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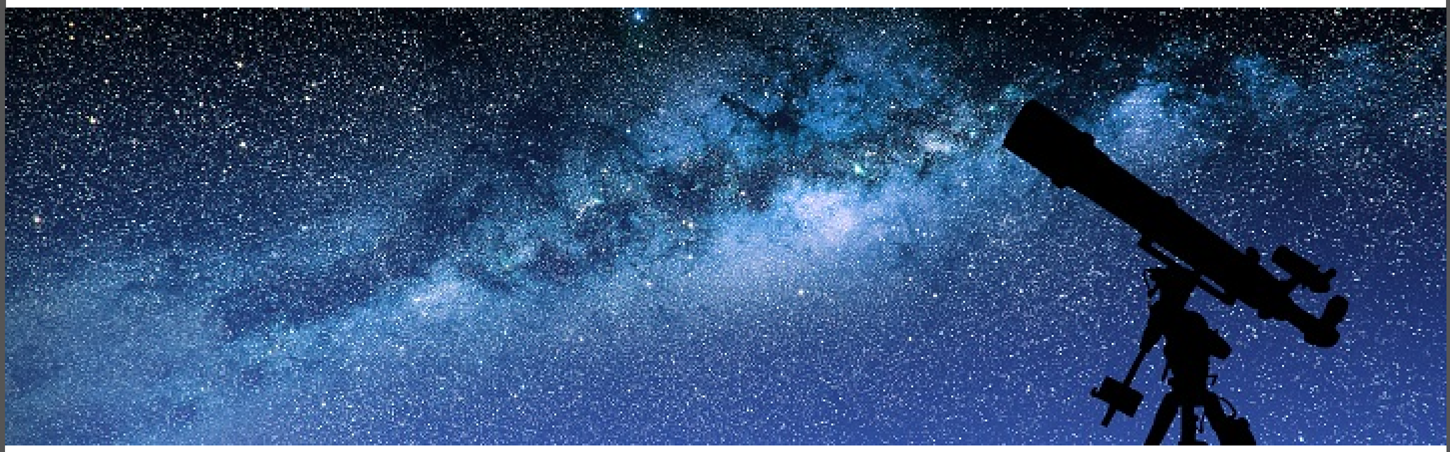

Japan's proposed adoption of BEPS Action 13 includes new prescriptive transfer pricing documentation rules

Global Transfer Pricing Alert 2016-002

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The Japanese Cabinet on December 24, 2015, approved the 2016 tax reform proposal, which includes new transfer pricing documentation rules. The National Diet is expected to approve the tax reform proposal before April 1, 2016. The new documentation rules follow the three-tier documentation approach contained in the Organization for Economic Cooperation and Development's "Transfer Pricing Documentation and Country-by-Country Reporting Final Report" issued on October 5, 2015.

Country-by-country report

Under the proposal, Japanese companies that are the ultimate parents of multinational groups and meet the filing threshold must file a report containing the information in Annex III of the OECD's Action 13 Final Report for tax years beginning on or after April 1, 2016. The filing threshold is group revenue of ¥ 100 billion (€780 million) or more in the previous year. The ultimate parent company is the company required to file consolidated financial statements for the multinational group that is not included in the consolidated financial statements of any other group. The report must be filed electronically in English within one year after the end of the multinational group's fiscal year.

A Japanese company required to file the country-by-country report may appoint another company to file the report on behalf of the group. The reporting entity must provide its name and location and similar information for other Japanese constituent entities.

A Japanese subsidiary of a multinational group or a Japanese permanent establishment of a non-Japanese group company in which the ultimate parent is not a Japanese company is required to file the country-by-country report if Japan has a double tax treaty with the jurisdiction of the ultimate parent company and the country-by-country report cannot be obtained from the other jurisdiction. If Japan does not have a double tax treaty with the other jurisdiction, the Japanese subsidiary or permanent establishment is not required to file the report separately.

The proposal indicates that penalties will apply if a required report is not filed. The nature of the penalties will be the subject of further guidance.

Master file

Japanese companies or permanent establishments that are members of a multinational group that meets the filing threshold must file a master file electronically with the Japanese tax authorities for tax years beginning after April 1, 2016. The multinational group filing threshold is group revenue of ¥100 billion (€780 million) or more in the previous year. The master file is due within one year after the year end of the company or permanent establishment required to file the master file.

The master file must contain the information specified in Annex I of the "Transfer Pricing Documentation and Country by Country Reporting Final Report." It may be prepared in Japanese or English. The proposal indicates that penalties will apply if a master file is not filed. The nature of the penalties will be the subject of further guidance.

Local file

Japanese companies and Japanese permanent establishments that meet the filing threshold must prepare a local file before they file their Japanese tax return, which, taking into consideration filing extensions, is three months after the end of the fiscal year. The local file must be provided to the Japanese tax authorities within 45 days of a request. The filing threshold is ¥5 billion of related-party transactions or ¥300 million of related-party intangible property transactions in the previous year (the current year if no previous year). Local files must first be prepared under the new rules for taxable years beginning after April 1, 2017, one year later than the first year for the master file and country-by-country report. The requirements for the local file have been expanded to include both the current requirements and those contained in Annex II of the "Transfer Pricing Documentation and Country by Country Reporting Final Report." As a practical matter, there is substantial overlap between the current requirements and Annex II. Information not required by both includes: key competitors, segmented related-party profit and loss statements, and bilateral and unilateral advance pricing agreements (APAs) that impact the transactions.

Companies that fail to provide a local file to the Japanese tax authorities within 45 days of a request are subject to Japanese tax authorities applying a presumed transfer pricing method, which could include the use of secret comparables. In the past, Japanese rules did not include a contemporaneous requirement and a specific due date to provide the transfer pricing report to the tax authorities.

Companies that do not meet the prescribed thresholds for filing the local file are nonetheless required to provide support for their transfer prices to the Japanese tax authorities within 60 days, or be possibly be subject to the same presumed transfer pricing methods.

Conclusion

The new Japanese transfer pricing rules adopting the OECD three-tier approach are significantly more prescriptive than the prior rules with respect to both the specific information to be provided and the timing for when that information must be provided. The requirement to file the master file with the Japanese tax authorities and the requirement to prepare the local file by the time the tax return is due will require Japanese multinationals and companies doing business in Japan to maintain robust documentation to meet the new deadlines. In many cases, the documentation process will need to start before the end of the year to coordinate the information contained in all the three reports and to meet the new strict deadlines. For many companies, this will require a new level of global coordination and documentation.

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