# CCI France Japon
# Japan Tax Update

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# Agenda

2016 tax reform

BEPS driven transfer pricing reforms

Japanese consumption tax update

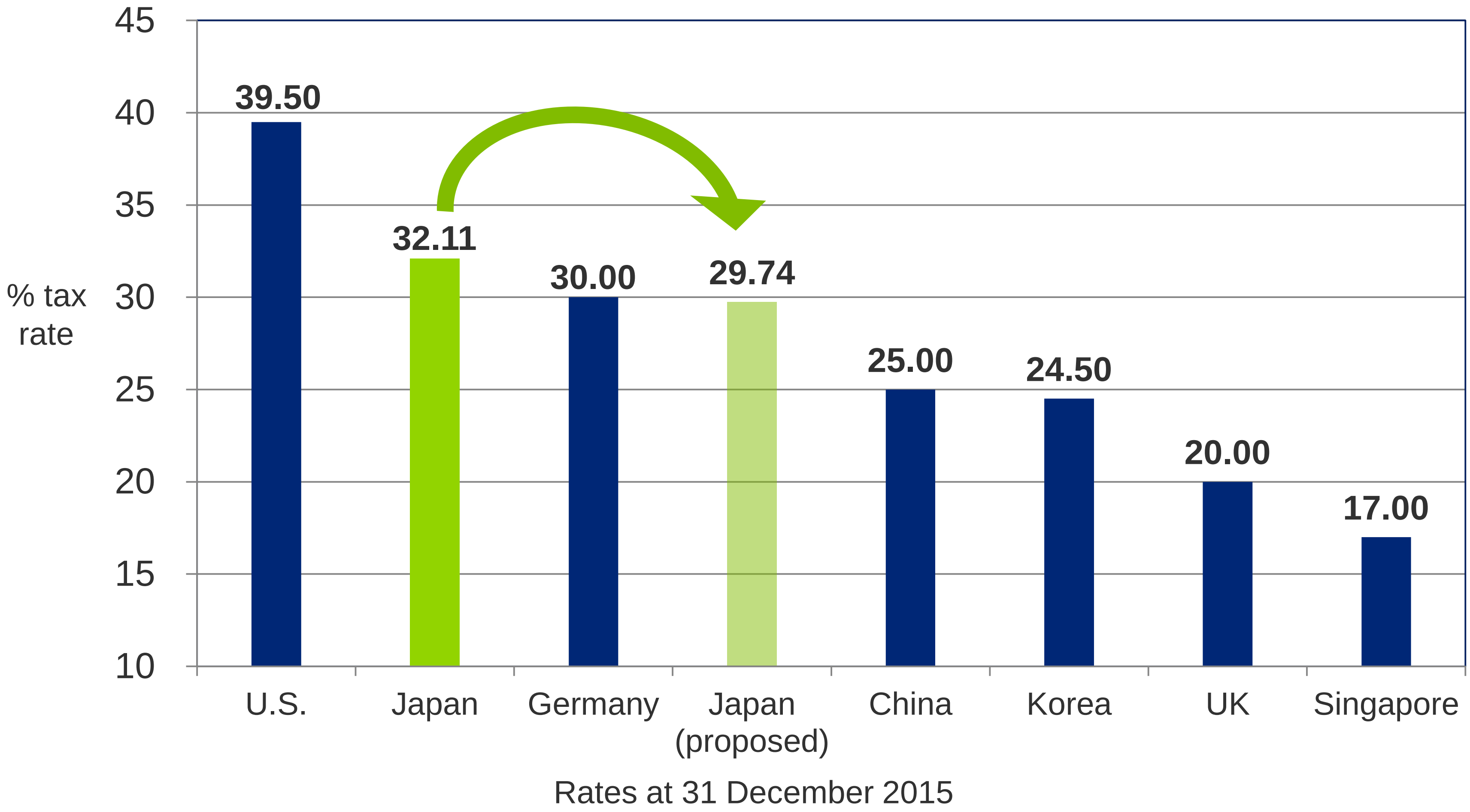
Recent court decision

Questions & Answers

# 2016 tax reform

# Effective tax rate (ETR) of national corporate and local income tax

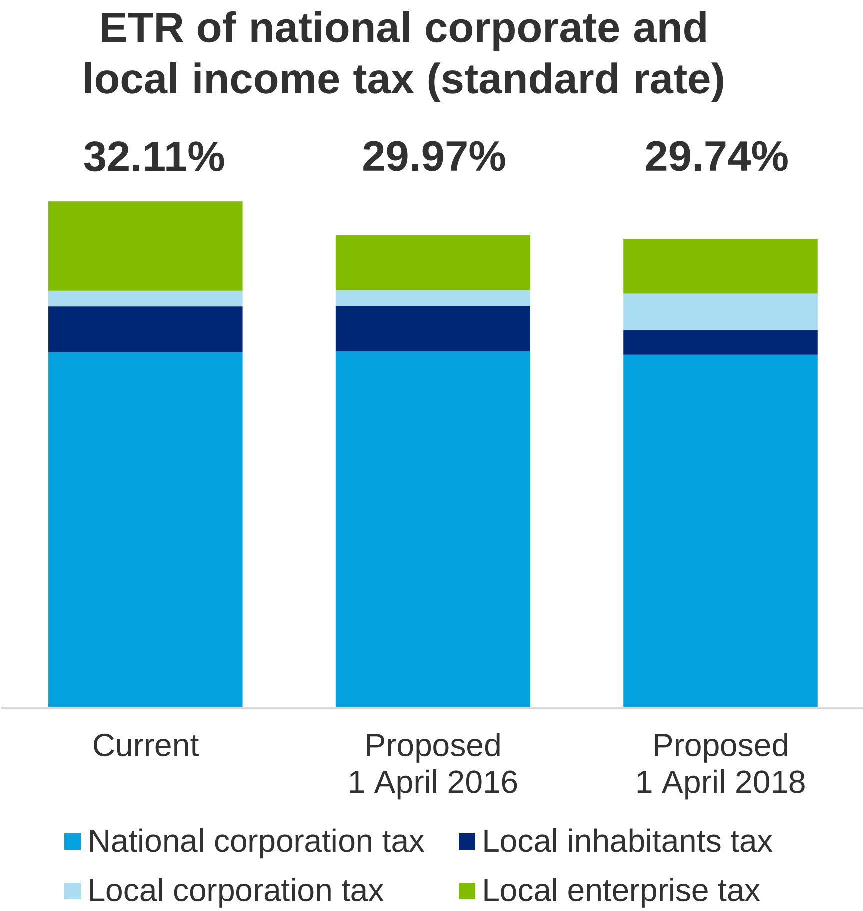
## Further reductions expected



# ETR of national corporate and local income tax
## Large companies

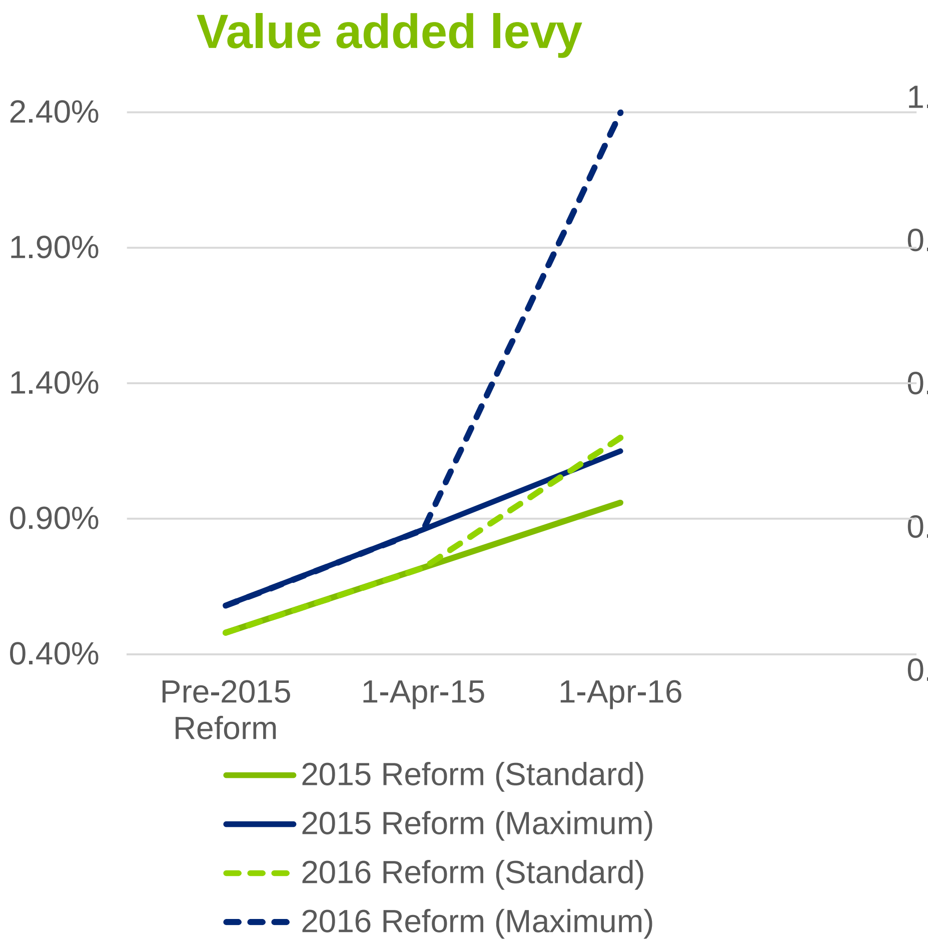
| | Current | Proposed | |
|---|---|---|---|
| | | 1 April 2016* | 1 April 2018* |
| National corporate tax rate | 23.90% | 23.40% | 23.20% |
| Factor-based enterprise tax income levy (standard rate)** | 6.0% | 3.6% | 3.6% |

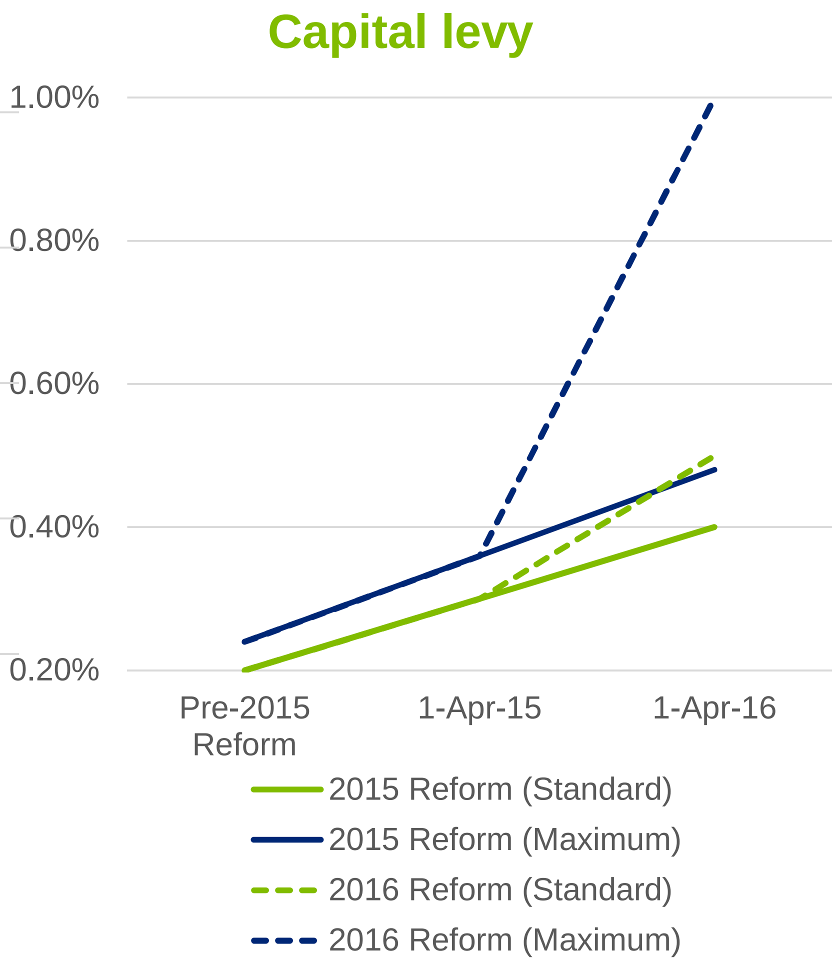
* For tax years beginning on or after such date
** Local governments may increase the standard rate by up to 200%



# Increase in rates of non-income based tax

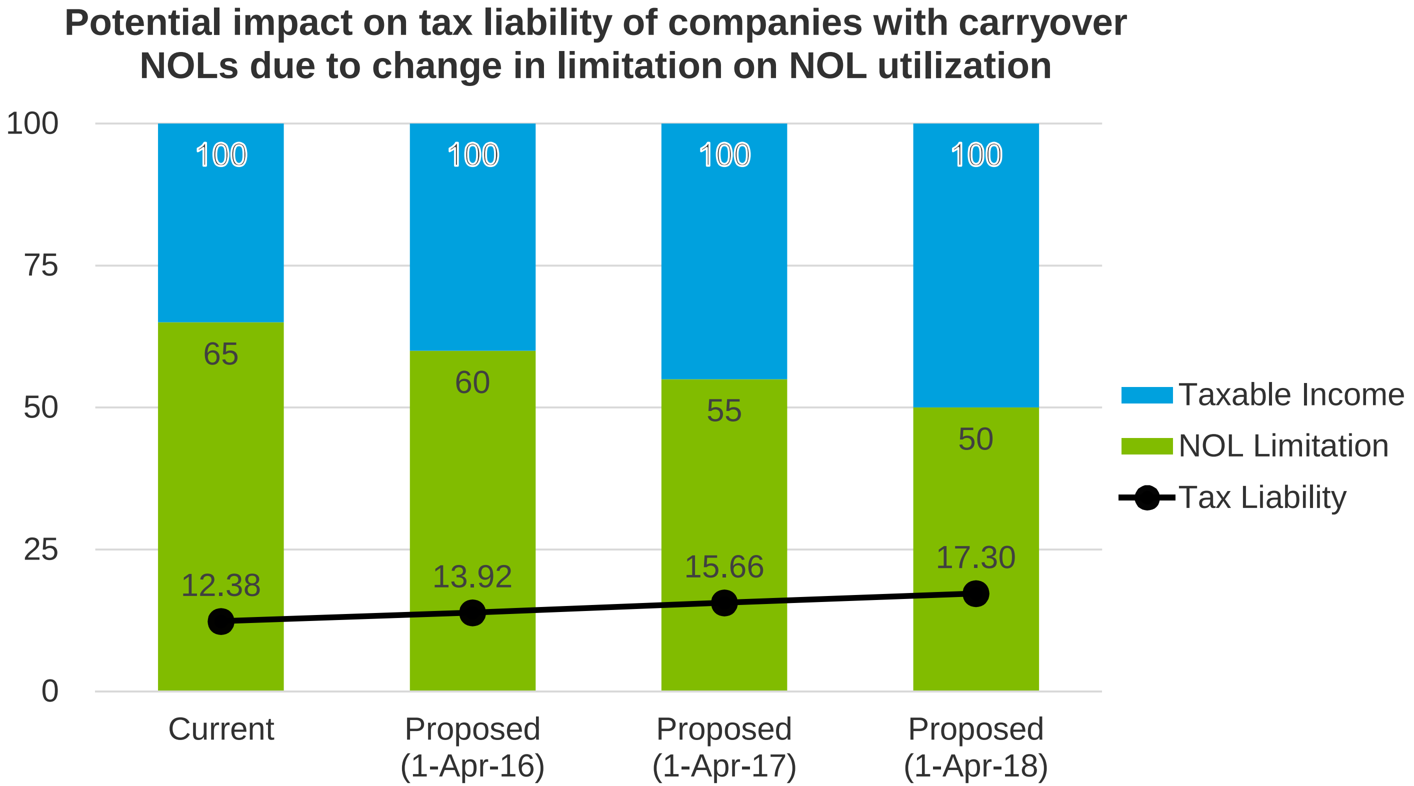
## Factor based enterprise tax value added and capital levy



# Net operating losses (NOL)

- Maximum amount of brought forward tax losses that can be offset against current year profits was reduced to 50% under the 2015 tax reform



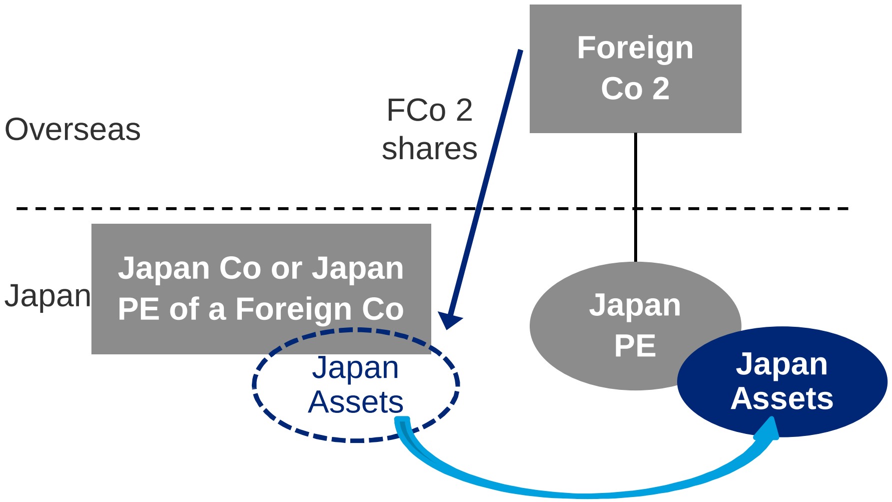

- Exemptions apply to certain SMEs, newly established entities, and for companies undergoing rehabilitation procedures
- Increase of carryover period form 9 to 10 years will be postponed one year to tax years beginning on or after 1 April 2018

# Corporate reorganizations

## Contribution-in-kind (1/3)

### Transaction scenario 1

Japan Co contributes Japan assets to a Japanese permanent establishment of Foreign Co 2, in exchange for shares in Foreign Co 2




### Current Japan tax treatment

- Non-qualified contribution-in-kind Japan Assets transferred at fair market value for Japan tax purposes
- Japan Co taxed on any built-in-gains on Japan Assets

### Proposed Japan tax treatment

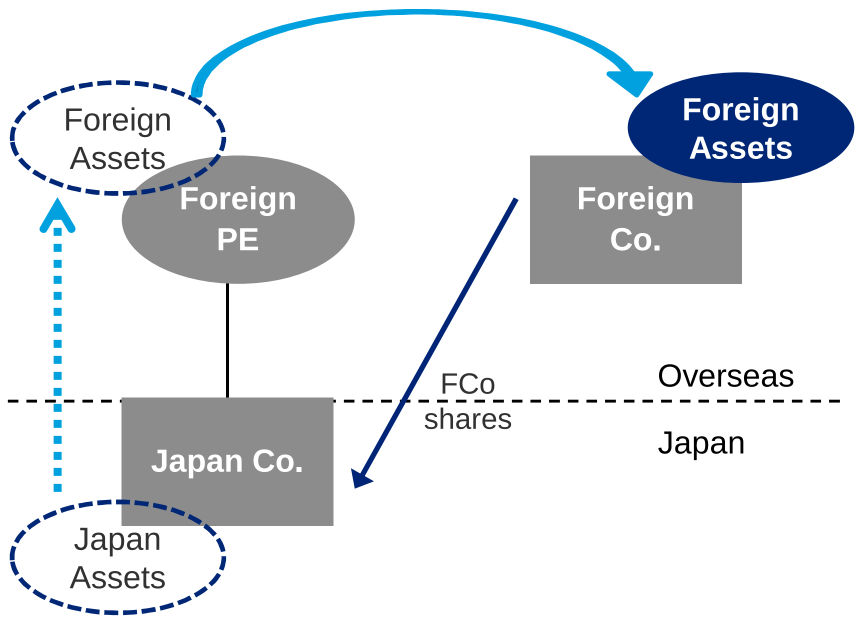
- Qualified contribution-in-kind (assuming certain conditions satisfied)
- Japan Assets transferred at book value
- Japan Co not taxed on any built-in-gains on Japan Assets

# Corporate reorganizations (cont'd)

## Contribution-in-kind (2/3)

**Transaction scenario 2**

1. Japan Co transfers Japan Assets internally to its foreign permanent establishment
2. Within 1 year, Japan Co contributes Foreign (formerly Japan) Assets to Foreign Co in exchange for shares in Foreign Co




**Current Japan tax treatment**

- Qualified contribution-in-kind (assuming certain conditions satisfied)
- Foreign Assets transferred at book value for Japan tax purposes
- Japan Co not taxed on any built-in-gains on Foreign (formerly Japan) Assets

**Proposed Japan tax treatment**

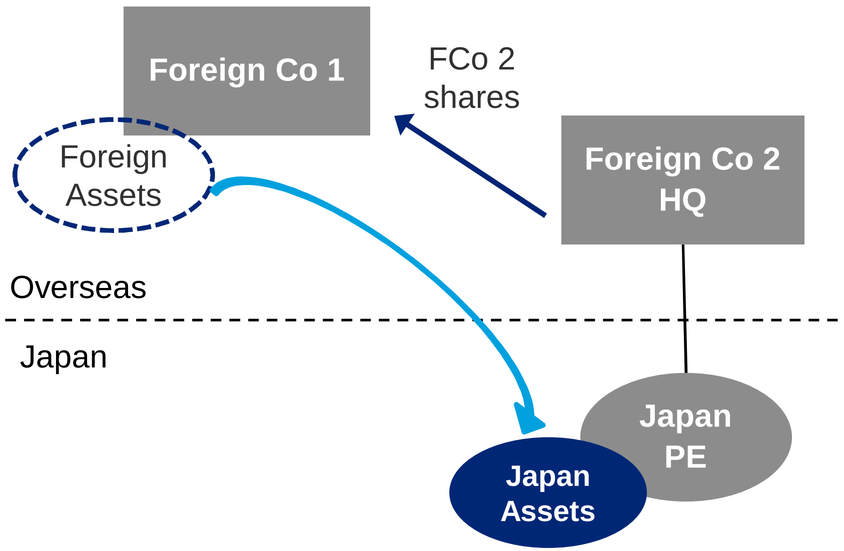
- Non-qualified contribution-in-kind
- Foreign Assets transferred at book value
- Japan Co taxed on any built-in-gains on Foreign (formerly Japan) Assets

# Corporate reorganizations (cont'd)

## Contribution-in-kind (3/3)

**Transaction scenario 3**

Foreign Co 1 contributes Foreign Assets to a Japanese permanent establishment of Foreign Co 2, in exchange for shares in Foreign Co 2




**Current Japan tax treatment**

- Qualified contribution-in-kind (assuming certain conditions satisfied)
- Foreign Assets transferred at book value for Japan tax purposes

**Proposed Japan tax treatment**

- Non-qualified contribution-in-kind
- Japan Assets transferred at fair market value

# BEPS driven transfer pricing reforms

# Japan BEPS scorecard

| | |
|---|---|
| **Action 1 digital economy** | • **2015 tax reforms:** from 1 October 2015, the place of supply for cross-border digital services change is the office or domicile of the recipient and supplies are classified as B2B supplies and B2C supplies according to their nature and service terms for Japanese Consumption Tax (JCT) purposes<br>• A reverse charge apply to B2B supplies and suppliers of B2C services must file a JCT return and pay JCT |
| **Action 2 hybrid instruments** | • **2015 tax reforms:** a foreign dividend exclusion no longer applies to foreign dividends deductible in the source country; a foreign tax credit may be taken for foreign withholding tax on the relevant dividends<br>• Reform is applicable to dividends received by Japanese companies from their foreign subsidiaries for tax years beginning on or after 1 April 2016 with certain applicable grace periods |
| **Action 6 CFC rules** | • **2015 reforms:** effective trigger rate reduced to "less than 20%"; rules for applying the regional HQ exemption relaxed; a CFC which receives dividends from a 25% or more shareholding that were deductible in the source country, can not exclude such dividend from its income when calculating Japanese shareholder's taxable income under the CFC rules |
| **Action 13 TP documentation** | **2016 proposed tax reform**: TP documentation reforms requiring taxpayers prepare and disclose Country by Country (CbC) reports, Masterfiles, and Local files |

# Transfer pricing documentation reform
## CbC report

- Information required is consistent OECD recommendations
- Filing required if
  - MNEs revenues equal to or greater than 100 billion JPY in prior fiscal year
  - Are a Japanese parent company of Japanese MNE
- For foreign MNE CbCs the NTA will rely primarily on tax treaty information exchange
- Filing required for fiscal years starting on or after 1 April 2016
- Filing is due one year after the close of fiscal year
- Filing via the District Director of Tax office via the electronic processing systems e-Tax
- Failure to file in a timely manner will result in a penalty
- Penalties to be articulated in future Guidelines

# Transfer pricing documentation reform

## Masterfile (MF)

- Information required is consistent OECD recommendations
  - Japanese or English language MF acceptable
- Filing required if
  - MNEs revenues equal to or greater than 100 billion JPY in prior fiscal year
  - Are a Japanese parent company of Japanese MNE, subsidiary of a foreign MNE, and permanent establishment of foreign companies within a foreign MNE
- One designated member of a group can meet the requirement for all group members
- Filing required for fiscal years starting on or after 1 April 2016
- Filing is due one year after the close of fiscal year
- Filing via the District Director of Tax office via e-Tax
- Failure to file in a timely manner will result in a penalty
- Penalties to be articulated in future Guidelines

# Transfer pricing documentation reform
## Local file (LF)

- Information required for LF is per OECD recommendations and Act on Special Measures Concerning Taxation Enforcement Order Article 22 -10 (domestic requirements)
- Must prepare contemporaneously, maintain, and provide to tax authorities if
  - Value of service or good transactions in prior year greater than or equal to 5 billion JPY *and* value intangible transaction in prior year greater than or equal to 300 million JPY
- Required for fiscal years starting on or after 1 April 2017 and documentation must be completed contemporaneously by corporate tax return filing date
- LF must be held for 7 years and the LF must be provided within 45 days of a tax authority request
- Additional information (over and above the LF) to support transfer pricing must be provided within 60 days of a tax authority request
- Entities not required to produce LFs must provide information to support transfer pricing within 60 days of a tax authority request

# Key observations

- Comparison with prior requirements
  - CbC and MF represent significant changes in content
  - LF content requirements similar to prior requirements (exception is APA info)
  - Penalty regime is significant change from the past and is to be clarified through new Guidelines
  - Clearly defined number of days for disclosing LF information when requested by tax authorities is significant change from the past
- Comparison with other countries' requirements
  - Content requirement aligns closely to other country requirements that are consistent with OECD recommendations
  - Have not observed other countries imposing penalties for failure to file CbC or MF in a timely manner
  - Have not observed other countries that appear willing to defer to treaty network for obtaining foreign MNEs' CbCs

# Key observations (cont'd)

- New requirements and current audit environment
  - Auditors have always focused on offshore information and are likely do so even more so going forward
  - Documentation is requested as part of most if not all tax audits
  - Auditors coming in and focusing almost exclusively on transfer pricing in some instances
  - The use of presumptive taxation is still something we see in the market
- Timing considerations
  - The first CbC and MF reporting year for Japanese and foreign MNEs with 1 January fiscal year start is the fiscal year starting 1 January 2017
  - The first LF reporting year for companies with 1 January fiscal year start is year starting 1 January 2018
  - The short period (3 months) between fiscal year end and corporate tax filing date will create challenges in meeting LF contemporaneous requirements

# Japanese consumption tax update

# Multi-rate tax system

## Context

**Rate hike**

- Burden of public debt and service provision

**Multiple rates**

- Softening impact of rate hike

**Tax invoicing**

- Data collection and tax compliance

# Multi-rate tax system

## Scope of covered items


*The amount following the description of each model means the estimated revenue fall per 1% JCT rate cut

# Multi-rate tax system

## Key exceptions from reduced rate categories

| Reduced rate items (8% JCT) | Exceptions (10% JCT) |
| --- | --- |
| • **Food** | • Eating out, including<br>– Restaurant and dining areas<br>– Hotel room service<br>– Company / college cafeterias etc. |
| • **Beverages** | • Alcohol |
| • **Newspapers (subscription)** | • Issued less than twice / week<br>• Sold at kiosk, etc. |

# Multi-rate tax system

## Transitional rules (1 April 2017 – 31 March 2021)

| Issue | Proposed transitional rule |
|---|---|
| • **Accounting records** | • Must identify<br>– Taxable purchases subject to reduced JCT |
| • **Invoice disclosures** | • Must identify<br>– Supplies subject to reduced JCT<br>– Total consideration at each rate<br>**Recipient may add these items** |
| • **Calculation of taxable sales / purchases** | • Simplified methods using estimated ratio of “low-taxed” / “total taxable” supplies and purchases **(only until end of period including 31 Mar 2018 for large companies)** |

# Multi-rate tax system

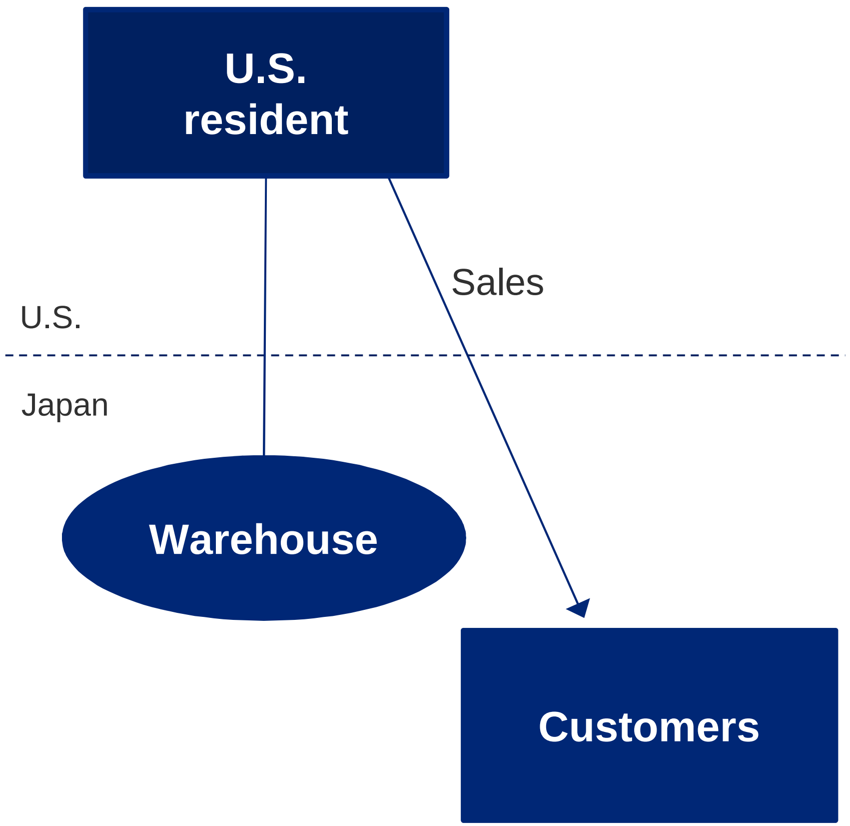
## Must retain tax invoices to claim input JCT credit

| | Current invoice disclosures | | Proposed disclosures (1 Apr 2021 ~) |
|---|---|---|---|
| 1 | Name of supplier | → | Same **(+ registration #)** |
| 2 | Transaction date | → | Same |
| 3 | Description of goods / services supplied | → | Same **(+ identify reduced rate items)** |
| 4 | Total amount of consideration (inc JCT) | → | Same **(+ inc or ex JCT by each JCT rate)** |
| 5 | Name of recipient | → | Same |
| 6 | N/A | → | **Amount of JCT** |

# Recent court decisions

# Warehouse PE

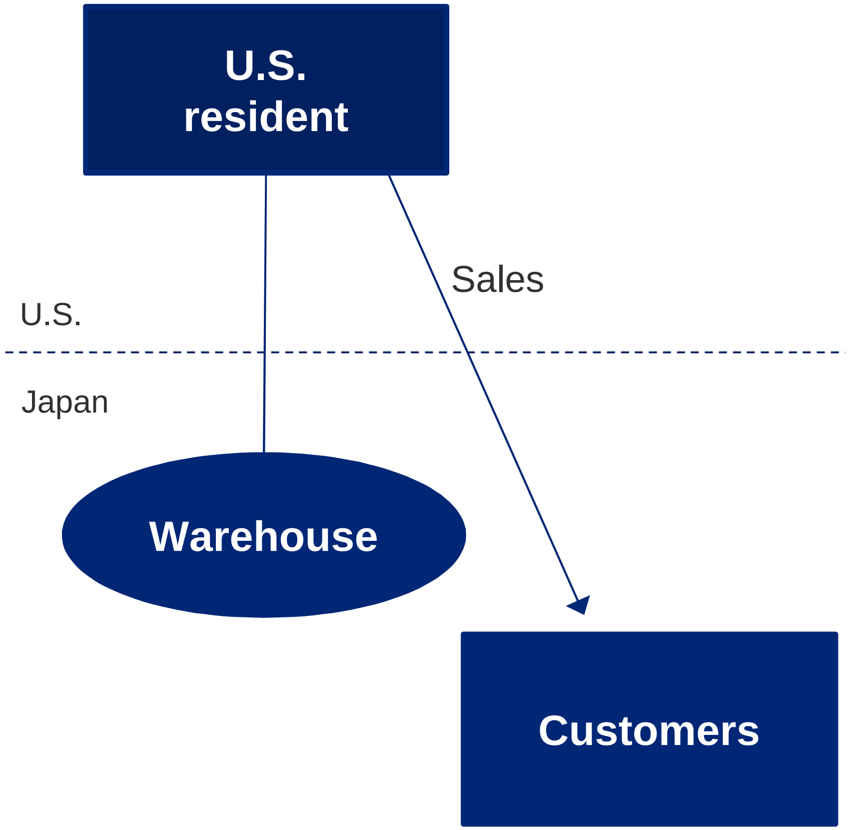
## Various activities conducted at U.S. taxpayer's Japan warehouse




- U.S. resident taxpayer: online business of selling goods to Japanese customers
- Warehouse in Japan
  - Storage of goods prior to delivery to customers
  - Packing customer orders
  - Making arrangements for delivery
  - Storage of returned goods
  - Part-time employees
- PE under Japan / U.S. treaty?

# Warehouse PE

## Warehouse is a fixed place of business PE, but does exemption apply?




- Prima facie, warehouse is Article 5(1) PE
  - Fixed place of business through which business of an enterprise is carried on
- Article 5(4) exception?
  - Paragraph (a)

    "the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise"
  - Paragraph (b)

    "the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery"
- "Preparatory or auxiliary character"

# Warehouse PE

## Activities were not preparatory / auxiliary – taxpayer has a PE

- BEPS Action 7 Proposals on Treaty Article 5
  - Include the “preparatory or auxiliary character” as a condition for application of all exemptions listed in Article 5(4)
- Tokyo District Court held that
  - “Preparatory or auxiliary character” condition should be “read into” Article 5 paragraphs 4(a) and (b)
  - Taxpayer failed both exemptions because
    - Japanese warehouse allowed quick delivery of goods to the customers
    - Was a “significant” part of the taxpayer’s business
    - Not merely preparatory or auxiliary
- Court held that the taxpayer has a PE in Japan

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