Transfer Pricing

Country Summary

Japan

March 2023

1. Introduction

Japan follows the OECD Guidelines, in its TP documentation requirements. This is noted in the The Commissioner's Directive on the Operation of Transfer Pricing ("CDOTP") where it is stipulated that the OECD Transfer Pricing Guidelines shall be referred to in the course of examination or APA.

2. Laws & Regulations

a) References to OECD/EU/Local Rules

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 and 2021.

b) 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.

c) Nature of Transfer Pricing Documentation

Although certain aspects of the rules (such as the lack of any mention of the transactional net margin method prior to 2004) and practices of the Japanese tax authorities have been criticized in the past as being inconsistent with the spirit of the OECD Guidelines, the Japanese transfer pricing rules are largely consistent with the OECD Guidelines.

d) Tax Havens & Blacklists

This section is not applicable.

e) Advance Pricing Agreement (APA)

PA 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.

f) Audit Practice

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.

3. Transfer Pricing Documentation

a) 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.

b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

e) Choice of Transfer Pricing Method

The following methods are accepted:

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

Similar methods of the above 5 methods are also accepted. 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. Moreover, it is necessary to note that the Order for Enforcement of ASMT provides for the valuation technique based on projected cash flows.

f) Economic Analysis – Benchmark Study

The Benchmark study is the most appropriate method to identify the Arm's length price of intra-company transactions. 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 nonJapanese 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.

g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the ''conduct of parties'' the prevailing concept.

h) Financial Statements

Taxpayers are required to disclose intra-company transactions in their Financial Statements.

i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)*(If "No", it can be filed in English)
Corporate Income Tax	File	Local GAAP	Within two months after the end of company's annual accounting period.	No	No	Yes
Master File	File	OECD Guidelines	Within one year of the closing day of the fiscal year under consideration.	No	Yes	Yes
Local File	Prepare	OECD Guidelines	For taxpayers who meet the transaction threshold, the Local File should be prepared by the deadline for the corporate tax return. If the taxpayer does not meet the threshold, they must submit within 45 days upon request.	No	Yes	No (Japanese upon request)
CbCR	File	OECD Guidelines	Within one year of the conclusion of the fiscal year of the Ultimate Parent Entity.	No later than the last day of the reporting fiscal year.	Yes	Yes
Form 17-4	File	Form 17-4 of CITR	Within 2 months after the fiscal year has ended.	N/A	Yes	Yes
Annual Accounts	N/A	N/A	N/A	N/A	N/A	N/A
Segmented P&L	N/A	N/A	N/A	N/A	N/A	N/A

* Japan has signed the MCAA agreement for the filing of CBCR.
* Japan does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises.

j) Mandatory Language

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.

k) Notification Requirement

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).

l) Record Keeping

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

m) Penalties and Interest Charges

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.