

APA Program Report 2007

October 2007

National Tax Agency

Contents

1	Recent Development	1
	(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 Method	
	d. The Number of Disposed BAPAs –by Region	
	e. Time Required per BAPA Case	
	(3) Recent Discussions	
2	Introduction	6
3	What Are Advance Pricing Arrangements (APAs)?	7
4	History of APAs in Japan and the World	8
5	Address at PATA	9
6	Overview of APA in Japan	10
	(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	
	(12) Pre-filing Consultation	
7	APA Process	16
	(1) Submission of APA Request	
	(2) Review by the Regional Taxation Bureau (RTB) APA Review Group	
	(3) MAP Negotiations and Agreement	
	(4) Review of Annual Compliance Reports, etc.	

【Chart】 Flowchart of BAPA Procedure

8 Staff in Charge of BAPA Cases 19

 (1) Staff in MAP Staff

 (2) APA Review Groups

9 Taxpayer Cooperation in APA 21

Attachment 1 Partner Countries of Mutual Agreement Procedure

Attachment 2 Summary of MAP Statistics

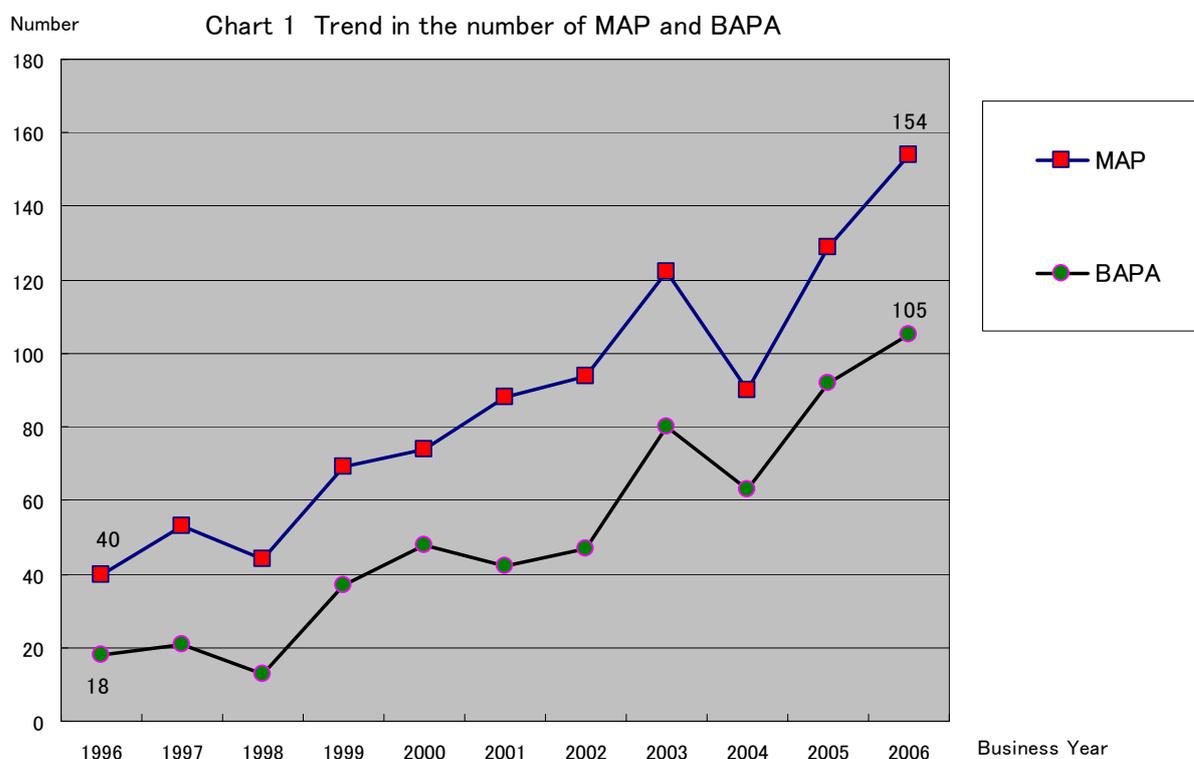
Reference Japan's Tax Convention Network

1. Recent Developments

(1) Recent Developments of Mutual Agreement Procedures (MAP)

The number of MAP cases tends to increase in recent years, and more than 90% of the cases are related to transfer pricing. In particular, the number of Bilateral Advance Pricing Arrangement (BAPA; APA accompanied by MAP) shares a major part of the increase in the number of MAP cases. During the business year 2006 (from July 2006 until June 2007), the National Tax Agency (NTA) received 154 MAP cases. Among those, the number of transfer pricing related cases was 141, out of which the number of BAPA cases was 105. Compared to the statistics of ten years before (the business year 1996), the number of MAP cases has increased approximately four times and the number of BAPA cases has increased approximately six times.

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



(Note)

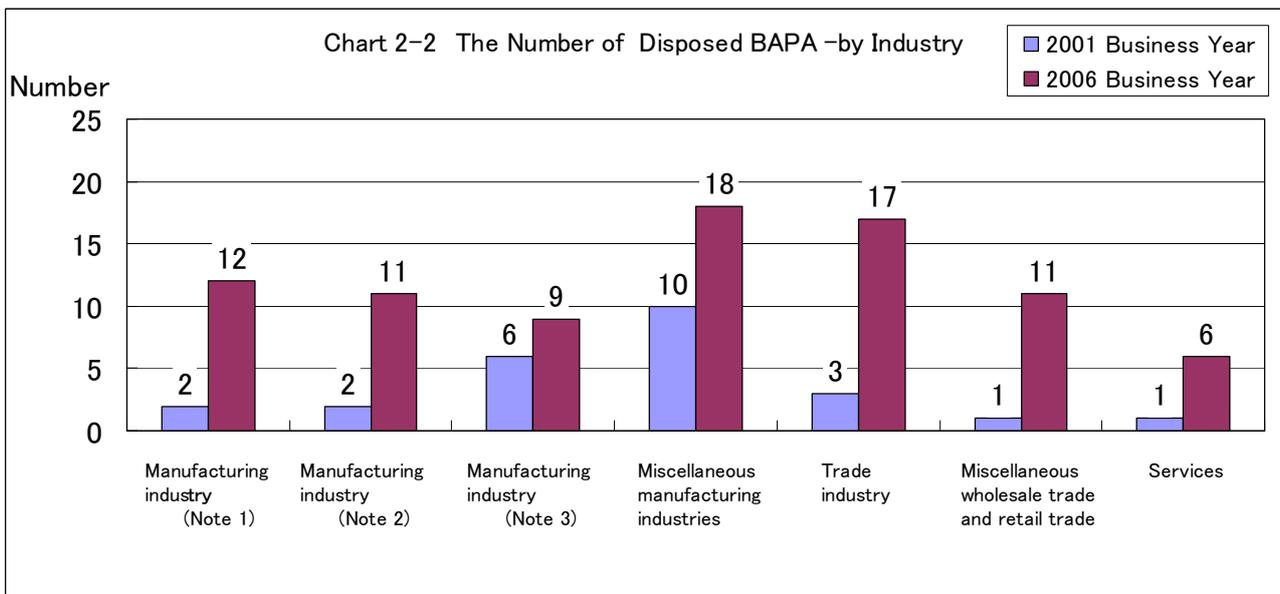
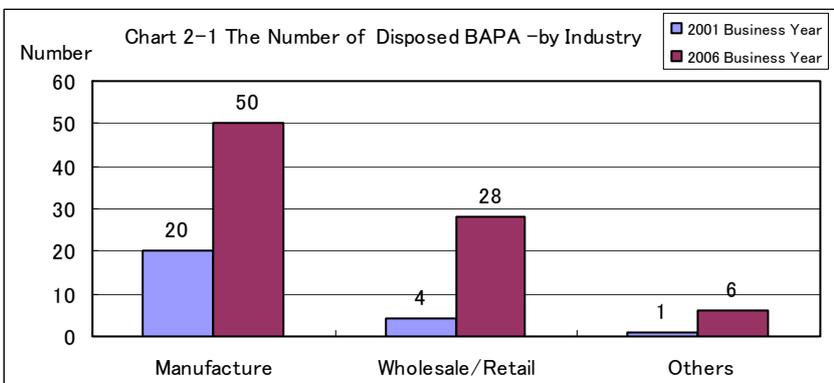
- 1 Business year is from the beginning of July through the end of June of the following year.
- 2 The number of MAP cases consists of both those cases which the NTA received the MAP requests from taxpayers in Japan and those cases which the NTA received the MAP requests from foreign tax authorities.
- 3 MAP cases on compensating adjustments and amendments of the previously agreed APA are counted as an individual MAP request, separated from their original APA cases.

(2) Recent Developments of BAPA

The number of disposed BAPA cases was 84 in the business year 2006, and Charts 2 through 5 below indicate the details.

a. The Number of disposed BAPA cases – by Industry

The number of BAPA cases disposed is categorized by industry of taxpayers' as in Chart 2 below. While the number of manufacturing companies was 20 and the number of wholesale / retail companies was 4 in the business year 2001, that of manufacturing companies is 50 and that of wholesale / retail companies is 28 in the business year 2006. The number of wholesale / retail companies has substantially increased. Further details of each industry are described in Chart 2-2 below.

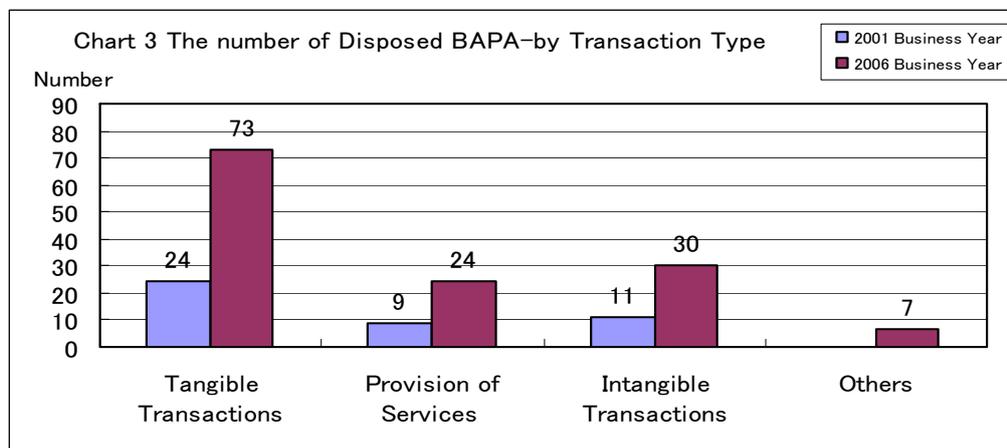


(Note)

- 1 Manufacture of household electric appliances and electric bulbs
- 2 Manufacture of transportation equipment
- 3 Manufacture of industrial electrical apparatus

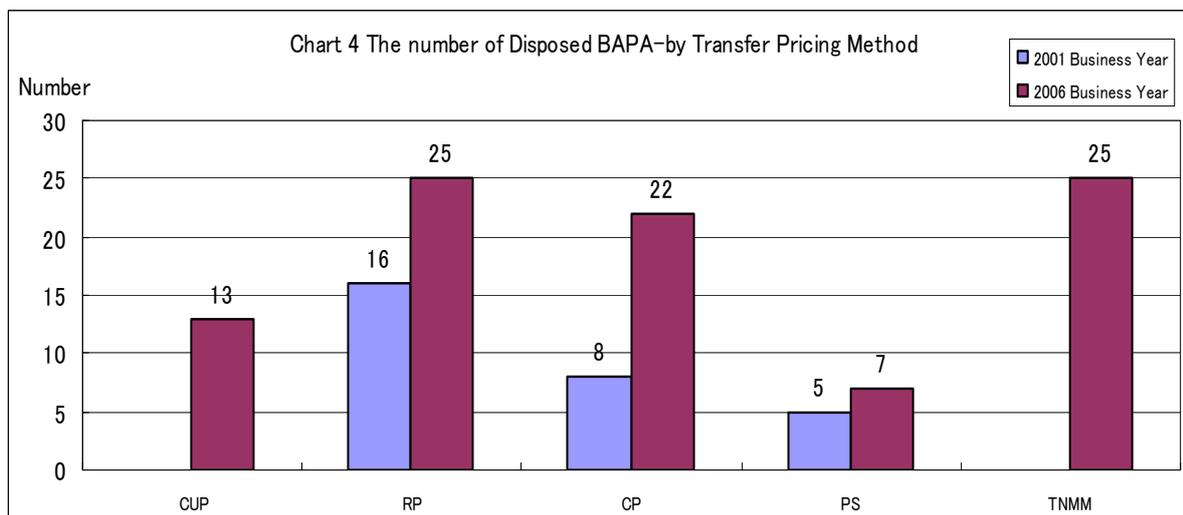
b. The Number of disposed BAPA cases – by Transaction Type

The number of disposed BAPA cases is categorized by transaction type as shown in Chart 3¹ below. While the number of Tangible Property Transactions was 24 and that of Provision of Services was 9 in the business year 2001, the number of Tangible Property Transactions is 73 and that of Provision of Services is 24 in the business year 2006.



c. The Number of disposed BAPA cases – by Transfer Pricing Method

The number of disposed BAPA cases is categorized by transfer pricing method as shown in Chart 4² below. In the business year 2006, the number of TNMM (Transactional Net Margin Method, introduced in March 2004) is increasing sharply.



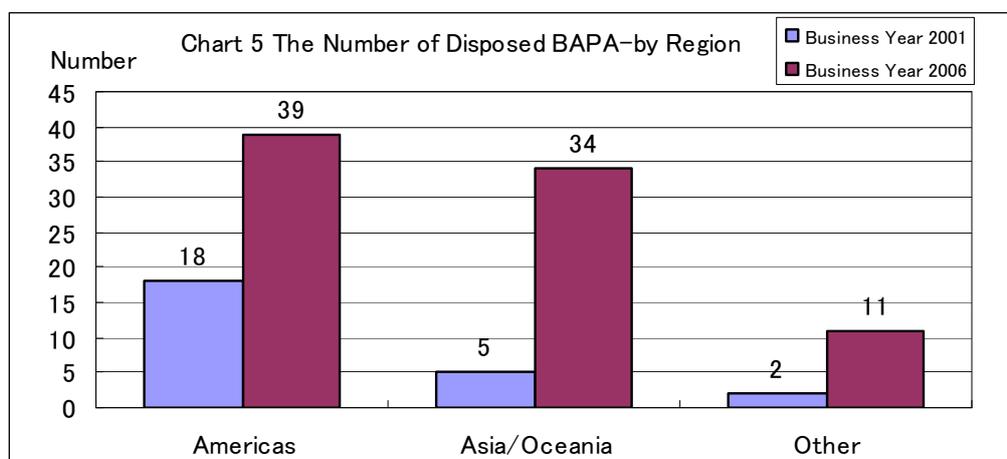
¹ Some cases include more than one transaction, and thus one case is counted more than once in accordance with the different types of transactions involved. “Others” refers to global trading-related transactions and etc.

² In some cases, more than one transfer pricing method is applied, as they contain more than one transaction, which requires different transfer pricing treatment.

d. The Number of disposed BAPA cases – by Region

The number of disposed BAPA cases is categorized by region as indicated in chart 5 below. Although the number of BAPA cases with USA, Australia, and Canada has made up a large share of entire BAPA cases, the number of BAPA cases with Asian countries with little experience in BAPA is increasing³. In light of the changes of their policy on BAPA in such countries, the number of BAPA cases with such countries will be expected to increase.

The number of countries with which the NTA was under negotiation for BAPA had been eleven in the business year 1996 (ten years before), and it increased to twenty-five in the business year 2006. The number of countries with which the NTA was negotiating (a) BAPA case(s) at the end of the business year 2006 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 in accordance with the nature of each case, e.g. whether the case is a new case or a renewal of an existing one, whether the case is for compensating adjustment, and etc.

(3) Recent Discussions and Developments in various fora

a. Discussion at the OECD

Dispute Resolution with regard to international double taxation including mutual agreement procedures had been discussed at the OECD since 2002. Through public comments and public consultation, the report entitled “Improving the Resolution of Tax Treaty Disputes” was released in February 2007.

In the report, it is proposed to add a provision about arbitration in Article 25 of the OECD Model Tax Convention and its commentaries. In the “Manual on Effective Mutual Agreement Procedures (MEMAP)” also released by the OECD during the same period, 25 best practices of MAP are proposed so as to improve the effectiveness of MAP

³ The treaty partners with which the NTA accepted the biggest number of BAPA cases in the business year 2006 are as follows in descending order : ①U.S. ②Australia ③China

b. Revision of Tax System in Japan

In the tax reform in 2007, grace of tax payment during the MAP concerning transfer pricing taxation cases, i.e. suspension of collection during the MAP on transfer pricing adjustment cases, was introduced and has become effective since the beginning of Fiscal Year 2007, i.e. April 1, 2007.

Under this system, a taxpayer may request the postponement of the payment of tax on transfer pricing adjustment until the termination of MAP.

This new system has been introduced to mitigate taxpayers' burden caused by international double taxation, and the NTA is making efforts to administrate the system properly and smoothly.

c. Improvement of Pre-filing Consultation of APA and Staff Increase engaged in APA Examination

In response to the report of the Tax Commission regarding the tax reform in Fiscal Year 2007, the NTA improved the APA system by facilitating the process of Pre-filing Consultation and expanded its APA examination capacity by increasing the number of staff engaged in the examination of APA requests.

Concerning the compliance activities on transfer pricing regulation, the NTA amended the Commissioner's Directive on Transfer Pricing in June 2007 through public consultation process in order to enhance the taxpayer's predictability and to further clarify the administration of transfer pricing regulation. At the same time, the NTA also established and released a series of case studies that show the examples of transfer pricing treatments under certain conditions.

2. Introduction

In Japan, transfer pricing taxation was introduced in 1986. In 1987, advance pricing arrangement (APA) started, making Japan the first country in the world to implement such a procedure.

Basic mechanism of the transfer pricing taxation is to compute taxable income of a corporation as if its transactions with its foreign-related entity/entities were conducted at arms' length price, in case that taxable income of the corporation was decreased as a result of the fact that its transactions with its foreign related entity/entities had not been based on the arms' length principle.

An APA is a framework for the tax administration and a taxpayer to agree that while the taxpayer files its tax return in accordance with the agreed APA conditions for the APA covered years, the tax administration refrains from transfer pricing taxation on the taxpayer(s).

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

The National Tax Agency (NTA) is promoting BAPA to facilitate the enforcement of transfer pricing regulation, to mitigate the administrative burden on corporations, and to ensure the tax predictability for corporate management. The number of BAPA cases is increasing in recent years as the globalization of Japanese economy is progressing, and also the system of APA has become more widely recognized among taxpayers.

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

The usefulness of APA is largely known among taxpayers, and the number of cases of second or third APA (i.e. APA subsequent to the initial APA of the same taxpayer) has been increasing recently. Moreover, the cases with countries without substantial experience in BAPA have occurred, and the NTA's BAPA partner has been expanding geographically.

This report outlines APA and the data concerning APA and MAP from 1 July 2006 to 30 June 2007. Although there are APA cases which involve only one country only, i.e. Japan only, this report mainly focuses on BAPA which make up the majority of APA cases in Japan. We hope that this report will deepen taxpayers' understanding of APA administration and further promote APA.

3. What is Advance Pricing Arrangement (APA)?

As noted above, an APA is a framework for the tax administration and (a) taxpayer(s) to agree that while (a) taxpayer(s) file its tax return in accordance with the agreed APA conditions for the APA covered years, the tax administration refrains from transfer pricing taxation on the taxpayer(s).

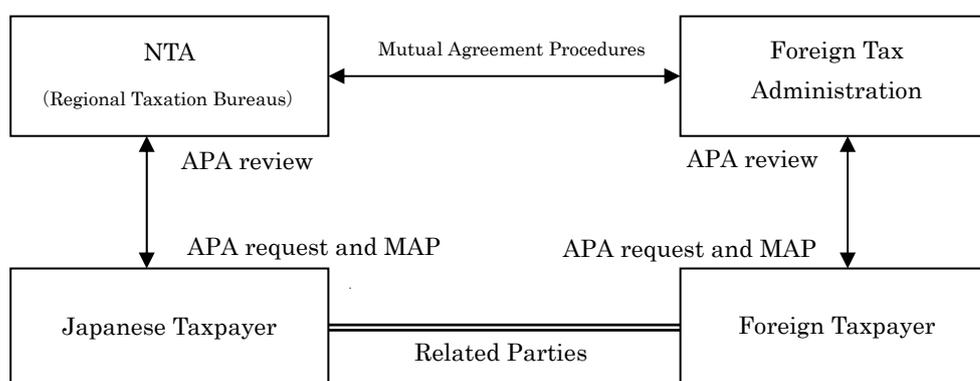
The objective of APA is to ensure the predictability of transfer pricing taxation for the taxpayer by confirming in advance the method of calculating arm's length prices between the tax administration and the taxpayer. This ensures the proper and smooth enforcement of transfer pricing taxation. Transfer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

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

A unilateral APA confirms the method to be used to calculate arm's length prices by the NTA for the taxpayer in Japan. A unilateral APA does not ensure that associated taxpayers in the other countries will avoid the risk of taxation by foreign tax administrations.

A BAPA, on the other hand, includes 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 the risks related to double taxation. With a BAPA, the taxpayer is ensured the legal stability of both tax administrations (all tax administrations in multilateral cases). This is the reason that many countries including Japan conduct BAPA.

Diagram of the BAPA Process



4. History of APAs in Japan and the World

In the nineteen eighties, because of the development of globalization of business activities, the need to address income shifting through transactions between a corporation and its foreign related entity/entities increased. Some foreign countries had already been 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.

The system of APA was first introduced in Japan in 1987. It was developed to ensure the proper and smooth enforcement of transfer pricing regulation 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) introduced APA. After the 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) created the system, and it truly became a focus of global interest⁴.

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 the number of BAPA requests, the 1987 Directive was revised in 1999, and the *Commissioner's Directive on Methods of Calculation of Arm's Length Prices (Administrative Guidelines)*, encouraging BAPA, was released. The content is retained in the successive *Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines)*⁵ (hereafter referred to as "Transfer Pricing Administrative Guidelines") issued on 1 June 2001, 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 2001⁶. The MAP Administrative Guidelines (provisional English translation) are available on the NTA website (www.nta.go.jp)⁷.

Countries such as the United States, Canada and Australia also publicize their APA reports every year in their websites.

⁴ The OECD issued the OECD/APA Guidelines in 1999, thereby committing to promoting BAPA.

⁵ Document ID: Examination Division 7-1 etc. dated 1 June 2001

⁶ 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.

⁷ The translation is provisional, and is in the process of being updated, as the introduction of "Grace of tax payment (suspension of collection during the MAP on transfer pricing taxation cases) is to be included in the Directive.

5. Efforts in Pacific Association of Tax Administrators (PATA⁸)

The Pacific Association of Tax Administrators (PATA) is comprised of representatives from the tax administrations of Japan, Australia, Canada, and the United States. Meetings organized under the framework of PATA and based on the Exchange of Information articles of the applicable Convention provide a forum for the administrations to exchange opinions and experiences 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 in which a taxpayer does not cooperate. Although MAP negotiation is a government-level process, the taxpayer which filed the APA request is permitted to participate at some sessions to provide factual information.

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

The 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 available on the NTA website (www.nta.go.jp).

⁸ 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 the suburb of London, it was agreed to set up the commissioners' meeting (named "Leeds Castle Group") including above eight countries and Germany and Korea, and consequently PATA was dissolved.

6. Overview of APA in Japan

(1) Definition of APA⁹

APA is defined as the confirmation made by District Director of Local Tax Office or Regional Commissioner of 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 the corporate taxpayer.

(2) Relationship between APA and MAP

a. Elimination of double taxation

BAPA is a means to eliminate double taxation before transactions are actually taken place. BAPA is established by the agreement reached by Competent Authorities (CA) of the countries concerned regarding suitable transfer pricing methods.

b. Recommendation of MAP requests when an APA request is filed¹⁰

To prevent double taxation and to ensure predictability of taxation, the division in charge at the RTBs shall provide the taxpayer who wishes to file an APA request with the necessary information, so that the taxpayer is able to consider what it should request in its APA application. The division in charge shall also recommend the APA applicant to file a MAP request in the case that it turns out to have an intention to file a BAPA request.

c. Collaboration between RTB's APA review teams and the MAP section¹¹

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

(3) Relationship between APA and Transfer Pricing Examination

a. Confirmation of future years' transfer pricing

APA is concerned with the appropriateness of the methods applied to calculate arm's length prices and of the profit level based on past financial data. Whereas an APA is to grant a confirmation for future transactions, transfer pricing examination deals 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, APA often sets a range which indicates that there is no income transfer when the financial

⁹ 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

¹⁰ Transfer Pricing Administrative Guidelines 5-12

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-12

¹¹ Transfer Pricing Administrative Guidelines 5-13

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-13

results of the transactions covered by the APA actually fell in the range.

c. Comparable transactions

APA is a system to confirm the appropriateness of the calculation methods proposed by the taxpayer itself, and therefore the selection of comparable transactions is based only on the information available to the taxpayer (e.g. public data, taxpayer's internal data, etc.).

d. Relationship between APA request and tax examination¹²

- Filing an APA request does not put into abeyance any examination of the same taxpayer and its transactions.
- In order to ensure confidence in the system, the information obtained from the taxpayer in the APA review process is not used for 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 an APA request¹³

A Special Application Form ("Request for APA of the Transfer Pricing Methodology") must be filed with the necessary documents no later than the deadline¹⁴ 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 request¹⁵

- Outline of organization conducting the foreign-related transactions and overall description of the transactions subject to the APA request
- Transfer pricing method to be confirmed and the explanation of the reason that the proposed method is the most rational one
- Material business and economic conditions essential to the APA
- Details of the transactions subject to the APA, e.g. cash flow, currency type and etc. of the transactions
- Capital relationships and substantial control relationships with foreign-related party/parties
- Functions performed by each transaction party
- Operational and accounting information for the prior three taxable years

¹² Transfer Pricing Administrative Guidelines 2–21

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 2-21

¹³ Transfer Pricing Administrative Guidelines 5–2

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–2

¹⁴ 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 5–22. Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–22.)

¹⁵ Transfer Pricing Administrative Guidelines 5–3, 5–4

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–3, 5–4

- Outline of transfer pricing examinations, appeals, lawsuits, and similar procedures pertaining to applicable foreign-related party/parties, and details of past taxation in their country/countries
- Results determined by applying the proposed transfer pricing methods to the prior three taxable years
- Miscellaneous documents that are considered necessary for the APA

c. Terms to be confirmed¹⁶

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

(5) Review of APA Request

The review is carried out based on the following items:

- a. Information about the actual business conditions of the APA-requesting taxpayer and its foreign-related party/parties, the particulars of the foreign-related transactions
- b. Analysis of the probability of income transfer in the past years, 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 (e.g. comparability of the listed items as below)
 - Types of inventories, content of services rendered, etc.
 - Stage of transaction
 - Volume of transactions
 - Terms and conditions of the transactions
 - Functions performed and risks assumed by the party/parties concerned
 - Intangible assets
 - Business strategy
 - Timing of entry into the market
 - Market conditions

(6) Effects of APA¹⁷

When a taxpayer files its tax returns prepared in accordance with the APA, the confirmed transaction is treated as having been conducted based on arm's length prices. If, after the APA is concluded, the taxpayer's income of the past APA periods turned out to be less than the appropriate figures calculated by applying the APA, the taxpayer must file amended tax returns for the past years. However penalties will not be imposed under the circumstances.

¹⁶ Transfer Pricing Administrative Guidelines 5–7
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–7

¹⁷ Transfer Pricing Administrative Guidelines 5–16
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–16

(7) Examination of Compliance Conditions¹⁸

A taxpayer who has received the APA confirmation (hereinafter referred to as “confirmed corporation”) must submit reports (hereinafter referred to as “annual compliance reports”) explaining that the reported income is compliant with the APA, by the deadline of the taxpayer’s final tax return for each year covered by the APA or the deadline otherwise predetermined by the District Director of the Local Tax Office. The division in charge at the RTB will examine the content of those reports.

(8) Compensating Adjustments¹⁹

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

If it is found that the income of the confirmed corporation is less than the appropriate level calculated by applying the APA, one of the two following procedures must be followed:

a. Adjustment of figures on the final tax return

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

b. Amended return

The confirmed corporation must promptly file an amended tax return if it turns out that, after filing the tax return, the income was understated in the tax return pertaining to the confirmed taxable years due to the inconsistency between the actual transaction and the results of applying the confirmed transfer pricing method.

If it is found that the income of the confirmed corporation is 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 return

The confirmed corporation may correct the taxable income in the final return based on the

¹⁸ Transfer Pricing Administrative Guidelines 5–18

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–18

¹⁹ Transfer Pricing Administrative Guidelines 5–19

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–19

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

b. Request for correction

The confirmed corporation may file a request for correction based on the mutual agreement for compensating adjustments if it turns out that the income was overstated due to the 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) Revision, Cancellation, and Renewal of APA

a. Revision²⁰

In the event where there is a situation that causes material differences to business and economic conditions essential to the continuation of the APA and critical assumptions compared to the situation when the APA was confirmed, the taxpayer must file a request for the APA revision.

b. Cancellation²¹

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 the APA arose.
- The confirmed corporation failed to comply with the contents of the APA in its tax return.
- 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. Renewal²²

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

(10) Rollbacks²³

When a taxpayer requests “rollback” treatment (i.e. retrospective application) of the transfer

²⁰ Transfer Pricing Administrative Guidelines 5–20
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–20

²¹ Transfer Pricing Administrative Guidelines 5–21
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–21

²² Transfer Pricing Administrative Guidelines 5–22
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–22

²³ Transfer Pricing Administrative Guidelines 5–23
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5–23

pricing method to the years prior to the APA period and the confirmed transfer pricing method in BAPA is regarded as the most appropriate one also for the years prior to the APA period, the rollback may be permitted.

(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 2005.²⁴ The parent corporation shall file the request for APA concerning its own transactions with foreign related entities in the name of the parent corporation to the District Director of the Local Tax Office with the jurisdiction over the place of its tax payment. The parent corporation, instead of its subsidiary, shall also file a request for APA on the foreign related transactions of the consolidated subsidiary to the District Director of the Local Tax Office with jurisdiction over the place of its tax payment²⁵.

The Commissioner's Directive on Mutual Agreement Procedures (Administrative Guidelines) was also revised to make the consolidated parent corporation the entity to request a MAP on behalf of its subsidiaries.²⁶

(12) Pre-filing Consultation²⁷

A Pre-filing Consultation is defined as a consultation between a taxpayer which is considering requesting an APA and relevant divisions of the Regional Taxation Bureau (APA teams) with regard to the method of calculation of arm's length prices. The NTA Head Office in charge of the APA program and/or the NTA's Office of Mutual Agreement Procedures may participate in the consultations if necessary. Agents may also hold an anonymous consultation on behalf of the client taxpayer.

Through the Pre-filing Consultation, both of the taxpayer and the APA team can establish a common basic understanding on the APA request. By doing so, it is expected that such effects as the reduction of the taxpayer's burden to prepare necessary documents and the facilitation of the review conducted by the APA team of the RTB will be brought about, because of which the APA teams offer counsel at pre-filing consultation in consideration of the following points:

- Explaining necessary matters for APA procedures, e.g. how to prepare the APA Application Form and its attachments, the deadline of filing, etc.
- Understanding the details of foreign-related transactions for the APA and providing the taxpayer with the necessary information to make an appropriate decision as to whether or not to apply for the APA and how to do it.

²⁴ See footnote 5.

²⁵ Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-1

²⁶ Document ID: Office of Mutual Agreement Procedures 1-18 etc. dated 8 June 2005 (amended)

²⁷ Transfer Pricing Administrative Guidelines 1-1, 5-10

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 1-1, 5-10

7. Flow of APA Process

In Japan, APA commences 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) review of the request 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 consultation with the tax authority before deciding whether to apply for an APA.²⁸ Where MAP proceedings are likely to be requested at a later date, the MAP Office of the NTA Head Quarter may participate in the consultation in addition to the relevant divisions of the Regional Taxation Bureau (RTB) and of the NTA Head Office in charge of the APA program. Further, there may be a case where the taxpayer applies for an APA, after a transfer pricing examination which resulted in transfer pricing adjustment, in order to avoid future risk of taxation and to ensure tax predictability for its business. In such a case, if a MAP is underway regarding the former transfer pricing adjustment case, the taxpayer can submit a request for APA to the MAP Office and then can arrange for a pre-filing consultation.

The NTA encourages taxpayers, who submit an APA request, to file a request for MAP in the case where the taxpayer has turned out to have an intention to initiate a BATA and has not filed it yet²⁹.

APA requests are submitted to the Local Tax Office or the RTB (depending on which jurisdiction the applicant corporation belongs to). The taxpayer is required to attach the necessary documents which sufficiently illustrate the transactions (see 5(4)b) to the request form for the purpose of facilitating the review of APA requests by the RTB review team.

(2) Review by the Regional Taxation Bureau (RTB) APA Review Team

When the APA request is submitted, the relevant division of the RTB designates a tax examiner to be responsible for the request and commences the review immediately. The APA review staff designated 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's APA review team conducts its review in accordance with the Transfer Pricing Administrative Guidelines 5-11 (Review of APA Requests).

²⁸ Transfer Pricing Administrative Guidelines 5-10

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-10

²⁹ Transfer Pricing Administrative Guidelines 5-12

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-12

(3) MAP Negotiations and Agreement³⁰

In the case of BAPA, a CA analyst drafts a position paper based on the conclusion reached by the APA review team of the RTB. Face-to-face negotiations between the CA staff of the countries concerned are generally held several times a year. In addition, communication between CAs by telephone, fax, and other means is conducted, to exchange opinions more frequently. The CA staff and APA review staff keep their regular contact and exchange views to confirm material facts.

When the APA agreement is reached, the content of which is the same as that of the original APA request, the APA review group within the RTB sends the notice of APA confirmation to the taxpayer. When the APA agreement is reached, the content of which is different from that of the original APA request, the taxpayer is required to submit a modified APA request in accordance with the agreement. The RTB's APA review team then sends the notice of APA confirmation to the taxpayer.³¹

(4) Review of Annual Compliance Report, etc.³²

After the APA confirmation notice is received, the taxpayer is required to submit, by the deadline for its final tax return or by an otherwise designated date, the annual compliance report which explains whether or not the business results reported in the year's tax return meet with the agreement. The division of the RTB in charge may request further explanation from the taxpayer if necessary, and it may also visit the taxpayer's premises for review in case of need. In the case that income figures are under-reported compared with the figures agreed, they must be adjusted upward in the modified tax return. Review of Annual Compliance Reports by the division of the RTB in charge corresponds to tax examination for corporate tax. Conversely, in the case that 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 for downward adjustment) based on the new MAP agreement.

When the conditions provided in critical assumptions are changed, the taxpayer must submit a request for new MAP consultation.

³⁰ Transfer Pricing Administrative Guidelines 5-13

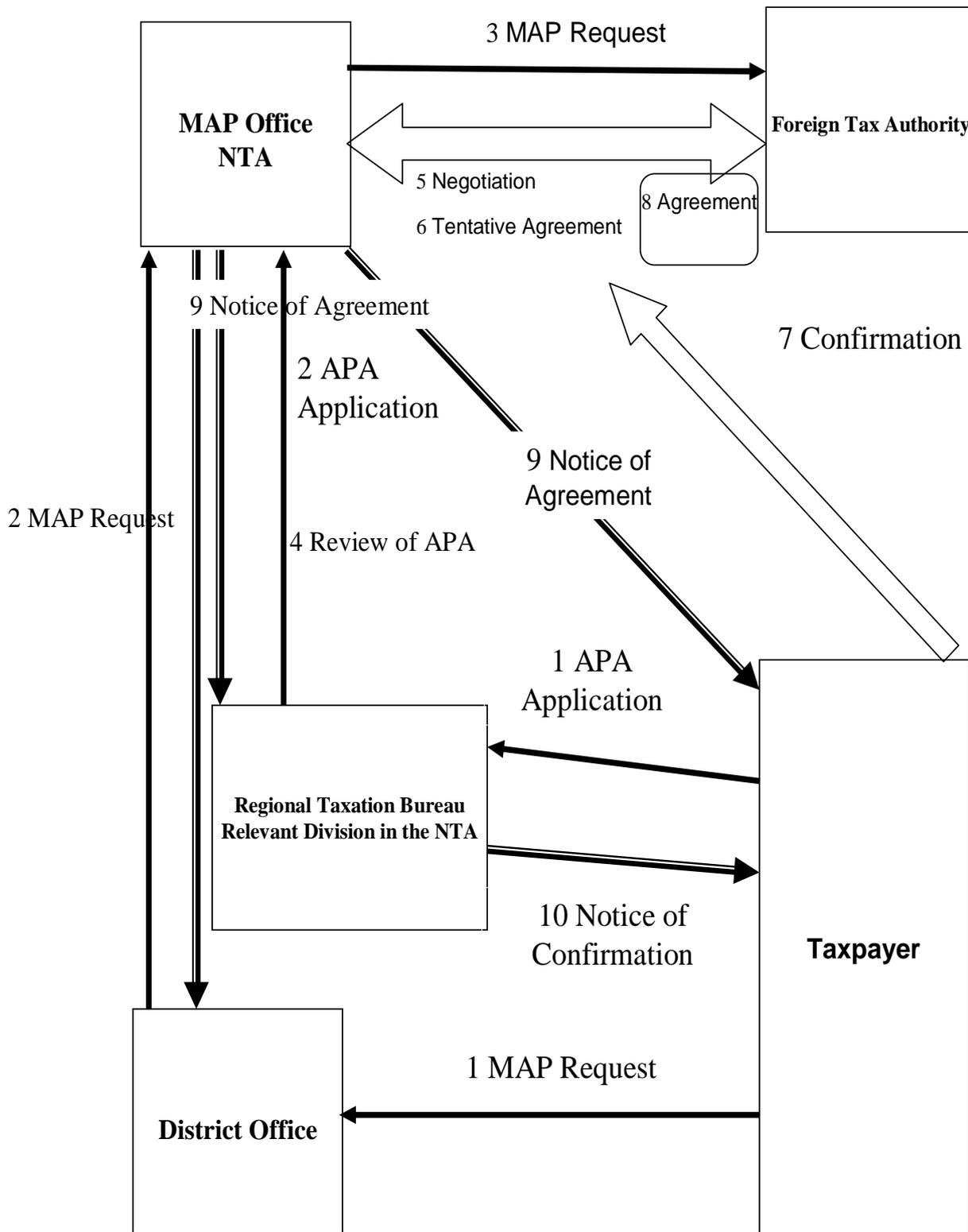
Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-13

³¹ 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.

³² Transfer Pricing Administrative Guidelines 5-17, 5-18

Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 5-17, 5-18

Flowchart of BAPA Procedure



8. Staff in Charge of BAPA Cases

(1) Staff in MAP Office

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]), who dealt with international conferences and mutual agreement procedures. The Office of International Operations was established in 1986. Subsequently, the position of the Director overseeing MAP cases was created in 1995. 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, permanent establishment cases and etc. However, APA cases have made up approximately 70% of all the cases handled by the Office of Mutual Agreement Procedures in recent years. The table below describes the current structure of the Office of Mutual Agreement Procedures.

		Group	Jurisdiction
			1-a
Deputy Commissioner (International Affairs)	Director, Office of Mutual Agreement Procedures	1-b	
		1-c	
		3-a	
	3-b	Mainly Western Europe and Asia	
Director (Mutual Agreement Procedures)	2-a		
		2-b	

(2) APA Review Groups

The Large Enterprise Examination Division of the Large Enterprise Examination and Criminal Investigation Department in the NTA established the Director (International Examination) and Transfer Pricing 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			
Deputy Commissioner (Large Enterprise Examination and Criminal Investigation)	Director, Large Enterprise Examination Division	Director (International Examination)	Transfer Pricing Section No. 1-3

The divisions in charge of APA within the Examination Department in the RTBs are as follows. In 2005, Advance Pricing Arrangement Division was established in Tokyo RTB to handle reviews of APA requests.

Regional Taxation Bureau (Office)			
Tokyo RTB	First Large Enterprise Examination Department	Deputy Assistant Regional Commissioner (International)	Advance Pricing Arrangement Division
Osaka RTB	First Large Enterprise Examination Department		Transfer Pricing Division
Nagoya RTB	Large Enterprise Examination Department		International Examination of Large Enterprise Division
Kantoshinetsu RTB	Large Enterprise Examination and Criminal Investigation Department		International Examination of Large Enterprise Division
Other RTBs	Large Enterprise Examination and Criminal Investigation Department		Management Division (Large Enterprise Examination)
Okinawa Regional Taxation Office			Large Enterprise Examination Division

9. Taxpayer Cooperation in APA

The APA system is based on taxpayer's initiative. The cooperation of the taxpayer to the review of the filed APA request is therefore indispensable for the smooth proceeding. In particular, timely submission of the relevant documents and other information significantly contribute to efficient case reviews and CA discussions. Prompt submission is thus essential.

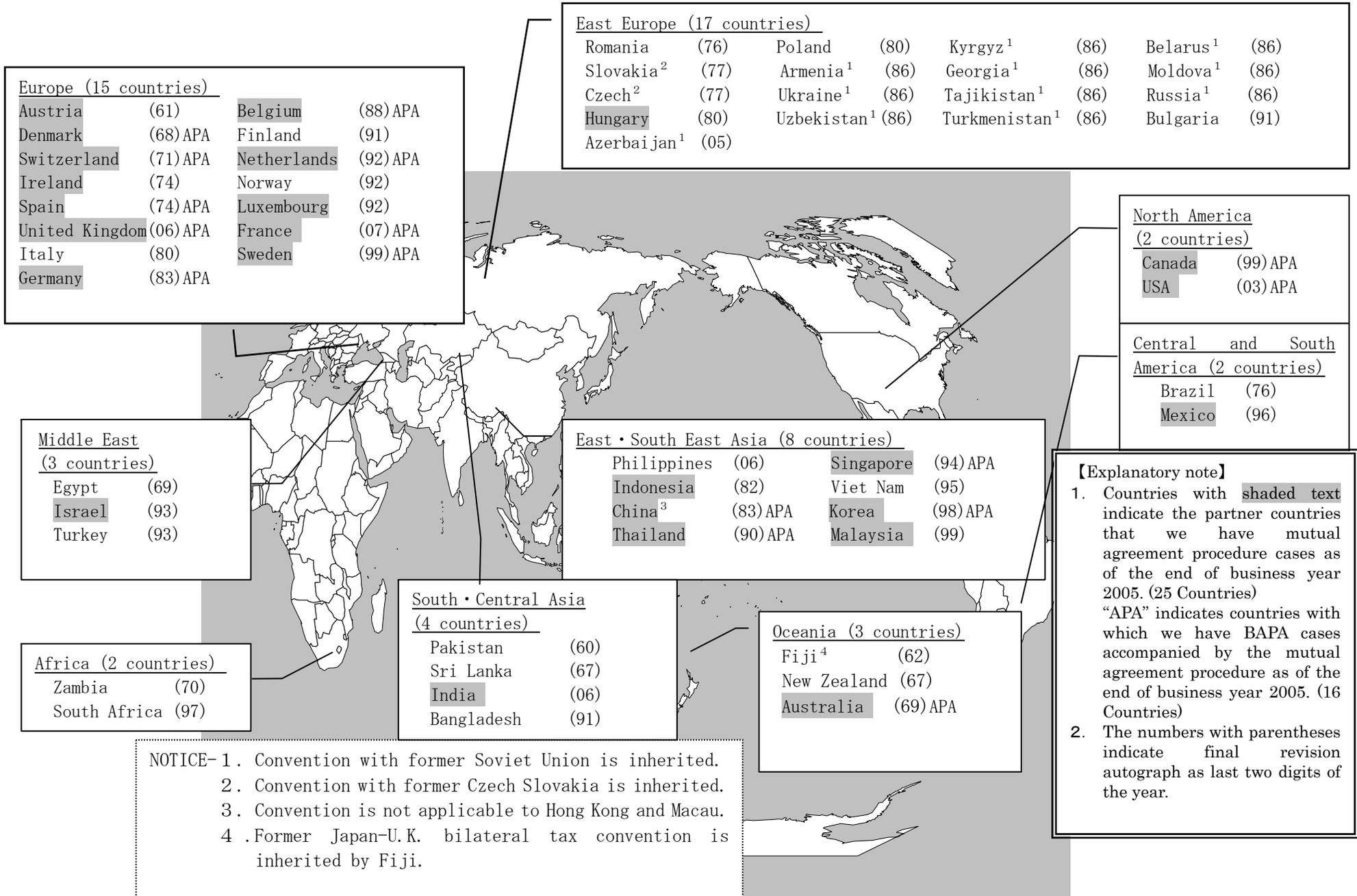
Further, when an APA request is submitted also to a foreign tax administration, the application should be submitted simultaneously to the NTA in order to enable more effective case review and CA discussions to be conducted.

Even after the commencement of MAP process, the CA analysts 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.

Partner Countries of Mutual Agreement Procedure

(Attachment 1)



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 convention is inherited by Fiji.

【Explanatory note】
 1. Countries with shaded text indicate the partner countries that we have mutual agreement procedure cases as of the end of business year 2005. (25 Countries)
 “APA” indicates countries with which we have BAPA cases accompanied by the mutual agreement procedure as of the end of business year 2005. (16 Countries)
 2. The numbers with parentheses indicate final revision autograph as last two digits of the year.

Summary of MAP Statistics

Business Year		BAPA	Transfer Pricing Taxation	Others	Total
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
2006	Cases Received	105	35	14	154
	Cases Disposed	84	16	15	115
	Cases Carried Over	191	59	26	276

(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)

Austria (61)	Belgium (88)
Denmark (68)	Finland (91)
Switzerland (71)	Netherlands (92)
Ireland (74)	Norway (92) CA
Spain (74)	Luxembourg (92) CA
United Kingdom (06) CA	France (07) CA
Italy (80)	Sweden (99) CA
Germany (83)	

East Europe (17 countries)

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

North America (2 countries)

Canada (99) CA
USA (03) CA

Central and South America (2 countries)

Brazil (76)
Mexico (96) CA

Middle East (3 countries)

Egypt (69)
Israel (93) CA
Turkey (93) CA

East • South East Asia (8 countries)

Philippines (06) CA	Singapore (94) CA
Indonesia (82)	Viet Nam (95) CA
China ³ (83)	Korea (98) CA
Thailand (90) CA	Malaysia (99) CA

Africa (2 countries)

Zambia (70)
South Africa (97) CA

South • Central Asia (4 countries)

Pakistan (60)
Sri Lanka (67)
India (06) CA
Bangladesh (91) CA

Oceania (3 countries)

Fiji ⁴ (62)
New Zealand (67)
Australia (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. (20 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.