

APA Program Report 2004

September 2004

National Tax Agency

Office of Mutual Agreement Procedures

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) PATA | |
| | (2) Amendment to the Japan-U.S. Tax Convention | |
| | (3) 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 | |
| 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. | |
| | 【Chart】 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 2001-2003 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

Advance Pricing Arrangements (APAs) were started in Japan in 1987, making Japan the first 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 the bilateral APAs (BAPAs) to realize the smoother enforcement of transfer pricing taxation, to mitigate the administrative burden on the company in question, and to ensure taxation predictability for the company's management. The number of APAs is also increasing with globalization and as APA becomes better known to taxpayers. Eighty APAs were received in the 2003 fiscal year,¹ which is about 1.7 times that of the preceding year and cases carried over exceeded 100 for the first time. In recent years, the number of APAs has been increasing sharply.

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

Recently, various international forums, including the OECD, the Pacific Association of Tax Administrators (PATA), and the Study Group on Asian Tax Administration and Research (SGATAR), are discussing the resolution of disputes arising out of transfer pricing taxation. 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 issues². PATA revised and released MAP Operational Guidance and BAPA Operational Guidance in June 2004 in response to the steep increase in MAP among PATA members and the use of MAP/ APA, and taxpayers' requests for international guidance.

The NTA issued the *APA Program Report* in September 2003, and this is the second such report. We hope that this report will deepen taxpayers' understanding of APA administration and further promote APAs.

¹ July 1, 2003 – June 30, 2004

² 1995 OECD Guidelines, Paragraph 4.124

2. What are Advance Pricing Arrangements (APAs)?

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

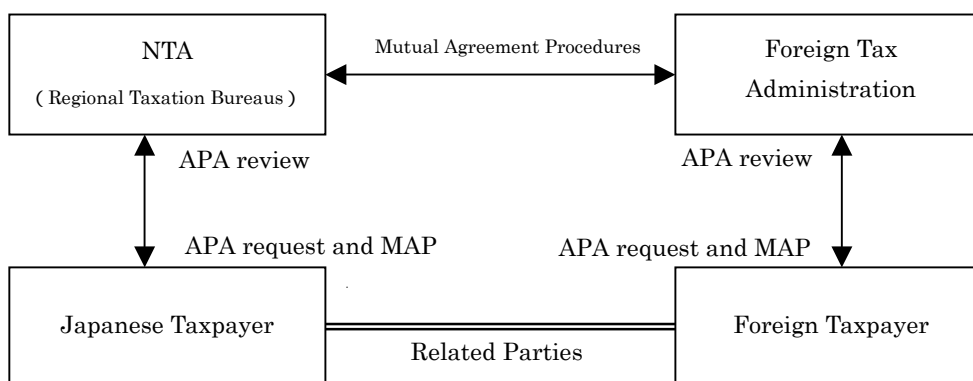
The objective of APAs is to ensure the predictability of transfer pricing taxation for the taxpayer by confirming in advance the method of calculating arm's length prices between the tax administration and the taxpayer. This ensures the proper and smooth enforcement of transfer pricing taxation. Transfer pricing taxation may often result in big amount of additional taxes the examinations often require a great length of time and MAP. 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. Accordingly, 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 1987³. The objective of developing APAs was 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.⁴

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 interest⁵.

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)*⁶ (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 June 25, 2001⁷. The MAP Administrative Guidelines (English version) are available on the NTA website (www.nta.go.jp).

³ "Guidance on Calculation of Arm's Length Prices, April 24, 1987" (hereafter referred to as "1987 Directive")

⁴ Ibid.

⁵ The OECD issued the OECD/APA Guidelines in 1999, thereby committing to promoting MAP/APAs.

⁶ Document ID: Examination Division 7-1 etc. dated June 1, 2001

⁷ Document ID: Office of Mutual Agreement Procedures 1-39 etc. dated June 25, 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 were main topics in fiscal year 2003.

(1) 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 increasing use of MAP and BAPA and subsequently, in response to growing demands 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 BAPAs . This two-year timeframe does not apply to certain cases, such as a case in which a taxpayer does not cooperate. Moreover, although negotiation of a MAP case is 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).

(2) Amendment to the Japan-U.S. Tax Convention

The Japan-U.S. Tax Convention was recently amended for the first time in about 30 years, and the new convention entered into force on March 30, 2004. The new Convention shall be applicable with respect to taxes withheld at source for amounts taxable after July 1, 2004 and with respect to taxes on income which are not withheld at source and enterprise tax, as regards income for a taxable year beginning after January 1, 2005.

As a matter relevant to MAP and APA, the provision with respect to mutual agreement at source in Article 25 was amended, and the term for the request was newly settled. Due to this article, the request for a mutual agreement must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

In addition, the Convention includes a description of APAs for the first time (Article 25.3(d)).

(3) Discussions at the OECD

The OECD Committee on Fiscal Affairs (CFA) has been working on the operation and substance 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.

NOTE

Convention between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Entered into force on March 30, 2004)

Article 25

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those Contracting States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.
2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the provisions of this Convention. Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States, except such limitations as apply for the purposes of giving effect to such an agreement.
3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Convention. In particular the competent authorities of the Contracting States may agree:
 - (a)
 - (b)
 - (c)
 - (d) to advance pricing arrangements.
4.

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 the 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 the RTBs. In actuality, however, many of the APA requests filed by corporations under the jurisdiction of a Tax Office are transferred, in conformance with given procedures, to the Examination Divisions of the RTBs and the APA review team takes charge of the cases. MAP for both types of corporations are exclusively addressed 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 RTB⁸ holds an APA pre-filing conference (described later) and carries out a review of the APA requests. 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 RTB⁹ holds an APA pre-filing conference (described later) and carries out a review of the APA requests. The Examination Division of the NTA may participate in the review, as necessary¹⁰.

⁸ 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.

⁹ The 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.

¹⁰ 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 filed¹¹

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 section¹²

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 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, which differs from transfer pricing examinations that 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. On the other hand, APAs often set a range that indicates that there is no income transfer.

¹¹ Transfer Pricing Administrative Guidelines 5 - 11.

¹² Ibid. 5 - 12.

c. Comparable transactions

APAs recognize the calculation methods proffered 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 examinations¹³

- 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 be used in the examination, except for factual information, such as financial statements, capital relationship diagrams, and summary statement of business.

(4) Request and Review Procedures

a. Deadline for filing APA requests¹⁴

A Special Application Form (“Request for APA of the Transfer Pricing Methodology”) must be filed with the necessary documents no later than the deadline 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. Though 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 ¹⁵

- 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

¹³ Transfer Pricing Administrative Guidelines 2 - 14.

¹⁴ Ibid. 5 - 1.

¹⁵ Ibid. 5 - 2.

c. Terms to be confirmed

Under the Transfer Pricing Administrative Guidelines, APAs in principle are applicable to three taxable years¹⁶. However, this may be extended flexibly in accordance with the content of the APA request.

(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 APAs¹⁷

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 Conditions¹⁸

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.

¹⁶ Transfer Pricing Administrative Guidelines 5 - 7.

¹⁷ Ibid, 5 - 16.

¹⁸ Ibid, 5 - 14.

(8) Compensating Adjustments¹⁹

In case incomes (actual figures) derived from the confirmed transactions during the APA-covered year do not comply with the conditions of the confirmed APA, the taxpayer must make necessary adjustments for the year. 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.

a. Correction of 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.

When MAP/APA is applied, the confirmed corporation may be adjusted by a. or b. as well as the following:

c. Correction of the final returns

The confirmed corporation may correct the taxable income on the final returns based on the mutual agreement 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.

d. Requests for correction of tax return

The confirmed corporation may file a request for correction of the tax return based on the mutual agreement 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.

¹⁹ Transfer Pricing Administrative Guidelines 5 - 17.

(9) Revisions, Cancellations, and Renewals

a. Revisions²⁰

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. Cancellations²¹

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 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. Renewals²²

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

(10) Rollbacks²³

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

²⁰ Transfer Pricing Administrative Guidelines 5 - 18.

²¹ Ibid. 5 - 19.

²² Ibid. 5 - 20.

²³ Ibid. 5 - 21.

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 consultation. 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 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 the taxpayer who submitted an APA request to file a request of MAP in the case where the taxpayer has not filed one.²⁴

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).

²⁴ Transfer Pricing Administrative Guidelines 5 - 11

(3) MAP Negotiations and Agreement

In the case of MAP/APAs, the CA analysts draft a position paper respecting 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 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.

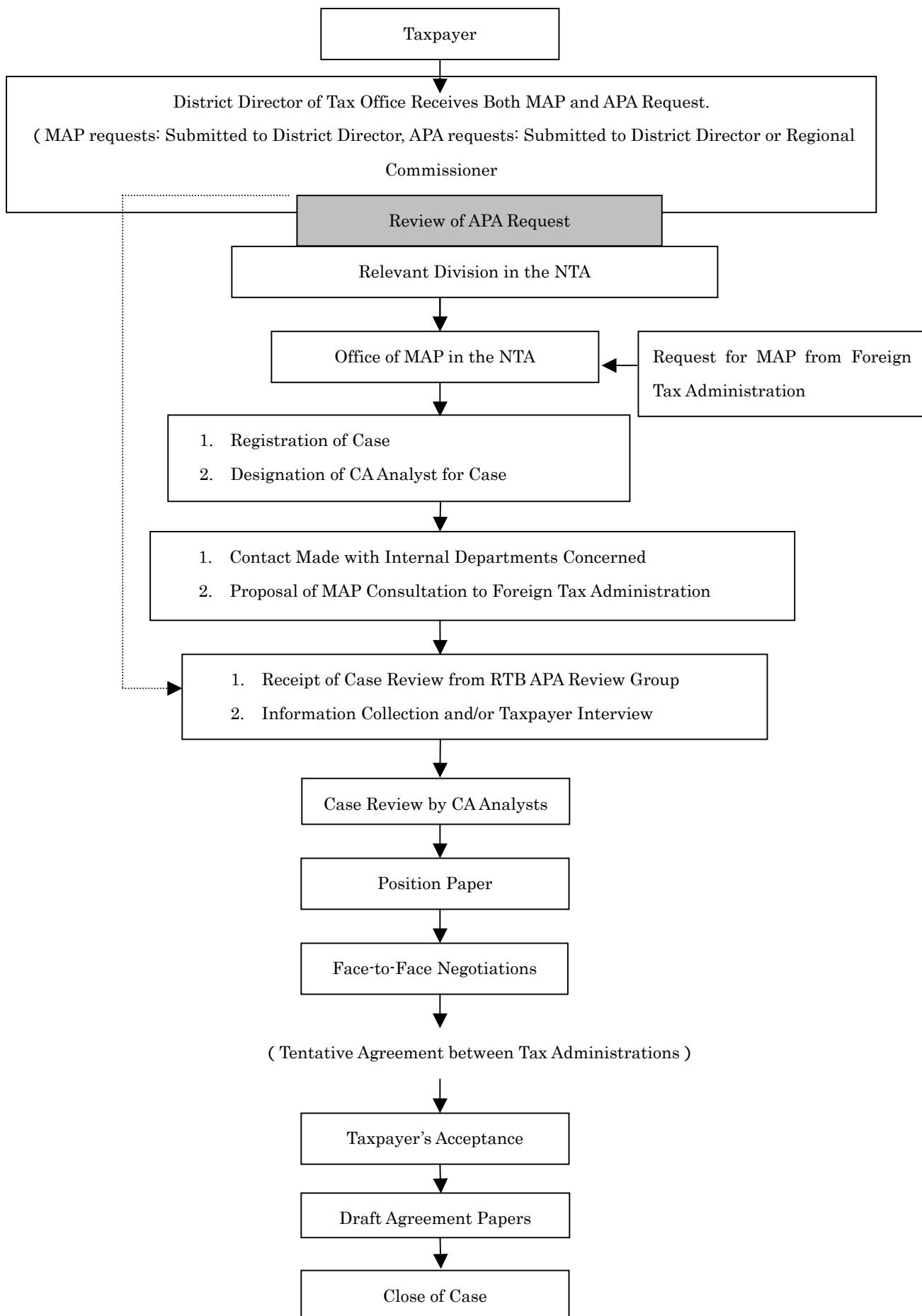
In the case of a unilateral APA, a modified APA request may be requested when the RTB APA review group judges the original APA request to be unreasonable. If the taxpayer does not accept the request for modification from the APA review group, the APA review group sends a notice of non-confirmation. When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

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 may 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 quick response is highly appreciated.

9. Status of APAs

As noted before, 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 17-year period from 1987 through 2003. 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.)²⁵

(Unit:Case)

| | Cases Received | | Cases Disposed | |
|------------|----------------|-------|----------------|-------|
| MAP/APA | 338 | 87.3% | 209 | 84.6% |
| Unilateral | 49 | 12.7% | 38 | 15.4% |

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 eightfold in 2003.

(Unit:Case)

| Cases Received | 1987-99 | 2000 | 2001 | 2002 | 2003 | Total |
|----------------|---------|------|------|------|------|-------|
| MAP/APA | 121 | 48 | 42 | 47 | 80 | 338 |

(2) Yearly Data on the Number of Cases Disposed

Between 1987 and 1999, a total of only 69 cases were disposed whereas 39 cases were completed in 2003 alone.

(Unit:Case)

| Cases Disposed | 1987-1999 | 2000 | 2001 | 2002 | 2003 | Total |
|----------------|-----------|------|------|------|------|-------|
| MAP/APA | 69 | 29 | 25 | 47 | 39 | 209 |

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

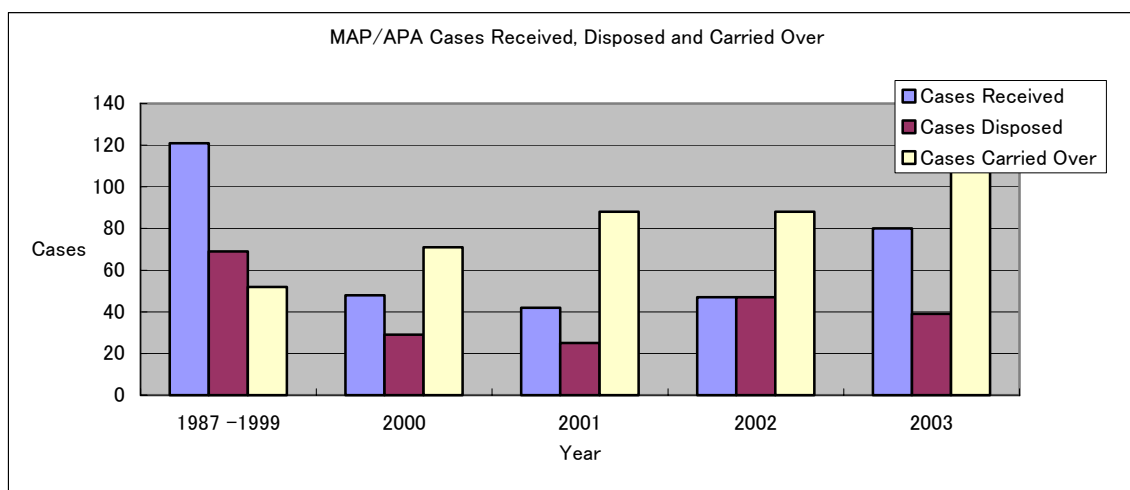
The number of cases carried over increased in 2003, due to a sharp increase in the number of cases received.

(Unit:Case)

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

²⁵ 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 agreement are included. APA cases disposed are the number of MAP closed such as MAP/APA agreement, the number of case withdrawals by the taxpayer.

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



(4) Analysis of 2001–2003 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 the majority of corporations using MAP/APAs.

(Unit: Case)

| | 2001 | 2002 | 2003 |
|------------------|------|------|------|
| Manufacturing | 20 | 22 | 19 |
| Wholesale/Retail | 4 | 13 | 17 |
| Others | 1 | 12 | 3 |
| Total | 25 | 47 | 39 |

- MAP/APA cases disposed - by transaction type

Transactions involving MAP/APA cases disposed are categorized by transaction type in the chart below.²⁶ Approximately about half of them are inventory transactions; the remainder is split between service provision and others.

(Unit: Case)

| | 2001 | 2002 | 2003 |
|------------------------|------|------|------|
| Inventory Transactions | 24 | 31 | 27 |
| Provision of Service | 9 | 20 | 15 |
| Others ²⁷ | 11 | 11 | 14 |

²⁶ Some cases include more than one transaction.

²⁷ “Others” refers to royalty- and global trading-related transactions.

- Transfer pricing methods for MAP/APA cases disposed

Transfer pricing methods used are as follows:²⁸

(Unit: Case)

| | 2001 | 2002 | 2003 |
|-----------------------------------|------|------|------|
| Three Basic Methods ²⁹ | 17 | 31 | 23 |
| Other Means | 12 | 23 | 23 |

- MAP/APA cases disposed - by region

(Unit: Case)

| Counterpart Countries | 2001 | 2002 | 2003 |
|-----------------------|------|------|------|
| Americas | 18 | 24 | 16 |
| Asia/Oceania | 5 | 17 | 18 |
| Other | 2 | 6 | 5 |
| Total | 25 | 47 | 39 |

(5) Time Required per MAP/APA Case

The average time spent to handle 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.

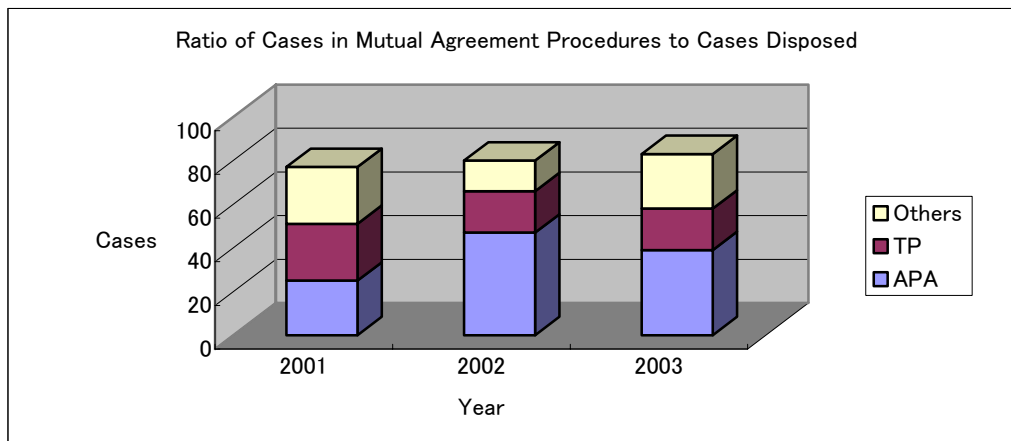
²⁸ Some cases is applied several transfer pricing methods.

²⁹ The three basic methods are the Comparable Uncontrolled Price method, the Resale Price method, and 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 3 years. As in 2002, 2003 MAP/APA cases received, disposed, and carried over made up the majority of APA cases. ³⁰

| | | MAP/APA | | Transfer Price Taxation | | Others | | Total | |
|------|--------------------|---------|-------|-------------------------|-------|--------|-------|-------|--------|
| | | | | | | | | | |
| 2001 | Cases Received | 42 | 47.7% | 30 | 34.1% | 16 | 18.2% | 88 | 100.0% |
| | Cases Disposed | 25 | 32.4% | 26 | 33.8% | 26 | 33.8% | 77 | 100.0% |
| | Cases Carried Over | 88 | 58.6% | 37 | 24.7% | 25 | 16.7% | 150 | 100.0% |
| 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 | 47.7% | 19 | 22.9% | 25 | 30.1% | 83 | 100.0% |
| | Cases Carried Over | 129 | 63.6% | 48 | 23.6% | 26 | 12.8% | 203 | 100.0% |



³⁰ For the definition of MAP/APA cases received and disposed, see footnote 25, page 16.

11. Staff in Charge of MAP/APA Cases

(1) MAP Staff

The 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 the all MAP cases, and so they handle not only MAP/APA cases, but also transfer pricing taxation cases, withholding cases, permanent establishment cases, among others. However, APA cases comprise approximately one-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 | | | |
| 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. The composition of the Examination Division of the NTA Head Office and the RTB Examination Division in charge of APA are as follows.

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

| Regional Taxation Bureau (Office) | | | |
|-----------------------------------|---|--|------------------------------------|
| Tokyo RTB | First Examination Department | Deputy Assistant Regional Commissioner (International) | 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 |