

Transfer Pricing Country Summary

Japan

July 2018

Legislation

Existence of Transfer Pricing Laws/Guidelines

The legal framework for transfer pricing is presented in the Corporate Tax Act of Japan, specifically the Act on Special Measures concerning Taxation ("ASMT") Article 66-4, ASMT Enforcement Order 39-12; ASMT Circular 66-4- (1)-1 to 66-4-(10)-1; and ASMT Ordinance of Enforcement ("ASMT Ordinance") 22-10. A Commissioner's Directive on the Operation of Transfer Pricing ("CDOTP") as the detailed transfer pricing administrative guidelines was issued on 1 June 2001 and partly revised in 2002, 2005, 2006, 2007, 2008, 2010, 2011, 2013, 2016, 2017 and 2018.

Definition of Related Party

According to the ASMT Article 66-4, a foreign-related person" is defined as a foreign corporation having an "associated relationship" with another corporation. A corporation is treated as "associated" with the other if it holds 50 percent or more of the total number of issued stocks or the amount of investment of the other corporation. The Order for Enforcement prescribes the other cases to be treated as having an "associated relationship."

Transfer Pricing Scrutiny

Companies, especially large corporations, can be audited in terms of transfer pricing if:

- In industries that are targeted by the National Tax Agency (NTA);
- Low profits or losses in Japan, with fluctuating profitability, with transactions with tax havens;
- In industries with high profit margin comparables.

The examination of related-party transactions are generally based on the following points:

- The gross profit margin or operating profit margin (hereinafter referred to as "profit margin") arising from foreign-related transactions of the corporation is excessively low compared with other transactions, which are conducted by the corporation with unrelated parties in a similar market and which are similar in quantity, market level, and other respects;
- The profit margin arising from foreign-related transactions of the corporation is excessively low compared with the profit margin of other unrelated parties engaged in the same category of business similar in quantity, market level, and other respects with the corporation;
- The corporation's profit arising from foreign-related transactions is relatively low compared with the foreign-related party's profit arising from the same transactions, in the light of the function performed or risks assumed by the corporation or the foreign-related party with respect to such foreign-related transactions.

The CDOTP prescribes that the OECD Transfer Pricing Guidelines shall be referred to in the course of examination or APA.

Transfer Pricing Penalties

There are no specific penalties regarding transfer pricing tax adjustments, thus general corporate tax penalties and interests are applied; penalties on tax adjustments at 10 percent up to the amount of the original tax return, or 15 percent in case no tax return was filed. 35 percent may be imposed in cases determined to involve fraud. The delinquency tax rate is normally the lower of 7.3 percent and 1.0 percent plus the special discount rate based on commercial banks' average short term lending rates.

Penalties are not deductible for corporate tax purposes. There is no interest charged on penalties.

For the Master file and Country-by-Country report there is a fine of up to 300,000 yen if corporations fail to submit a Master file/CbC Report to the tax authorities by the deadline without good reason

For ensuring the duty of transfer pricing documentation, if the Local file is not presented or submitted by a certain appointed date, the tax authorities can impose tax by estimation.

Advance Pricing Agreement (APA)

APA is available, including unilateral and bilateral type (bilateral APA is preferred by the NTA). The requirements for APA application are stated in the Chapter 5 of the CDOTP.

The effective period of an APA is between 3 to 5 accounting periods. Rollback is available for bilateral APA. No fee is charged on APA application.

Applicants for APA shall be requested to submit Japanese translations if any of the attached documents are written in foreign languages.

Documentation and Disclosure Requirements

Tax Return Disclosures

Taxpayers are required to disclose detailed information about foreign affiliate entities, 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

In examinations, it shall be ascertained whether any problem under transfer pricing taxation exists by obtaining information on the actual circumstances of the foreign-related transaction from documents (including books and records, and other materials), such as:

- Documents that describe the capital relationship and details of business of the corporation and each foreign-related party;
- Documents listed in Item 1 of Article 22-10(1)-1 of the ASMT Ordinance (“Documents containing the details of foreign-related transactions”);
- Documents listed in Item 2 of Article 22-10(1)-2 of the ASMT Ordinance (“Documents used by the corporation for the calculation of arm’s length prices”);
- Other documents:
 - (a) Documents containing the details of the accounting standards of the corporation and the foreign-related party;
 - (b) Documents containing the details of the transfer pricing examinations or APA conducted with regard to foreign-related parties by foreign tax authorities;
 - (c) If the foreign-related party, under the system of a foreign country corresponding to transfer pricing taxation, has prepared any document pursuant to the rules that require the preparation of appropriate documents for supporting the effectiveness of the system (referred to as “Documentation Rules”), then the documents so prepared;
 - (d) Other documents as deemed necessary.

MNEs are required to prepare:

- Master File, consistent with Annex I to Chapter V of the OECD Transfer Pricing Guidelines;
- Local File, consistent with Annex II to Chapter V of the OECD Transfer Pricing Guidelines;
- Country-by-Country Report (CbCR), consistent with Annex III to Chapter V of the OECD Transfer Pricing Guidelines.

Record Keeping

Local files should be kept for 7 years after the deadline date of submitting the subject year’s corporate tax return.

Language for Documentation

Documentation that is to be submitted to the tax authorities upon audit should generally be in Japanese.

The Master file should be filed in Japanese or English. For the Local file no language requirements apply, however, if the Local File is prepared in a non-Japanese language, the tax authorities may request corporations to submit its Japanese translation as required. The Country-by-Country report should be filed in English.

Small and Medium Sized Enterprises (SMEs)

The Japanese legislation provides exemption from transfer pricing documentation obligation in the following cases:

- For the Master file and Country-by-country report for MNE Groups with a total consolidated revenue for the Ultimate Parent Entity's preceding fiscal year of less than 100 billion yen;
- For the Local file corporations are exempted from the duty of contemporaneous documentation for Controlled Transactions with one foreign-related party during the current business year.
 - i. If the amount of transactions (total of receipts and payments) with the foreign related party during the previous business year (the current business year if there was not the previous one) was less than 5 billion yen; and
 - ii. If the amount of transactions of intangibles (total of receipts and payments) with the foreign-related party during the previous business year (the current business year if there was not the previous one) was less than 300 million yen.

Deadline to Prepare Documentation

The Local file has to be prepared contemporaneously by the deadline date of the subject year's corporate tax return, i.e., within 2 months following the tax year end (request for 1 month extension is possible).

Deadline to Submit Documentation

The Master file has to be submitted to the tax authorities within 1 year of the day following the one when the Ultimate Parent Entity's fiscal year ends.

The Local file has to be prepared by the final return filing due date, and to be maintained for 7 years. Deadline for submission: To be presented or submitted within a certain appointed period (within 45 days) if requested during the course of tax examination.

The Country-by-Country report has to be submitted to the tax authorities within 1 year of the day following the one when the Ultimate Parent Entity's fiscal year ends.

Statute Of Limitations

The general statute of limitations for transfer pricing adjustments by the tax authorities is 6 years, although the limit is 7 years fraud or tax evasion.

Transfer Pricing Methods

The following methods are accepted:

- Comparable uncontrolled price ("CUP") method;
- Resale price method;
- Cost plus method;
- Profit split methods ("PSMs", including Contribution-based PSM, Comparable PSM and Residual PSM);
- Transactional net margin method ("TNMM");

- Similar methods of the above 5 methods.

The most appropriate method should be selected, considering the facts and circumstances of each controlled transaction, including function performed and risk assumed. The 3 traditional transfer pricing methods, especially the CUP method, are preferred in case multiple methods are equally applicable, in line with the revised OECD Transfer Pricing Guidelines.

Comparables

The tax authority uses global commercial database such as ORBIS by Bureau van Dijk. Considering the differences of market conditions where the comparables locate, local comparables are preferred which locate in the same jurisdiction as the tested party over foreign comparables. Furthermore, as there are over 4,000 publicly listed companies in Japan, the tax authority believes that sufficient number of domestic comparables is available for inbound transactions (Japanese subsidiaries of non-Japanese group). Therefore, foreign comparables are generally not accepted at tax authorities.

If the Local File is not presented or submitted by a certain appointed date, the tax authorities can inspect persons engaged in similar businesses by asking questions. Information obtained through such inspections may be used as secret comparables.

This document was updated in cooperation with Takuma Mimura, [Cosmos International Management Co., Ltd](#)