Japan tax bulletin

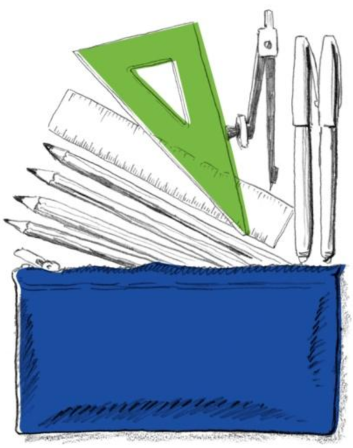
Newsletter on important tax and business developments in Japan

May 2012

In this issue

Japan's new renewable energy incentives, a recent transfer pricing case and new taxation agreements

This edition of our newsletter contains information on the government's attempts to encourage investment into renewable energy, a brief outline of the failure of the Mutual Agreement Procedure in a transfer pricing case and a summary of recent taxation agreements.



Renewable energy incentives

2011 Tax Reforms

After last year's earthquake and the resulting Fukushima disaster, Japan's nuclear reactors were shut down for maintenance and stress-testing. The last operational reactor was put offline at the beginning of May this year. The understandable resistance of residents towards restarting power stations in their local area has left the government with the difficult task of replacing a source of power that had provided nearly 30% of Japan's energy needs.

Renewable Energy Law

The Renewable Energy Law was passed in August 2011 with the aim of encouraging the use of renewable energy as a more stable and clean source of Japan's power needs. Under the law, electric utility companies will be obliged to purchase electricity from suppliers where the electricity has been generated by wind, solar, hydro, geothermal or biomass sources. The law is similar to Feed-In Tariffs which are in use in many other countries.

The price to be paid and the length of the obligation for each source of renewable energy have not been finalized yet. However the intention is to make sure that the initial price paid for each kWh produced is enough to overcome the high initial cost of production equipment. For solar power an estimate of JPY42 per kWh produced and a term of 20 years have been discussed.

Tax incentives

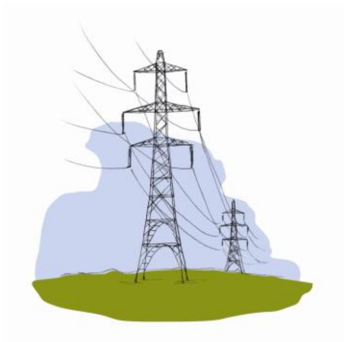
In addition to the above tariffs, the 2012 tax reform introduced special tax incentives for renewable energy equipment. Assets purchased between 1 July 2012 and 31 March 2013 and utilized in the business within one year of purchase, can benefit from a 100% depreciation deduction in the first year. As a result some companies with large profits are looking to invest in solar energy production in order take advantage of the initial tax losses created.

Depreciable assets are normally subject to depreciable asset tax of 1.4% of the purchase price over the useful life of the asset. The tax reform introduced a special incentive for renewable energy equipment by reducing the tax base by one third for the first two years.

Summary

The tax incentives should encourage businesses with excess profits to invest in solar and other renewable sources of energy. However Tokyo Electric Power Company will be allowed to pass the cost of the tariffs on to the end consumer, which raises the possibility of burdening them with higher power costs if the tariff is set too high.

The ongoing discussions over the level of tariff and length of the obligation will prove complex as the government needs to find a balance that achieves its aims of increasing clean energy production without putting undue financial burden on the population.



Transfer pricing case

Background

Takeda Pharmaceutical Company Limited ("Takeda") is the largest pharmaceutical company in Japan. In 1995 it formed a 50:50 joint venture through a US subsidiary with Abbot Laboratories in order to promote one of its drugs, Prevacid, in the USA.

Correction notice

In 2006 the Osaka Regional Taxation Bureau ("ORTB") raised a correction notice of JPY122.3 billion of additional income for the fiscal years ended March 2000 through March 2005, on the basis that Takeda's profits on the product supply and licence transactions with the joint venture were too low. The additional national and local taxes due were approximately JPY57.1 billion.

Takeda paid the taxes but insisted that the prices were essentially at arm's length as they had to be agreed with Abbot Laboratories, a third party. They requested that the ORTB reinvestigate the assessment. This request was later put on hold while Takeda applied for relief through the Mutual Agreement Procedure.

Mutual Agreement Procedure

The taxpayer requested a Mutual Agreement Procedure under Article 25 of the US –Japan tax treaty in July 2008 for relief from double taxation. However in November 2011, their case was closed with no resolution as the US and Japan authorities were unable to reach agreement. Takeda subsequently resumed its appeal with the ORTB.

Taxpayer victory

In April 2012 the ORTB reduced the assessment from JPY122.3 billion to JPY24.6 billion. Takeda has since appealed asking for the assessment to be reduced to zero.

Summary

The case is highly unusual in that the competent authorities were unable to reach agreement over reducing the potential double taxation despite three years of discussion. Ultimately the issue was resolved through appealing to the domestic authority.

It is generally accepted that mutual agreement will be successful and double taxation can be relieved in many cases, especially between Japan and the US. However, this case which involved an extremely large tax assessment shows that mutual agreement is not a remedy for all situations. Although this course of action may not always be successful, it highlights the need to have robust transfer pricing documentation in place or apply for an Advance Pricing Agreement to defend a company's position.

Recent taxation agreements

Tax treaties

Since our last update, Japan has been active in reaching agreements with the following countries:

Portugal

Japan has recently signed a new treaty with Portugal. Although it has not yet come into force, the headline rates are as follows:

Income type		Tax rate
Dividends	At least 10% shareholding	5%
	Other	10%
Interest		10%/5%[1]/0%[2]
Royalties		5%

As is becoming common in recent treaties that Japan has signed, there are also provisions allowing Japan to impose tax at source on income and gains derived from a sleeping partnership (Tokumei Kumiai).

Oman

A basic agreement has been reached with Oman on the first double tax treaty between the two nations. The draft rates are as follows:

Income type		Tax rate
Dividends	At least 10% shareholding	5%
	Other	10%
Interest		10%[2]
Royalties		10%

There are also provisions allowing Japan to impose tax at source on income and gains derived from a sleeping partnership (Tokumei Kumiai).

Switzerland

A protocol amending the treaty with Switzerland came into force and applies to taxes from 1 January 2012. The rates are as described in our October 2009 bulletin.

The Netherlands

The new treaty with the Netherlands, as described in our October 2010 bulletin has entered into force and applies to taxes from 1 January 2012.

Germany

Japan has begun negotiations with the government of Germany to revise the treaty between the two nations. The current treaty entered into force in 1967 and was partially revised in 1980 and 1984.

Luxembourg

The tax treaty between Japan and Luxembourg has been revised so that the tax information exchange provisions are brought more into line with international standards.

Tax Information Exchange Agreements

Tax information exchange agreements have been signed with Jersey and Guernsey. In addition, a basic agreement has been reached with Liechtenstein.

[1] 5% for interest paid to banks
[2] 0% for interest paid to government bodies and central banks

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