

JAPAN

LEGISLATION	
Existence of Transfer Pricing Laws/Guidelines	<p>Transfer pricing legislation is contained in the Special Taxation Measures Law Article 66-4; STML-Enforcement Order 39-12; STML – Circular 66-4-(1)-1 to 66-4-(7)-2; and Enforcement Regulation 22-10. Administrative Guidelines were issued on 1 June 2001 and partly revised in 2002, 2005, 2006 and 2007.</p> <p>The recent revision in June 2007 provides additional guidance on the role of intangibles in setting prices, Advance Pricing Agreement (APA) procedures and the use of profit allocation method by tax authorities.</p>
Transfer Pricing Scrutiny	<p>The risk of transfer pricing scrutiny in Japan is high, especially for large taxpayers with significant related party transactions. The risk is increased for taxpayers in particular industries that are targeted by the National Tax Agency (NTA), or with low profits or losses in Japan, with fluctuating profitability, with transactions with tax havens, or in industries with high-margin (sometimes secret) comparables. The NTA released partial revision of the Transfer Pricing Administrative Guidelines as of June 2007 which featured the NTA’s point of view with regard to 26 specific case studies.</p> <p>Transactions involving intangible property are gaining increasing focus in transfer pricing audits as there are often substantial sums at stake in such transactions. The recent revision to the transfer pricing administrative guideline also amends the definition of “valuable intangible assets” to include know-how developed through human resource expertise and knowledge.</p>
Definition of Related Party	<p>Corporations are deemed to be related if there is a 50% or more of common, direct or indirect ownership or if “special relationship” exists between two companies or between the employees or officers of the companies. An affiliation will also exist if a considerable proportion of a company’s outstanding loan has been guaranteed by another company.</p>
Transfer Pricing Penalties	<p>General tax penalty provisions apply. Penalties on transfer pricing adjustments at 10% up to the amount of the original tax return, 15% for the tax increment resulting from the adjustment, or where no tax return was filed. In addition, 35% may be imposed in cases determined to involve tax evasion or fraud. Penalties are not deductible for corporate tax purposes.</p>
Advance Pricing Agreement (APA)	<p>APA guidelines were included in the Administrative Guidelines issued in 2001 and partially revised in 2002, 2005, 2006 and 2007.</p> <p>Both unilateral and bilateral APAs are available, although the NTA clearly prefers bilateral with treaty partners. The NTA has stated that APAs are the preferred method for dealing with double taxation issues. The APA program is very well established and substantially used.</p>

DOCUMENTATION AND DISCLOSURE REQUIREMENTS	
Tax Return Disclosures	Taxpayers are required to disclose detailed information about foreign affiliate persons, related party transactions, and for fiscal years beginning on or after 1 April 2003 taxpayers are required to disclose their transfer pricing methods used for intercompany transactions.
Level of Documentation	There are no statutory documentation requirements. However, taxpayers failing to provide documentation listed in the Administrative Guideline in a timely manner upon request can trigger the tax examiner's authority to collect transactional data from comparable independent firms to use as a "secret comparable" for the taxpayer. The information that may be requested by the NTA includes details of capital relationships, inter-company transactions, business activities, financial performance, method selection, search process and comparables selected.
Record keeping	No specific requirements, other than the six year limit for transfer pricing adjustments in accordance with the statute of limitations.
Language for documentation	Documentation that is to be submitted to the tax authorities should be in Japanese.
Small and medium sized enterprises (SMEs)	There are no special provisions governing SMEs.
Deadline to Prepare Documentation	Documentation relevant to the establishment of the arm's length price is required in a timely manner upon request. Therefore, taxpayers should be proactive and ensure that documentation is prepared during or shortly after the tax year in which the transactions take place.
Deadline to Submit Documentation	Documentation relevant to the establishment of the arm's length price is required in a timely manner upon request.
STATUTE OF LIMITATIONS	
The general statute of limitations for transfer pricing adjustments by the tax authorities is six years, although the limit is seven years for failure to file, fraud or tax evasion.	

TRANSFER PRICING METHODS

Japan generally follows the OECD Guidelines as far as methodologies are concerned. In general, the traditional transaction-based methods are strongly preferred over the profit-based methods, and this is sometimes used as a justification for the use of secret comparable transaction data rather than the use of publicly available data for an application of a profit-based method. The TNMM is only strictly available for use for fiscal years starting on or after 1 April 2004.

Recent revisions to the Transfer Pricing Administrative Guideline require the NTA to detail in writing the method it uses if it rejects the taxpayer's method for determining arm's length prices.

COMPARABLES

Where the tested party is located in Japan, there is a requirement for comparables from the Japanese market. Detailed information and data on Japanese companies is available from a number of Japanese and regional financial databases, such as JADE from Bureau van Dijk. There is a risk that secret comparables may be used in some transfer pricing audits, or in cases where the taxpayer does not prepare transfer pricing documentation.

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