3 countries)

<b>Egypt</b> (69)
<b>Israel</b> (93)CA
<b>Turkey</b> (93)CA

East - South East Asia ( 8 countries )

Philippines (80)	<b>Singapore</b> (94)CA
Indonesia (82)	<b>Viet Nam</b> (95)CA
China <sup>3</sup> (83)	<b>Korea</b> (98)CA
Thailand (90)CA	<b>Malaysia</b> (99)CA

Africa (2 countries)

<b>Zambia</b> (70)
<b>South Africa</b> (97)CA

South - Central Asia (4 countries)

<b>Pakistan</b> (60)
<b>Sri Lanka</b> (67)
<b>India</b> (06)CA
<b>Bangladesh</b> (91)CA

Oceania (3 countries)

<b>Fiji</b> <sup>4</sup> (62)
<b>New Zealand</b> (67)
<b>Australia</b> (69)

**【Explanatory note】**

- 1 . Countries with **bold** indicate OECD member countries. (26 Countries)
- 2 . "CA" indicates countries with which we have correlative adjustment provision in the tax treaty. (19 Countries)
- 3 . The numbers with parentheses indicate final revision autograph as last two digits of the year.

**NOTICE-** 1 . Convention with former Soviet Union is inherited.  
 2 . Convention with former Czech Slovakia is inherited.  
 3 . Convention is not applicable to Hong Kong and Macau.  
 4 .Former Japan-U.K. bilateral tax agreement is inherited by Fiji.