

# APA Program Report 2005

September 2005

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 | MAP / APAs Today .....  | 4  |
|   | (1) The Establishment of the Commissioner's Directive on the Operation of Transfer Pricing Related to Consolidated Corporate Groups (Administrative Guidelines) and The Revision of Commissioner's Directive on Mutual Agreement Procedures (Administrative Guidelines) |    |
|   | (2) The Geographical Expansion - The First Agreement on BAPA with China   |    |
|   | (3) PATA  |    |
|   | (4) Discussions at the OECD   |    |
| 5 | APA Enforcement System .....  | 6  |
|   | (1) Corporations under the Jurisdiction of a Tax Office   |    |
|   | (2) Corporations under the Jurisdiction of the Examination Division of an RTB   |    |
| 6 | Overview of APAs in Japan .....   | 7  |
|   | (1) Definition of APA   |    |
|   | (2) Relationship between APA and MAP  |    |
|   | (3) Relationship between APAs and Transfer Pricing Examinations   |    |
|   | (4) Request and Review Procedures   |    |
|   | (5) Review of APA Requests  |    |
|   | (6) Effects of APAs   |    |
|   | (7) Examination of Compliance Conditions  |    |
|   | (8) Compensating Adjustments  |    |
|   | (9) Revisions, Cancellations, and Renewals  |    |
|   | (10) Rollbacks  |    |
|   | (11) Procedures for consolidated corporations   |    |
| 7 | APA Process .....   | 12 |
|   | (1) Submission of APA Request   |    |
|   | (2) Case Review by the RTB APA Review Group   |    |
|   | (3) MAP Negotiations and Agreement  |    |
|   | (4) Examination of Annual Compliance Reports, etc.  |    |
|   | <b>【Chart】</b> Flowchart of Bilateral APA   |    |

|    |  |    |
|----|--|----|
| 8  | Taxpayer Cooperation in APAs .....                       | 15 |
| 9  | Status of APAs .....                                     | 16 |
|    | ( 1 ) Yearly Data of on the Number of Cases Received     |    |
|    | ( 2 ) Yearly Data of on the Number of Cases Disposed     |    |
|    | ( 3 ) Yearly Data of on the Number of Cases Carried Over |    |
|    | ( 4 ) Analysis of 2002-2004 MAP/APA Cases                |    |
|    | • MAP/APA Cases Disposed by industry                     |    |
|    | • MAP/APA Cases Disposed by transaction type             |    |
|    | • Transfer Pricing Methods for MAP/APA Cases disposed    |    |
|    | • MAP/APA Cases Disposed by region                       |    |
|    | ( 5 ) Time Required per MAP/APA Case                     |    |
| 10 | MAP Status .....   | 19 |
| 11 | Staff in Charge of MAP/APA Cases .....                   | 20 |
|    | ( 1 ) MAP Staff  |    |
|    | ( 2 ) APA Review Groups                                  |    |

## 1. Introduction

In Japan, Transfer Pricing Taxation was introduced in 1986. In 1987, transfer pricing taxation came into force, and Advance Pricing Arrangements (APAs) started in Japan, making Japan the first country in the world to adopt such procedure. An APA is a confirmation made by a District Director of a Tax Office or a Regional Commissioner of a Regional Taxation Bureau that the methodologies used to calculate arm's length prices and the specific details thereof are deemed to be the most reasonable for the corporation in question. The National Tax Agency (NTA) is promoting bilateral APAs (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 APAs is also increasing with the globalization of the economy and as APA become more widely known among taxpayers.

APA cases make up the majority of MAP cases today. This indicates a shift from an era in which double taxation occurred triggered by transfer pricing and was resolved thereafter through mutual agreement procedures (MAP), to an era in which such double taxation is prevented before it occurs by using APAs.

As stated in the OECD Guidelines, APAs are considered the most useful in supplementing traditional mechanisms, such as appeals, litigation, and MAP, for resolving transfer pricing issues<sup>1</sup>. The usefulness of APAs is largely known among taxpayers, and the number of cases of second or third APAs has recently increased. Moreover, cases with nations without any experience in MAP/APA have occurred, and MAP/APAs have been expanded geographically.

This report outlines APAs and the data concerning APAs and MAP from 1 July 2004 to 30 June 2005. Although APAs may involve one country only (unilateral APAs), this report mainly focuses on bilateral (or multilateral) APAs which make up the majority of APAs in Japan. We hope that this report will deepen taxpayers' understanding of APA administration and further promote APAs.

---

<sup>1</sup> 1995 OECD Guidelines, Paragraph 4.124

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

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.

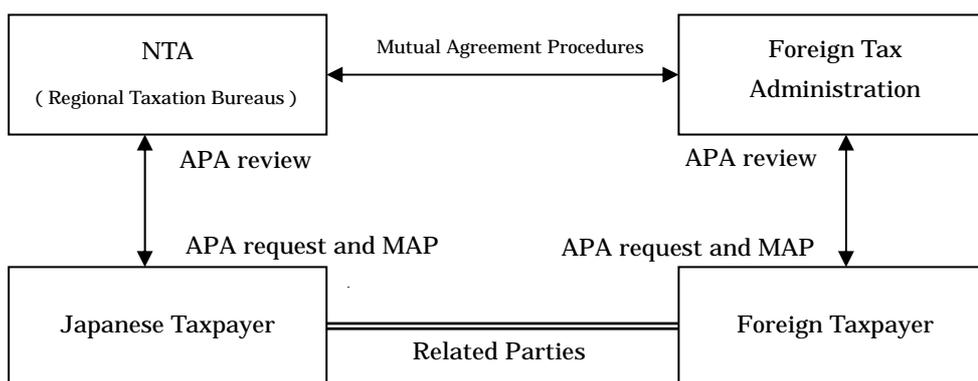
The objective of APAs is to ensure the predictability of transfer pricing taxation for the taxpayer by confirming in advance the method of calculating arm's length prices between the tax administration and the taxpayer. This ensures the proper and smooth enforcement of transfer pricing taxation. Transfer pricing taxation may often result in a large amount of additional taxes, and the examinations often require a great deal of time and MAP 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 (bilateral APAs or multilateral APAs, hereinafter referred to as "MAP (Mutual Agreement Procedures) /APAs").

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 allow associated taxpayers in other countries to avoid the risk of taxation by foreign tax administrations.

MAP/APAs, 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 MAP/APAs, 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 endorse MAP/APAs.

### Diagram of the MAP/APA Process



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

APAs were first created in Japan in 1987<sup>2</sup>. 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<sup>3</sup>.

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), Brazil (1997), 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>4</sup>.

With this increase in global recognition, the number of APA requests has risen, and since 1994, MAP/APA requests in Japan have also increased. Due to this increase in requests for MAP/APAs, 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 MAP/APAs was released in June 1, 2001. This document was superseded by the *Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines)*<sup>5</sup> (hereafter referred to as Transfer Pricing Administrative Guidelines) and is still in effect.

Comprehensive guidelines for MAP on which MAP/APA 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>6</sup>. The MAP Administrative Guidelines (English version) are available on the NTA website ([www.nta.go.jp](http://www.nta.go.jp)).

---

<sup>2</sup> "Guidance on Calculation of Arm's Length Prices, 24 April 1987" (hereafter referred to as "1987 Directive")

<sup>3</sup> Ibid.

<sup>4</sup> The OECD issued the OECD/APA Guidelines in 1999, thereby committing to promoting MAP/APAs.

<sup>5</sup> Document ID: Examination Division 7-1 etc. dated 1 June 2001

<sup>6</sup> Document ID: Office of Mutual Agreement Procedures 1-39 etc. dated 25 June 2001  
MAP as related to APA is regulated in the MAP Administrative Guidelines.

#### **4. MAP/APAs Today**

In recent years, interest in MAP and APAs has been increasing around the world. The following points have been main topics in the past several years.

**(1) The Establishment of the Commissioner's Directive on the Operation of Transfer Pricing Related to Consolidated Corporate Groups(Administrative Guidelines) and The Revision of Commissioner's Directive on Mutual Agreement Procedures(Administrative Guidelines)**

The Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines) provides not only guidelines concerning transfer pricing but also procedures for APAs. As the Directive does not include guidelines concerning consolidated corporate groups, the NTA established the Commissioner's Directive on the Operation of Transfer Pricing Related to Consolidated Corporate Groups<sup>7</sup> (Administrative Guidelines on Consolidated Corporate Groups). The consolidated taxation system views a parent corporation and a subsidiary as a single corporation in tax return filing, tax payment, and other taxation procedures. Thus, a parent corporation files the request for APAs on behalf of its subsidiaries.

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>8</sup>.

**(2) The Geographical Expansion – The First Agreement on BAPA with China**

Although the majority of MAP/APA cases have been with the other PATA nations (United States, Australia, and Canada), there have been cases with countries which have no experience with MAP/APAs, including Asian nations.

Because such nations have not had a positive attitude towards APAs, they have little experience with MAP/APAs. However, it seems that they are changing their attitude, and the number of APA cases is expected to increase from now on.

**(3) PATA**

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 BAPAs. 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.

---

<sup>7</sup> Document ID: Examination Division 7-4 etc. dated 28 April 2005

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

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)).

#### **(4) Discussions at the OECD**

The OECD Committee on Fiscal Affairs (CFA) has been working on the operation and framework of MAP and on supplementary dispute solution mechanisms to resolve international tax disputes. Based on the issues discussed by the CFA, the OECD released a progress report entitled “Improving the Process for Resolving Tax Disputes” for public comment in July 2004.

## 5. APA Enforcement System

In Japan, APA administration and jurisdiction differ based on the size of the corporation. As a rule, the Corporation Taxation Divisions of the Regional Taxation Bureaus (RTBs) are responsible for reviewing APA requests filed by corporations under the jurisdiction of a Tax Office; and the Examination Divisions of the RTBs are in charge of reviewing APA requests filed by corporations under the jurisdiction of the Examination Division of an RTB. In actuality, however, many of the APA requests filed by corporations under the jurisdiction of a Tax Office are transferred, in accordance with given procedures, to an Examination Division of an RTB and the APA review team takes charge of the cases. MAPs for both types of corporations are exclusively handled by the Office of Mutual Agreement Procedures at the NTA.

### (1) Corporations under the Jurisdiction of a Tax Office

Corporations submit their APA and MAP requests to the Examination Group (Corporation) of their Tax Office. The Corporation Taxation Division of the RTB<sup>9</sup> holds an APA pre-filing conference (described later) and performs a review of the APA request. The Corporation Taxation Division of the NTA may participate in the review, as necessary.

### (2) Corporations under the Jurisdiction of the Examination Division of an RTB

Corporations submit their APA requests to the jurisdictional RTB and MAP requests to the jurisdictional Tax Office. The Examination Division of the RTB<sup>10</sup> holds an APA pre-filing conference (described later) and performs a review of the APA request. The Examination Division of the NTA may participate in the review, as necessary<sup>11</sup>.

---

<sup>9</sup> Corporation Taxation Divisions of the Second Taxation Departments of RTBs (or of Taxation Departments in the cases of the Kanazawa, Takamatsu, and Kumamoto RTBs); or Corporation Taxation Division of the Okinawa Regional Taxation Office

<sup>10</sup> Second Transfer Pricing Division, First Examination Department of the Tokyo and Osaka RTBs; the International Examination Division, Examination Department of the Nagoya RTB; the International Examination Division, Examination and Criminal Investigation Department of the Kanto-Shinetsu RTB; the Management Division (Examination), Examination and Criminal Investigation Department of the Sapporo, Sendai, Kanazawa, Hiroshima, Takamatsu, Fukuoka, and Kumamoto RTBs; and the Examination Division of the Okinawa Regional Taxation Office.

<sup>11</sup> The Corporation Taxation Division (the division in charge of corporations under the jurisdiction of the Tax Office) or Examination Division (the division in charge of corporations under the jurisdiction of the Examination Division of the RTBs) of the RTBs are hereafter referred to as the "division in charge at the RTBs," and the Corporation Taxation Division, the Taxation Department (the division in charge of corporations under the jurisdiction of the Tax Office) or the Examination Division, the Examination and Criminal Investigation Department (the division in charge of corporations under the jurisdiction of the Examination Division of the RTBs) of the NTA are hereafter referred to as the "division in charge at the NTA."

## 6. Overview of APAs 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

APA is defined as the confirmation made by a District Director of a Tax Office or a Regional Commissioner of an 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

MAP/APA 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>12</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>13</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 APAs and Transfer Pricing Examinations

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

APAs examine 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

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

---

<sup>12</sup> Transfer Pricing Administrative Guidelines 5–11.

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–11.

<sup>13</sup> Ibid. 5–12.

c. Comparable transactions

APAs 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>14</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>15</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>16</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>17</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 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

---

<sup>14</sup> Ibid. 2–14

<sup>15</sup> Ibid. 5–1. Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–1

<sup>16</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. (Ibid. 5–20.)

<sup>17</sup> Ibid. 5–2.

c. Terms to be confirmed

Under the Transfer Pricing Administrative Guidelines, APAs 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 APAs<sup>18</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>19</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 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>20</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

---

<sup>18</sup> Ibid. 5–16. Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–16

<sup>19</sup> Ibid. 5–14.

<sup>20</sup> Ibid, 5–17.

adjustments for the year. 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 MAP/APA 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

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>21</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. Cancellation<sup>22</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. Renewal<sup>23</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>24</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 MAP/APA 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 parent corporation shall file the request for APAs 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>25</sup>.

---

<sup>21</sup> Ibid. 5–18.

<sup>22</sup> Ibid. 5–16.

<sup>23</sup> Ibid. 5–20.

<sup>24</sup> Ibid. 5–21.

<sup>25</sup> Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–1

## **7. APA Process**

In Japan, APAs commence at the request of the taxpayer. The NTA does not charge any fee for APA proceedings. APA procedures, as a rule, can be divided into the following four steps: (1) submission of APA request, (2) case review by the APA review group of the RTB in question, (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. Where MAP proceedings are likely to be requested at a later date, the relevant divisions of the 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>26</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 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).

---

<sup>26</sup> Transfer Pricing Administrative Guidelines 5-11  
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-11

### **(3) MAP Negotiations and Agreement**

In the case of MAP/APAs, 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 in 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.

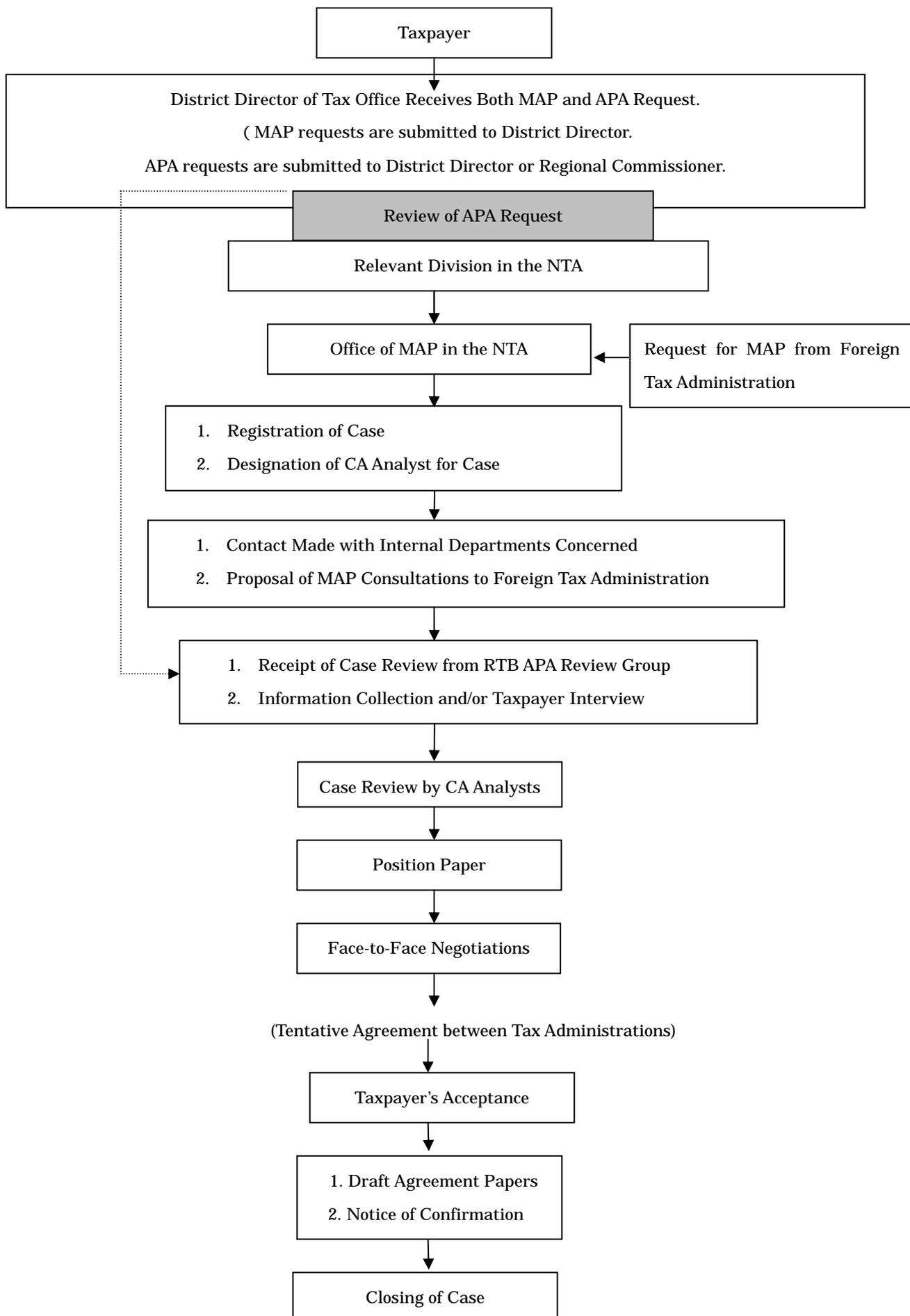
In the case of a unilateral APA, a modified APA request may be requested when the RTB APA review group judges the original APA request to be unreasonable. If the taxpayer does not accept the request for modification from the APA review group, the APA review group sends a notice of non-confirmation. When 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.

### **(4) Examination of Annual Compliance Reports, etc.**

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.

### Flowchart of Bilateral APA



## **8. Taxpayer Cooperation in APAs**

The APA system is based on taxpayer initiative. The cooperation of the taxpayer is therefore indispensable for APAs 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. Status of APAs

As noted before, the APA was first created in Japan in 1987. The following chart indicates the MAP/APA and unilateral APA cases received and disposed of over the 18-year period from 1987 through 2004. It shows clearly that the majority are MAP/APA cases. (MAP/APA cases are counted by the number of tax treaty countries involved in a specific case; unilateral APA cases are counted by the number of domestic corporations involved.)<sup>27</sup>

(Unit: Case)

|            | Cases Received |       | Cases Disposed |       |
|------------|----------------|-------|----------------|-------|
| MAP/APA    | 401            | 87.6% | 258            | 85.1% |
| Unilateral | 57             | 12.4% | 45             | 14.9% |

MAP/APAs are explained below in detail.

### (1) Yearly Data on the Number of Cases Received

The number of MAP/APA cases received increased after 1994, when the MAP/APA program started to gain recognition worldwide. From 2000, 12 years after the system began, the average number of cases (previously 10 cases annually) grew fourfold, and then grew sixfold in 2004.

(Unit: Case)

| Cases Received | 1987-99 | 2000 | 2001 | 2002 | 2003 | 2004 | Total |
|----------------|---------|------|------|------|------|------|-------|
| MAP/APA        | 121     | 48   | 42   | 47   | 80   | 63   | 401   |

### (2) Yearly Data on the Number of Cases Disposed

Owing to closer cooperation on APAs with RTBs, an historic number of cases were disposed in 2004.

(Unit: Case)

| Cases Disposed | 1987-1999 | 2000 | 2001 | 2002 | 2003 | 2004 | Total |
|----------------|-----------|------|------|------|------|------|-------|
| MAP/APA        | 69        | 29   | 25   | 47   | 39   | 49   | 258   |

<sup>27</sup> MAP/APA cases received are counted by the number of MAP requests submitted or requests by a partner country. They are defined as cases of MAP based on APA. MAP related to compensating adjustments and revisions following APA agreements are included. APA cases disposed are the number of MAP closed such as MAP/APA agreements and the number of case withdrawals by taxpayers.

Hereafter, a year is defined as 1 July to 30 June of the following year.

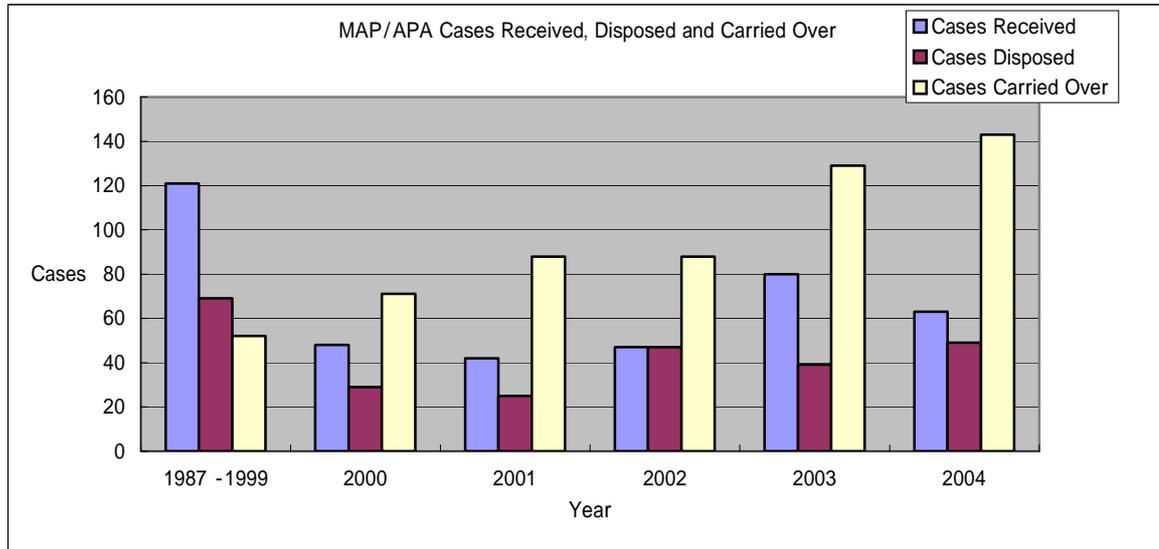
Between these data and the data of "The Status of APA Cases Received and Disposed Related to Transfer Pricing" (attached table 5(4)) in "The Data of Corporations (under the Jurisdiction of the Examination Division of the RTBs) Taxation concerning the Period from 1 July 2004 to 30 June 2005" published yearly, there are some differences because the latter data includes unilateral APAs, not compensating adjustments.

**(3) Yearly Data on the Number of Cases Carried Over**

Although the number of disposed cases increased, the number of cases carried over also increased, due to a sharp increase in the number of cases received over those disposed.

(Unit: Case)

| Cases Carried Over | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--------------------|------|------|------|------|------|------|
| MAP/APA            | 52   | 71   | 88   | 88   | 129  | 143  |



**(4) Analysis of 2002–2004 MAP/APA Cases**

- MAP/APA cases disposed – by industry

MAP/APA cases disposed are categorized by industry in the chart below. Manufacturing companies make up more than half of all corporations using MAP/APAs.

( Unit: Case )

|                  | 2002 | 2003 | 2004 |
|------------------|------|------|------|
| Manufacturing    | 22   | 19   | 35   |
| Wholesale/Retail | 13   | 17   | 13   |
| Others           | 12   | 3    | 1    |
| Total            | 47   | 39   | 49   |

- MAP/APA cases disposed – by transaction type

Transactions involving MAP/APA cases disposed are categorized by transaction type in the chart below<sup>28</sup>. More than half of them are inventory transactions; the remainder is split between service provision and others.

(Unit: Case)

|                        | 2002 | 2003 | 2004 |
|------------------------|------|------|------|
| Inventory Transactions | 31   | 27   | 53   |
| Provision of Services  | 20   | 15   | 12   |
| Others <sup>29</sup>   | 11   | 14   | 8    |

- Transfer pricing methods for MAP/APA cases disposed

Transfer pricing methods used are as follows<sup>30</sup>

(Unit: Case)

|                                   | 2002 | 2003 | 2004 |
|-----------------------------------|------|------|------|
| Three Basic Methods <sup>31</sup> | 31   | 23   | 24   |
| Other Means                       | 23   | 23   | 27   |

- MAP/APA cases disposed – by region

( Unit: Case )

| Counterpart Region | 2002 | 2003 | 2004 |
|--------------------|------|------|------|
| Americas           | 24   | 16   | 20   |
| Asia/Oceania       | 17   | 18   | 26   |
| Other              | 6    | 5    | 3    |
| Total              | 47   | 39   | 49   |

##### (5) Time Required per MAP/APA Case

The average time spent on a MAP/APA 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.

<sup>28</sup> Some cases include more than one transaction.

<sup>29</sup> "Others" refers to royalty- and global trading-related transactions.

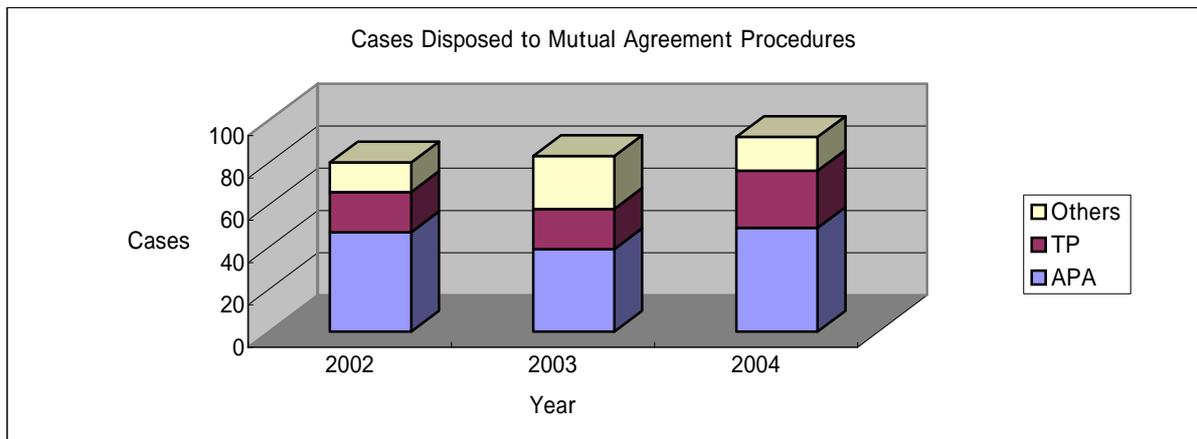
<sup>30</sup> In some cases, several transfer pricing methods are applied.

<sup>31</sup> The three basic methods are the Comparable Uncontrolled Price method, the Resale Price method, the Cost Plus method, and their equivalents as well as identical methods thereof.

## 10. MAP Status

The following table itemizes MAP cases for the past three years. As in 2004 MAP/APA cases received and carried over made up more than 70% of total MAP cases<sup>32</sup>.

|      |                    | MAP/APA |       | Transfer Price Taxation |       | Others |       | Total |        |
|------|--------------------|---------|-------|-------------------------|-------|--------|-------|-------|--------|
|      |                    |         |       |                         |       |        |       |       |        |
| 2002 | Cases Received     | 47      | 50.0% | 19                      | 20.2% | 28     | 29.8% | 94    | 100.0% |
|      | Cases Disposed     | 47      | 58.7% | 19                      | 23.8% | 14     | 17.5% | 80    | 100.0% |
|      | Cases Carried Over | 88      | 53.6% | 37                      | 22.6% | 39     | 23.8% | 164   | 100.0% |
| 2003 | Cases Received     | 80      | 65.6% | 30                      | 24.6% | 12     | 9.8%  | 122   | 100.0% |
|      | Cases Disposed     | 39      | 47.0% | 19                      | 22.9% | 25     | 30.1% | 83    | 100.0% |
|      | Cases Carried Over | 129     | 63.6% | 48                      | 23.6% | 26     | 12.8% | 203   | 100.0% |
| 2004 | Cases Received     | 63      | 70.0% | 8                       | 8.9%  | 19     | 21.1% | 90    | 100.0% |
|      | Cases Disposed     | 49      | 53.3% | 27                      | 29.3% | 16     | 17.4% | 92    | 100.0% |
|      | Cases Carried Over | 143     | 71.1% | 29                      | 14.4% | 29     | 14.4% | 201   | 100.0% |



<sup>32</sup> For the definition of MAP/APA cases received and disposed, see footnote xxvii.

## 11. Staff in Charge of MAP/APA 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), and the Director (Mutual Agreement Procedures) overseeing MAP (1997) 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 MAP/APA 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 | Team Name | Jurisdiction                     |
|---|---|-----------|----------------------------------|
|   |   | Unit 1    | Mainly North America and Oceania |
| Unit 2                                      |   |           |                                  |
| Unit 5                                      |   |           |                                  |
| Unit 6                                      |   |           |                                  |
|   | Director (Mutual Agreement Procedures)          | Unit 3    | Mainly Western Europe and Asia   |
|   |   | Unit 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 APAs within the Examination Division in the RTBs are as follows. In 2005, Second Transfer Pricing Division was established to handle reviews of APAs 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               |