

Japan updates its Administrative Guidelines on the Mutual Agreement Procedure based on the BEPS Action 14 Final Report “Making Dispute Resolution Mechanisms More Effective”

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In brief

Where double taxation arises as a result of a transfer pricing assessment, notwithstanding domestic courses of action, Japan's income tax treaties provide for the mutual agreement procedure (the 'MAP') – a consultation between the relevant governments with the aim of providing relief from the double taxation. In the post-BEPS (Base Erosion and Profit Shifting) era, countries are more aggressively enforcing their transfer pricing legislation, and the effectiveness of the MAP to eliminate double taxation is more important than ever.

The BEPS Action 14 Final Report, “Making Dispute Resolution Mechanisms More Effective,”¹ released in October 2015, recommends that taxpayers entitled to the benefits of a tax convention be granted broad access to the MAP. Based on this recommendation, Japan's National Tax Agency ('NTA') revised its Administrative Guidelines on the Mutual Agreement Procedure to clarify that a MAP request can be filed by a Japanese taxpayer in relation to a foreign affiliate's filing of amended tax returns in a treaty partner jurisdiction to voluntarily make transfer pricing adjustments based on the domestic law of the treaty partner jurisdiction.

This newsletter describes the BEPS Action 14 Final Report recommendations for securing taxpayers' access to MAP and provides an overview of the revisions to the Administrative Guidelines on the Mutual Agreement Procedure in Japan based on these recommendations.

Japanese version of this newsletter is available in the below.

<https://www.pwc.com/jp/ja/knowledge/news/tax-transfer-pricing/tp-report20230403.html>

¹ <https://www.oecd.org/tax/making-dispute-resolution-mechanisms-more-effective-action-14-2015-final-report-9789264241633-en.htm> (for Japanese, see <https://www.nta.go.jp/taxes/shiraberu/kokusai/beps/index.htm>).

In detail

1. Eligibility of MAP for adjustments effectuated by taxpayer's filing of amended tax return as a result of audit

The MAP as a means of dispute resolution to eliminate double taxation is based on bilateral tax conventions, and the MAP clauses in Japan's bilateral tax conventions are basically in line with the OECD Model Tax Convention. The OECD Model Tax Convention provides as follows regarding the MAP:(Paragraph 1 of Article 25 of the OECD Model Tax Convention)

'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 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 phrase 'the actions of one or both of the Contracting States,' which give rise to the right to pursue the MAP to eliminate double taxation, is generally considered to mean a tax assessment made by the tax authority as a result of a tax audit. In Japan, however, when the need for corrections is pointed out by the tax authority in the course of a tax audit, the tax audit procedure is completed, in practice, by the taxpayer submitting an amended tax return to make such corrections itself (after being encouraged to do so by the tax examiners).

Paragraph 14 of the Commentary on Article 25 of the OECD Model Tax Convention: Concerning the Mutual Agreement Procedure provides the following examples of 'the actions of one or both of the Contracting States':

'Other examples include filing a return in a self assessment system or the active examination of a specific taxpayer reporting position in the course of an audit, to the extent that either event creates the probability of taxation not in accordance with the Convention (e.g. where the self assessment reporting position the taxpayer is required to take under a Contracting State's domestic law would, if proposed by that State as an assessment in a non-self assessment regime, give rise to the probability of taxation not in accordance with the Convention, or where circumstances such as a Contracting State's published positions or its audit practice create a significant likelihood that the active examination of a specific reporting position such as the taxpayer's will lead to proposed assessments that would give rise to the probability of taxation not in accordance with the Convention). Another example might be a case where a Contracting State's transfer pricing law requires a taxpayer to report taxable income in an amount greater than would result from the actual prices used by the taxpayer in its transactions with a related party, in order to comply with the arm's length principle, and where there is substantial doubt whether the taxpayer's related party will be able to obtain a corresponding adjustment in the other Contracting State in the absence of a mutual agreement procedure.'

In light of the commentary above, it is reasonable to understand that the submission of an amended tax return as part of the procedure for completing a tax audit pursuant to Japanese practice can be equivalent to 'filing a return in a self assessment system or the active examination of a specific taxpayer reporting position in the course of an audit, to the extent that either event creates the probability of taxation not in accordance with the Convention'. As an OECD member country, Japan is required to comply with the commentary on the OECD Model Tax Convention in the interpretation and implementation of the provisions of its bilateral tax conventions. Therefore, it is reasonable to understand that the submission of an amended tax return as a part of the procedure for completing a tax audit falls under the category of 'the actions of one or both of the Contracting States' and is

² Paragraph 1 of Article 25 of the OECD Model Tax Convention.

therefore treated as subject to MAP, to the extent that it creates the probability of taxation not in accordance with the Convention.³

2. BEPS Action 14 Final Report “Making Dispute Resolution Mechanisms More Effective” and the revision of Administrative Guidelines on the Mutual Agreement Procedure

Under the OECD/BEPS project launched in 2012, discussions were held to eliminate uncertainties, such as unexpected double taxation associated with the introduction of the new rules, to ensure predictability, and to make the MAP more effective. In the BEPS Action 14 Final Report “Making Dispute Resolution Mechanisms More Effective” released in October 2015, a minimum standard – the minimum actions that each country should take to remove obstacles that hinder the implementation of effective MAP – and best practices for their implementation are recommended.

In Best practice 9 of the BEPS Action 14 Final Report, it is stated that countries’ MAP guidance should provide taxpayers will be allowed access to the MAP to ensure that competent authorities may resolve through consultation the double taxation that can arise in the case of a bona fide taxpayer-initiated foreign adjustment made to reflect results that, in the taxpayer’s view, are in compliance with the arm’s length principle.

In response to this recommendation, the following sentence, reflected in the BEPS Project Final Report, was added to paragraph 14 of the Commentary on Article 25 of the OECD Model Tax Convention:

‘Such actions⁴ may also be understood to include the bona fide taxpayer-initiated adjustments which are authorised under the domestic laws of some countries and which permit a taxpayer, under appropriate circumstances, to amend a previously-filed tax return in order to report a price in a controlled transaction, or an attribution of profits to a permanent establishment, that is, in the taxpayer’s opinion, in accordance with the arm’s length principle.’

Additionally, based on the above recommendation in the BEPS Action 14 Final Report, Japan revised its Administrative Guidelines on the Mutual Agreement Procedure (May 2019) to add a new provision to the effect that a Japanese taxpayer may file a request for a MAP for the elimination of double taxation that has arisen due to the submission of an amended return by a foreign-affiliated taxpayer in a treaty partner jurisdiction, as follows.

‘3. Request for a MAP

- (1) A request for a MAP can be made, as illustrated in the following examples, pursuant to the provisions of an applicable tax treaty, and in accordance with paragraph 1 of Article 12 [Procedures for Requests Related to Taxation Not in Accordance with the Provisions of a Tax Treaty] or Article 13 [Procedures for Requests Related to Dual Residency] of the Ministerial Ordinance (Income Tax Treaty) or paragraph 1 of Article 3 [Procedures for Requests Related to Double Taxation] of the Ministerial Ordinance (Inheritance Tax Convention).

³ Paragraphs 63 and 64 on page 38 of the “MAP Peer Review Report, Japan (Stage 1)” released in August 2017 reports as follows on providing access to the MAP in relation to amended tax returns in cases where the taxpayer agrees with the view pointed out by the examiner in the course of a tax audit and files an amended tax return reflecting such view:

‘Where taxpayers file an amended tax return, for which the legal basis is Article 19(1) of the Act on General Rules for National Taxes, they have to waive their rights to initiate domestic available administrative or judicial remedies with regard to the amounts that are reflected in the amended tax return. In this respect, Japan reported that the voluntary filing of a tax return, however, has no effect on taxpayers’ access to MAP for the amount of adjusted income.’

<https://www.oecd.org/tax/beps/making-dispute-resolution-more-effective-map-peer-review-report-japan-stage-1-9789264304307-en.htm>

⁴ Refers to actions taken in one or both of the Contracting States.

(a) Cases in which a domestic corporation requests a MAP on the grounds that the corporation has been, or will be subject to transfer pricing taxation in Japan or in a treaty partner regarding transactions between the domestic corporation and its foreign affiliated person.

(Note)2. It should be noted that a domestic corporation can make a request for a MAP in order to eliminate double taxation arising from its foreign affiliated person's action taken in a treaty partner, which is equivalent to filing an amended return described in paragraph 3 of Article 19 [Amended Return] of the Act on General Rules for National Taxes subject to paragraph 5 of 65 [Additional Tax for Deficient Returns] of the said Act, regarding the transaction between the domestic corporation and the foreign affiliated person.'

Based on the above, it has been clarified that a Japanese taxpayer can file a request for a MAP in Japan for double taxation arising from an action taken in a treaty partner jurisdiction, such as the submission of an amended tax return by a foreign affiliated person in the treaty partner jurisdiction to make a voluntary adjustment to reflect a result that complies with the arm's length principle under the treaty partner jurisdiction's domestic law.

On the other hand, there are no special provisions regarding the treatment in the cases where double taxation occurs when the taxpayer voluntarily files an amended tax return in Japan to reflect the results in compliance with the arm's length principle without anticipating an audit. In this regard, as for the double taxation arising by means of an amended return filed in Japan, since the relevant treaty partner would be in the position of allowing a corresponding adjustment, even if the MAP request is accepted in Japan, it is unclear whether the treaty partner would also accept the MAP request.

It should also be noted that, after a MAP request is filed, the Japan competent authority, which is in charge of MAPs, will determine whether or not the taxpayer's request is justified, and will request consultation with the treaty partner only if the taxpayer's request is recognised as justified. Therefore, taxpayers need to provide a reasonable explanation that supports that the adjustments they have made voluntarily are bona fide adjustments of prices in the affiliated transaction for the purpose of reflecting results in compliance with the arm's length principle.

The takeaway

In the post-BEPS era, transfer pricing taxation risk has increased and the effectiveness of the MAP as a means of dispute resolution to eliminate double taxation has increased in importance. In the BEPS Action 14 Final Report, it is recommended that each country secure access to the MAP for those taxpayers that meet the requirements in their tax conventions. Accordingly, the NTA has revised the Administrative Guidelines on the Mutual Agreement Procedure to clarify that a Japanese taxpayer may file a MAP request in Japan in relation to double taxation arising as a result of the filing of amended returns by a foreign affiliated taxpayer in a treaty partner jurisdiction to voluntarily make transfer pricing adjustments based on the domestic laws of the treaty partner jurisdiction.

Regarding double taxation arising as a result of the filing of amended returns by a Japanese taxpayer in Japan to voluntarily make transfer pricing adjustments based on Japan law, it is unclear whether treaty partners would accept requests for the MAP. The OECD is currently conducting peer reviews of the status of implementation of the BEPS Action 14 recommendations in each member country of the Inclusive Framework. Peer review is a process whereby the countries mutually review and assess each other's compliance with the measures presented in the BEPS Action 14 Final Report. To date, reviews have been conducted of 82 countries/regions among the members of the Inclusive Framework, and, in order to make the MAP more effective in the future, it is expected that access to the MAP will be broadly secured in each country.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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Please click here for details and to apply (charges apply):

www.pwc.com/jp/e/tax-academy

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