

# Japan Tax Bulletin

## The incorporation of BEPS Action 7 into Japan domestic tax laws as part of the 2018 Tax Reform

### January 2018

The Outline of the 2018 Tax Reform, which was released on December 22, 2017, includes a proposal to amend the definition of a PE in line with BEPS Action 7. The amendments have been already included in the 2017 draft OECD Model Tax Convention and bilateral tax treaties Japan has concluded.

#### 1. *Expanded agent PE concept – Commissionaire arrangements and similar strategies*

The agent PE concept has been expanded to deal with commissionaire arrangements and similar strategies. Where an agent plays habitually the principal role leading to contracts that are routinely concluded without material modification by an enterprise, the agent is deemed a PE even though it does not have the authority to actually conclude contracts.

These contracts are:

- a) in the name of the enterprise, or
- b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
- c) for the provision of services by that enterprise.

An independent agent who acts for an enterprise in the ordinary course of its business is not deemed an agent PE. However, if the agent acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent.

#### 2. *Preparatory or auxiliary character – Specific activity exemption*

Where activities conducted in a fixed place of business are of the type listed below, the fixed place of business does not constitute PE provided such activities are of a preparatory or auxiliary nature. The preparatory or auxiliary nature condition was applicable only to f) in Article 5 of the 2014 Model Convention. In the 2017 Model Convention, the condition is applicable to all of the activities.

- a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

- d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e).

#### 3. *Anti fragmentation of activities rule*

A further provision has been made to prevent abuse of the activities exemptions above by fragmenting the functions of an overall business operation into smaller operations in order to take the position that the smaller operations are each preparatory or auxiliary. The new provision seeks to combine the activities conducted in a place of business, with activities conducted in another place by the same or a related enterprise.

The Model 2017 Conventions states:

“The above rule shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same country and:

- a) that place or other place constitutes a Permanent Establishment for the enterprise or the closely-related enterprise, or
- b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely-related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.”

As a result, although fragmenting the activities of a business operation may mean that each activity is preparatory or auxiliary in nature, this strategy will not result in the activities exemption being met and a PE may still be created



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#### 4. *Splitting-up contracts*

A building, construction or installation project crosses the threshold for a PE if it continues for 12 months or longer. To avoid this it was possible previously to split a contract split into separate contracts each lasting fewer than 12 months.

Under the reform, if the principal purpose of splitting up a contract to avoid creating a PE, the duration of the project is determined by aggregating the period of each split contract.

#### 5. Other amendments

In addition to BEPS Action 7, the following amendments are proposed:

- Where the definition of PE exists in both domestic tax laws and in a bilateral tax treaty, the definition under the bilateral treaty should be take precedence.
- A “fills order agent” (an agent “who maintains in Japan sufficient goods to meet the normal requirements of a foreign corporation's or non-resident's customers and delivers the goods to the customers to meet such requirements) and a “secures order agent” (an agent who exclusively or principally on behalf of a foreign corporation or non-resident secures orders) are excluded from the definition of a PE.

Contact us for any enquiry on our services:

[tax-news@jp.gt.com](mailto:tax-news@jp.gt.com)

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