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Japan Inbound Tax & Legal Newsletter

Japan deposits instrument of acceptance of MLI

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In Brief

On 26 September 2018, Japan deposited its instrument of acceptance of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)[1] with the OECD. Consequently, the MLI will enter into force for Japan on 1 January 2019, and its provisions will take effect for Japan's "covered tax agreements" (CTAs) where the relevant treaty partner has similarly deposited its instrument of ratification, acceptance or approval with the OECD.

This article provides an overview of when the MLI provisions will become effective and highlights some immediate impacts on Japan's key tax treaties.

1. Timetable and affected CTAs

(1) Timetable

According to its terms, the MLI will enter into force for a jurisdiction on the first day of the month following the expiration of a period of three calendar months beginning on the date the jurisdiction deposits its instrument of acceptance with the OECD. Further, the MLI can enter into effect for a specific CTA only after the three-month period has expired for both contracting parties. The default timings are as follows:

- Modified withholding tax provisions will have effect for payments made on or after the first day of the following calendar year; and
- Changes relating to taxes levied with respect to taxable periods will have effect for taxable periods beginning on or after a period of six calendar months has elapsed (or less if both parties agree) from the latest date the MLI enters into force for the contracting parties.

Based on these provisions, the MLI will enter into force for Japan on 1 January 2019. The first impacts of the MLI on Japan's CTAs will be for those agreements where the MLI has also entered into force for the treaty partner by that same date. For these CTAs, the relevant MLI provisions will take effect for withholding taxes on 1 January 2019 and, for all other taxes, for taxable years beginning on or after 1 July 2019. (For further information on how the MLI is applied, please refer to our Inbound Tax Alert No.24 from August 2017.)

(2) Affected CTAs

The following table lists Japan's CTAs, with the treaty partner jurisdictions that have deposited their MLI instruments of ratification with the OECD as of 30 September 2018 highlighted in green. As mentioned above, the MLI will enter into force for these jurisdictions on or before 1 January 2019 and, accordingly, will become effective for these CTAs on 1 January 2019 for withholding taxes and for taxable years beginning on or after 1 July 2019 for all other taxes.

For treaty partner jurisdictions that deposit their MLI instruments of ratification, acceptance or approval with the OECD after 30 September 2018, the MLI provisions for the relevant CTA with Japan will take effect based on the date the MLI comes into force for the treaty partner jurisdiction.

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1 OECD - Text of the Multilateral Instrument (MLI)

List of Japan's CTAs (Jurisdictions with instruments deposited as of 30 September 2018 highlighted in green)					
Australia	Finland	Ireland	Malaysia	Portugal	Turkey
Bulgaria	France	Israel	Mexico	Romania	Ukraine
Canada	Germany	Italy	Netherlands	Saudi Arabia	UAE
China	Hong Kong	Kazakhstan	New Zealand	Singapore	UK
Czech Rep.	Hungary	Korea	Norway	Slovakia	
Egypt	India	Kuwait	Pakistan	South Africa	
Fiji	Indonesia	Luxembourg	Poland	Sweden	

2. Impacts on Japan's CTAs

For the above highlighted CTAs (for which the MLI will come into effect beginning 1 January 2019), the key impacts of the MLI will include anti-avoidance provisions (mainly the "principal purpose test," or PPT) and an expanded definition of a permanent establishment (PE). In particular, all CTAs will include the PPT (MLI Article 7), and for Israel, Poland and Slovakia, the addition of the PPT will be the first comprehensive anti-avoidance provision to be included in their treaties with Japan. Changes to the definition of a PE will be made to Japan's CTAs with France, Israel, New Zealand, Slovakia and the UK, and these changes will be in the form of:

- Anti-fragmentation provisions under MLI Article 13(4);
- A reduced threshold to create a dependent agent PE under MLI Article 12 (not applicable to the UK CTA); and
- The requirement that each specific activity exception listed in a CTA be preparatory or auxiliary in nature under MLI Article 13(1) (not applicable to the France or UK CTAs).

Deloitte's View

By depositing its instrument of acceptance with the OECD, Japan has indicated that it is prepared for the MLI to take effect with respect to its bilateral tax treaties as from 2019. Companies impacted by Japan's CTAs should consider reviewing their affected treaty positions, including whether positions will be valid after the MLI provisions come into effect.

Similarly, companies in tax treaty countries where the MLI's expanded definition of a PE will apply should consider reviewing any structures in Japan to ensure that there will be no unexpected PE consequences after the MLI takes effect, especially for companies that currently rely on an exception under the definition of a PE or provide certain sales or marketing-related services.

Finally, it should be noted that the specific MLI impacts on each of Japan's CTAs may be different, and CTAs will need to be analyzed individually to determine which MLI provisions apply. In addition, a number of Japan's key treaty partners have yet to deposit their instruments of ratification, and the MLI provisions for these treaties will begin to take effect after the instruments are deposited. Companies should monitor further developments.

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Contacts

Deloitte Tohmatsu Tax & Legal Inbound Group

Not all facts and circumstances are covered in this alert. If you have any questions regarding your specific situation, please contact one of the tax professionals at our Deloitte office in Tokyo as follows:

Jun Sawada, Inbound Group Leader		jun.sawada@tohmatsu.co.jp	+81 3 6213 3927
Business Tax Services	Sunie Oue, Partner	sunie.oue@tohmatsu.co.jp	+81 3 6213 3753
	David Bickle, Partner	david.bickle@tohmatsu.co.jp	+81 3 6213 3743
Indirect Tax Services	Chikara Okada, Partner	chikara.okada@tohmatsu.co.jp	+81 3 6213 3900
Global Employer Services	Russell Bird, Partner	russell.bird@tohmatsu.co.jp	+81 3 6213 3979
Transfer Pricing	Timothy O’Brien, Partner	timothy.obrien@tohmatsu.co.jp	+81 3 6213 3923
	Samuel Gordon, Partner	samuel.gordon@tohmatsu.co.jp	+81 3 6213 3760
Tax Management Consulting	Sam Reeves, Director	sam.reeves@tohmatsu.co.jp	+81 80 4087 6475
Financial Service Industry	Yang Ho Kim, Partner	yangho.kim@tohmatsu.co.jp	+81 3 6213 3841
	Kai Hielscher, Partner	kai.hielscher@tohmatsu.co.jp	+81 90 9855 9819
Tax Controversy	Yutaka Kitamura, Director	yutaka.kitamura@tohmatsu.co.jp	+81 70 3192 5611
Legal	Kaori Oka, Partner	kaori.oka@tohmatsu.co.jp	+81 3 6895 2678
Immigration	Yoshito Kijima, Partner	yoshito.kijima@tohmatsu.co.jp	+81 80 4183 4429

Issued by

Deloitte Tohmatsu Tax Co.
Tokyo Office
Shin-Tokyo Building 5F, 3-3-1 Marunouchi, Chiyoda-ku, Tokyo 100-8305, Japan
Tel: +81 3 6213 3800
email: tax.cs@tohmatsu.co.jp
Corporate Info: www.deloitte.com/jp/en/tax