Chapter 14

JAPAN

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I INTRODUCTION

During 2006 and 2007, the Japanese tax authorities aggressively pursued reassessments of large amounts of corporate taxes relating to transfer pricing through tax audits, exemplified by an extraordinarily large tax assessment against Takeda Pharmaceutical Company of an additional tax of ¥57.1 billion in 2006. However, some of these tax assessments were eventually withdrawn by the Japanese tax authority following mutual arrangement procedures (MAPs), and recently transfer pricing-related disputes in Japan have become smaller in scale.

According to the National Tax Authority (NTA), the additionally taxed income per transfer pricing case has gradually become smaller, while the number of cases is growing. In the 2012 business year, it was ¥439 million per case (222 cases in total), whereas it was ¥460 million in 2011 (182 cases in total), ¥478 million in 2010 (146 cases in total) and ¥687 million in 2009 (100 cases in total). Among these cases, some larger-scale cases have also been reported. For example, Olympus and Hoya received tax assessments regarding transfer pricing, involving alleged additional tax amounts of ¥4.9 billion and ¥3.3 billion, respectively. On the other hand, the Japanese tax authorities aggressively rejected tax declarations with regard to corporate reorganisations, such as the tax assessments of an additional tax of ¥26.5 billion on Yahoo! Japan, and more than ¥30 billion on IBM Japan, both reported in 2010. Yahoo! Japan and IBM Japan filed tax lawsuits in 2011, and these cases are currently being tried in the Tokyo District Court.

Tax code amendments to harmonise the Japanese rules with international standards are under way. The Japanese Tax Bureau of the Ministry of Finance is currently

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working on changing the Japanese international taxation scheme to adopt the Authorized OECD Approach for recognition of profits attributable to permanent establishments, to achieve consistency with the new Article 7 of the OECD Model Convention adopted in 2010. Currently, the revision is expected to be completed in 2014.

II COMMENCING DISPUTES

i Types of procedure, relevant time limits and trigger points

Explanations below apply to a typical case in which a taxpayer challenges his or her tax assessment by the tax authorities regarding national tax, such as income tax or corporate tax, unless otherwise indicated.

Tax authorities, such as the district director of the tax office, may apply assessments against a taxpayer if the taxpayer's tax return does not comply with the applicable tax code and the tax authorities believe that the taxpayer should pay higher taxes. If the taxpayer does not agree with the tax assessment, he or she may request reinvestigation by the tax authority within two months of the day following the one on which the taxpayer came to know of the assessment. If the request is rejected, the taxpayer may submit a request for reconsideration with the National Tax Tribunal (NTT) within one month of the day following the day of service of the decision on the request. Taxpayers may dispense with the reinvestigation proceedings above and may directly file a request for reconsideration with the NTT if the taxpayer is eligible for a 'blue return'. If the tax authority does not make any decision in response to the taxpayer's request for reinvestigation within three months of the day following the date of the request for reinvestigation, the taxpayer may immediately file a request for reconsideration with the NTT. If the NTT makes no decision in response to the taxpayer's request for reconsideration within three months of the day following the date of the request for reconsideration, the taxpayer may immediately file a lawsuit with a court.

ii Mechanism for dispute resolution regarding local tax

A different mechanism for dispute resolution is provided regarding local tax disputes. Generally, taxpayers must file a request for reconsideration with a higher administrative agency within 60 days of the date on which the taxpayer came to know of the assessment. For disputes regarding the valuation of fixed assets used in levying fixed assets taxes, there is a special filing procedure for review with a fixed assets appraisal and review committee established by local governments.

III THE COURTS AND TRIBUNALS

i The National Tax Tribunal

The NTT is annexed to the NTA and has 12 branch offices in Japan. Its authority is said to be exercised independently from the other national agencies, including the NTA, but many tax practitioners doubt this, as the majority of its examiners are dispatched from regional tax bureaux and tax offices.

The NTT examiners investigate requests for reconsideration by taxpayers through examination of submissions from the taxpayers and tax authorities, and also conduct interviews with both parties. The examiners may conduct their own investigation *ex officio* to assess the request. No filing fees are necessary to request reconsideration with the NTT. The proceedings are not open to the public. In the 2012 fiscal year, 96.2 per cent of cases before the NTT were resolved within one year of the commencement of proceedings. The NTT is the administrative authority and its decision is the final determination; if the tax authority receives an unfavourable decision from the NTT, it cannot appeal to a court to request reversal of the decision.

ii Court

The Japanese court system tries tax disputes in three tiers: district courts as the courts of first instance, high courts as the courts of second instance and the Supreme Court as the final court of appeal. All tax disputes are tried by professional judges.

To commence a tax lawsuit, a court filing fee must be paid, the amount of which is based on the amount of the claim. For example, in cases where the claimed amount is ¥100 million, the court filing fee is ¥320,000. In cases where the claimed amount is ¥1 million, the court filing fee is ¥10,000. The filing fee for courts of second instance is 150 per cent of the initial filing fee for courts of first instance and the filing fee for the Supreme Court is 200 per cent of the initial filing fee.

Courts of first and second instance can try issues of fact and law, but the Supreme Court can only address constitutional issues, grave procedural errors and important legal issues. Taxpayers have a right to make a second appeal to the Supreme Court if the grounds for appeal involve constitutional issues or grave procedural errors specifically provided by law. Taxpayers may make a discretionary appeal to the Supreme Court, similar to *certiorari* in the US, if the grounds for appeal involve important legal issues.

In 2011, administrative lawsuits, including tax litigation, lasted an average of 15 months in courts of first instance, 6.6 months in courts of second instance and 6.5 months in the court of final instance (i.e., the Supreme Court). However, tax disputes of greater scale and complexity generally last longer, especially in courts of the first instance, where a case usually remains for approximately two years. No arbitration exists for tax disputes, and formal settlement is not available for tax disputes, but when the tax authority considers it difficult to continue a lawsuit, it may voluntarily annul its previous tax assessment, and the taxpayer can withdraw the lawsuit following this annulment. The total number of tax lawsuits challenging tax assessments pending before courts as of the end of March 2013 is 294. The recent rates of success for taxpayers in challenging tax assessments in court are as follows:

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Taxpayer's claims fully granted	7.3%	6.5%	8.0%	3.8%	12.1%	9.0%	8.9%	2.8%	4.7%	9.6%	3.7%
Taxpayer's claims partly granted	4.3%	7.0%	5.9%	6.4%	7.5%	6.9%	4.1%	3.2%	3.6%	5.8%	3.0%
Taxpayer's claims completely dismissed	88.4%	86.5%	86.1%	89.8%	80.4%	84.1%	87.0%	94.0%	91.7%	84.6%	93.3%

(Source: the NTA)

IV PENALTIES AND REMEDIES

The rates of penalties for tax payers applicable after 1 January 2014 have been changed from those applicable previously. If a taxpayer does not pay a tax bill by the due date designated by law, the taxpayer will have to pay 'delinquent taxes' on any amount in arrears. Such delinquent taxes accrue on unpaid taxes beginning on the day after the due date for a tax payment and continuing until the day on which the due tax is paid in full. The mechanics of determining the rate of the delinquent taxes applicable after 1 January 2014 are complicated, and the rate will be decided annually with due consideration of a special standard rate to be announced by the finance minister by the middle of December of the year preceding the applicable year. This special standard rate shall be based on the average interest rate for short-term loans by banks. For the first two months, the rate of the delinquent tax is expected to be approximately 3 per cent per annum; for the period from two months after the due date until the remaining taxes due are paid in full, the delinquent tax rate is expected to be approximately 9.3 per cent per annum.

If a taxpayer does not comply with required tax obligations, an 'additional tax' will also be imposed in addition to the above delinquent tax. In the event that a taxpayer files a tax return by the due date but the amount paid in the tax return is found to be less than the amount due to be paid, the taxpayer has to pay 10 per cent of the tax amount of the difference as an 'additional tax for understatement' in addition to the tax itself; 5 per cent is further added as an additional tax for understatement if the unpaid tax amount is larger than a certain amount. In the event that a taxpayer does not file a tax return by the due date, the taxpayer has to pay an 'additional tax for failure to file', which is 15 per cent of the tax amount to be paid. In the event that a person who deducts withheld taxes (e.g., from employee's salaries) and is obliged to pay the tax does not pay such tax by the due date, 10 per cent of the tax amount is imposed as an 'additional tax on non-payment'. In the event that a taxpayer does not pay, or reduces payment of tax by concealing or giving a false appearance of all or a part of the facts that should be the basis for the calculation of a tax amount, then 35 per cent of the tax amount to be paid is imposed as a 'heavy additional tax' instead of an additional tax for understatement, and 40 per cent of the tax amount to be paid is imposed instead of the normal 15 per cent additional tax for failure to file.

In addition to the above civil sanctions, a taxpayer may be punished with criminal sanctions. If a taxpayer is exempted from a tax or receives a tax refund by means of deception or other wrongful conduct, they may be punished by imprisonment with labour for not more than 10 years, or a fine of not more than ¥10 million. In the event that a failure to file a tax return is not connected with deception or other wrongful conduct but reduces the tax to be paid by a taxpayer, such a taxpayer may be punished for his or her failure to file a tax return by imprisonment with labour for not more than five years, or a fine of not more than ¥5 million. In the event that a simple failure to file a tax return is not connected with deception or other wrongful conduct, such a failure is not regarded as tax evasion; however, a taxpayer may be punished for his or her simple failure to file a tax return by imprisonment with labour for not more than a year, or a fine of not more than ¥500,000. Other criminal sanctions exist, including penalties for failing to cooperate with a tax audit. These penalties are imposed in the event that a person fails to answer, or gives a false answer, to questions asked by auditors, or refuses or avoids audits, or gives false records to auditors. Imprisonment may be the punishment for such cases.

V TAX CLAIMS

i Recovering overpaid tax

In the event that a taxpayer pays tax based on a tax return, but the amount of tax paid is later found to be excessive, then the taxpayer is allowed to request that the district director of the tax office reassess the tax base or mistakenly paid tax amount stated in the tax return. Without a reassessment of the tax base or tax amount by the district director of the tax office, the taxpayer is generally unable to recover overpaid taxes by filing a litigation against the government.[2] Time limitations for a request of reassessment depend upon the type of tax at issue. Generally, a taxpayer is allowed to request reassessment within five years of the statutory tax return due date; however, the time limitation extends to six years, for example, if the tax in question is a corporate tax relating to transfer pricing.

As explained above, a prior reassessment is required to recover overpaid taxes. However, a court precedent holds that taxpayers are able, without a reassessment, to recover the tax amount overpaid based on their own mistake if there are special circumstances, such as if a taxpayer has paid the tax based on an objectively apparent material mistake, and if the restriction of the means of correcting the tax amounts to only a reassessment by the district director of the tax office and brings substantial detriment to the interest of the taxpayer.[3]

2 *Samukawa v. Japan*, 18 MINSHÛ 1762 (Sup. Ct., 22 October 1964) (holding that a taxpayer must request reassessment first before filing a lawsuit to request a tax refund).

3 Id.

ii Challenging inappropriate administrative decisions on grounds of unequal treatment or the legitimate expectation of taxpayers

It is theoretically possible, but practically difficult, to challenge an administrative decision on grounds of inequality, in the event that a taxpayer is harmed when a tax authority treats such a taxpayer unequally.[4] Furthermore, if the tax authority provides taxpayers with a public opinion upon which a taxpayer reasonably relies, and the taxpayer takes action based on reliance upon the tax authority's opinion, then it is theoretically possible, but again practically difficult, that the good faith and fair dealing doctrine may apply to protect the taxpayer in that specific case.[5]

iii Refund claims

Persons whose rights or interests are infringed by administrative tax decisions or orders may bring tax claims. Under the Japanese consumption tax system (Japanese VAT), invoices are not necessarily attached to the tax return to deduct the input tax, and the deduction of such input tax is allowed as long as the amount of the input tax is calculated based on properly kept accounting books and invoices. Therefore, the circumstances relating to claims for a refund of VAT are different from those in other countries.

On the other hand, in the case of withholding taxes, a person who pays a consideration such as cash (the withholding person) withholds taxes when he or she pays such a consideration; however, the person from whom taxes are withheld (the withheld person) from earned income or declared revenue, does not directly pay taxes on his or her income or revenue, as the tax has already been withheld. Instead, the withholding person is obliged to pay the tax to the tax authority. In the event that the withholding person mistakenly withholds an excessive amount from the withheld person's income and pays this excessive tax to a tax authority, the withheld person may not request a refund of the overpaid withheld tax from the tax authority; instead, the withheld person may directly require the withholding person, who mistakenly withheld excessive taxes, to refund them to the withheld person.

VI COSTS

Various costs arise in connection with tax disputes, including court costs and the fees for attorneys. One of the typical court costs is the court filing fee necessary to initiate court proceedings (see Section III, *supra*). In Japan, some attorneys charge their fees at an hourly rate based on the time spent on the case, while others work on a contingency-fee basis with some initial payment and the balance only on the success of the claim. The amount of the fee for an attorney for a tax dispute depends upon the agreement with the attorney, but factors such as the value of the dispute, the number of issues and

4 *Nakamura v. Japan*, 22 KÔMINSHÛ 682 (Osaka High Ct., 30 September 1969) (holding that a tax treatment against accepted practice is illegal).

5 *Bunka Gakuen v. Governor of Tokyo*, 16 GYÔSAISHÛ 1033 (Tokyo Dist. Ct., 26 May 1965), rev'd by *Governor of Tokyo v. Bunka Gakuen*, 17 GYÔSAISHÛ 607 (Tokyo High Ct., 6 June 1966).

the complexity of the case will determine the fee. The filing fees are reimbursed by the adverse party (i.e., the government of Japan) if the taxpayer eventually prevails, but fees to retain legal counsel must be borne by the taxpayer. There are no rules that allow tax authorities to charge their costs for tax disputes, except for the penalties explained above (see Section IV, *supra*).

VII ALTERNATIVE DISPUTE RESOLUTION

As explained previously (see Section III, *supra*), no arbitration is available for tax disputes between taxpayers and tax agencies in Japan, and neither is mediation.

The Japanese tax code does not provide an advance tax ruling system, but the tax authority provides written answers upon taxpayers' requests, except where the administrative guidelines provide an exemption. The written answers of the tax authority, together with the original queries, are publicly disclosed. In reality, the tax authority's system of written answers is not commonly used, especially when the relevant parties contemplate sophisticated and complex transactions, as it often takes more time than anticipated to receive an answer from the tax authority. Furthermore, this system does not apply to inquiries relating to transactions the main purpose of which is to avoid taxes, or financially unreasonable transactions. Instead, parties sometimes informally ask the relevant tax authority for its expected treatment of the issues they encounter. The tax authority does not respond to such informal queries in writing, but it does provide an oral, non-binding answer. Although such an oral answer cannot be relied upon, it does not take a long time and discussions with the tax authority are useful for improving a tax analysis, so this approach is more commonly used for complex issues instead of a request for written answers.

VIII ANTI-AVOIDANCE

i Anti-avoidance rules in specific circumstances

The Japanese tax code provides some specific anti-avoidance rules, allowing the tax authority to recharacterise transactions, and recalculate the taxable income and the amount of tax, in cases where the transactions or calculations made by the corporations would result in an 'improper decrease' of the tax burden, and where other conditions stipulated in specific provisions such as Article 132 and 132-2 of the Corporate Tax Act (CTA) are satisfied.

Article 132 of the CTA provides the anti-avoidance rule regarding taxation on transactions between family corporations that have three or fewer shareholders holding more than 50 per cent of the issued shares of the corporation concerned and their shareholders or related corporations. This provision aims to prevent family corporations from obtaining an improper decrease of the tax burden by conducting manipulated transactions or calculating profits inappropriately. Lower court precedents tend to interpret the term 'improper decrease' to mean that the act or computation would be unreasonable and unnatural for a purely economic person, in consideration of a business purpose for the overall transaction and for each of the relevant steps of the transaction.[6]

Article 132-2 of the CTA provides a specific anti-avoidance rule regarding taxation on corporate reorganisations such as mergers, corporate splits, share transfers, share exchanges and dividends in kind. This provision allows the tax authorities to disregard certain manipulated reorganisation transactions to determine the taxable income and the amount of tax of the relevant parties involved in corporate reorganisations. Article 132-2 of the CTA was introduced in 2001 but until recently we had not seen a great deal of focused audit activity regarding corporate reorganisations. However, as explained previously (see Section I, *supra*), recent tax audit trends seem to suggest that audit activity in this area will increase.

ii Anti-avoidance rules in international taxation

Transfer pricing rule in Japan

The Japanese tax code provides the transfer pricing rule to prevent evasion of Japanese taxes through manipulation of the amount of the consideration in a transaction between a Japanese company and a related foreign company, which basically reflects the arm's-length principle stipulated in the OECD Transfer Pricing Guidelines.

In Japan, there have been relatively few transfer pricing lawsuits, as many disputes have been resolved through MAPs, especially disputes involving developed countries. However, transfer pricing disputes and litigations will probably increase as the tax authorities strengthen their tax audits on transactions between Japanese companies and their related companies in developing countries such as China, the South East Asian countries and India, as APAs and MAPs with these countries have not worked effectively.

A recent noteworthy case in this area was Takeda Pharmaceutical Company, which was the largest transfer pricing case in Japan with a disputed tax amount of approximately ¥57.1 billion, and which involved the issue of an application of the transfer pricing rule to a transaction between Takeda and its joint venture company with an unrelated US company on a fifty-fifty basis. The negotiations between Japan and the United States through the MAP broke down in 2011, but approximately two-thirds of the additional tax amount was repealed in 2012 in the administrative reinvestigation procedure and ¥57.2 billion, including interest, was refunded to Takeda. For the remaining portion, Takeda filed a request for reconsideration with the NTT, and the NTT repealed that portion of the tax assessment as well, and ¥15.2 billion, including interest, was refunded to Takeda in 2013.

6 For example, *Chûshô Kigyô Joseikai & Fujita v. Tokyo Reg'l Comm'r*, 24 GYÔSAISHÛ 115 (Tokyo High Ct., 14 March 1973); *Yamabishi Fudôsan v. Nihon Bashi Dist Dir of Tax Office*, 25 GYÔSAISHÛ 1310 (Tokyo High Ct., 29 October 1974); and *Minami Nihon Kôatsu Concrete v. Kawauchi Dist Dir of Tax Office*, 31 GYÔSAISHÛ 1982 (Fukuoka High Ct., Miyazaki Branch, 29 September 1980).

CFC rule in Japan

The Japanese tax code provides a controlled foreign corporations (CFC) rule, which is also known as the anti-tax haven rule, to prevent avoidance of taxes through certain related subsidiaries in low-tax jurisdictions. Under the current rule, when a domestic corporation owns 10 per cent or more of the issued stocks of a foreign subsidiary whose tax rate would be 20 per cent or less, and more than 50 per cent of the stocks are owned by residents or domestic corporations, the profits of the foreign subsidiary attributed to the shares are included in the gross income of that domestic corporation unless the exclusion rule applies.

Several courts have dealt with issues regarding the exclusion rule in tax disputes. For example, in respect of the unique structure of the Hong Kong subsidiaries of Japanese manufacturers using contract manufacturing companies in Chinese factories, some courts have recently rendered judgments in favour of the tax authorities on the grounds that the requirements of the exclusion rule were not satisfied, although the transaction schemes vary depending on the cases.[7]

Thin capitalisation and earnings stripping rules

The Japanese thin capitalisation rule prevents taxpayers from eroding their tax base by paying an unreasonably excessive amount of deductible interest expenses, focusing on the balancing of debts and equities. This rule, however, cannot effectively prevent tax avoidance if the Japanese corporation keeps the balance of debt and equity at a ratio of less than three-to-one and pays interest on an amount that is inappropriate when compared with the company's income. In light of the recent trend for tax treaties involving developed countries to provide an exemption from withholding tax on interest in the source country, the 2012 tax reform introduced new earnings stripping rules, similar to those in the United States and some European jurisdictions, to prevent tax avoidance through the payment of excessive interest for certain taxable income.

iii Comprehensive general anti-avoidance rules

The Japanese tax code does not provide a comprehensive general anti-avoidance rule. Lower court precedents have been split on the issue of whether the tax authorities are allowed to deny specific acts and computations if the transactions are unreasonable and unfair in cases where no specific provisions to deny such acts and computations, such as Articles 132 and 132-2 of the CTA, are applicable. Recent court precedents tend to disallow such a denial.[8]

7 For example, *X v. Japan, Court HP* (Tokyo High Ct., 30 August 2011); *Funai-Denki v. Japan*, unpublished (Osaka High Ct., 20 July 2012). See also *NTT* (Tokyo) ruling on 20 February 2008 (revoking a tax assessment).

8 For example, *X v. Tokyo Setagaya Dist Dir of Tax Offices*, 21 SHÔMU GEPPÔ 1315 (Tokyo High Ct., 30 March 1975); *X v. Tokyo Ueno & Asakusa Dist Dir of Tax Offices*, 47 SHÔMU GEPPÔ 184 (Tokyo High Ct., 21 June 1999); and *X v. Y*, 255 ZEIMU SOSHÔ SHIRYÔ 10180 (Nagoya High Ct., 27 October 2005).

IX DOUBLE TAXATION TREATIES

Double taxation treaties provide various tax treatments to avoid double taxation in different jurisdictions. The Supreme Court of Japan rendered a noteworthy judgment in respect of the interpretation of a provision in the double taxation treaty between Japan and Singapore (the Treaty).[9] This case discussed whether Japanese CFC rules, which are intended to serve as a deterrent to the use of tax havens, violate a provision in the Treaty. Under the Japanese CFC rules, in the event that Japanese companies control their subsidiaries in countries with low income tax rates and some other requirements are met, the income of such subsidiaries is included in the revenue of the Japanese parent company (see Section VIII.ii, *supra*). A taxpayer, a Japanese parent company with a subsidiary in Singapore, argued that this treatment is against the principle provided in Article 7 of the Treaty. The Court dismissed the taxpayer's arguments, holding that the current CFC taxation in Japan does not violate the Treaty. To interpret the relevant provision in the Treaty, the Court held that the Commentary on the OECD Model Tax Convention can be referred to as a 'supplementary means of interpretation' in Article 32 of the Vienna Convention on the Law of Treaties, although Singapore is not a member country of the OECD.

X AREAS OF FOCUS

Currently, one area of focus in the tax community in Japan has been how foreign entities established, or foreign corporate reorganisations conducted, in accordance with the laws and regulations of foreign countries are treated for Japanese tax purposes. These two issues have common features, in that there are no clear definitions of entities such as corporations, or corporate reorganisations including mergers and corporate splits, under the Japanese tax code, and there are also no clear, established standards for determining how to classify concepts or terms in foreign laws under related legal terms provided in the Japanese tax code. Some recent movements regarding these issues are summarised below.

i Classification of foreign entities

Under the Japanese tax code, entities are classified into three categories: corporations, associations or foundations without legal personality (non-juridical organisations), and others, including partnerships. Corporations and non-juridical organisations are treated as taxable entities, while entities that are classified as partnerships are generally treated as non-taxable entities ('pass-through' entities). Thus, the entity classification issue entails critical tax consequences for the entity and its shareholders or partners.

The courts have recently ruled on the issues regarding classification of certain foreign entities. Specifically, three appellate courts have rendered judgments on the entity classification issue in relation to limited partnerships formed under the Delaware

9 *Glaxo v. Kôjimachi Dist Dir of Tax Office*, 63 MINSHÛ 1881 (Sup. Ct., 29 October 2009).

Uniform Limited Partnership Act (Delaware LPs) in 2013.[10] Although the facts of these cases are substantially the same, the courts have been split in their opinions.

By applying the following criteria of entity classification the Nagoya High Court has held that a Delaware LP is not a corporation or a non-juridical organisation but a pass-through entity for Japanese tax purposes, and as such it has overturned the upward adjustment of income taxes of the tax authorities. The criteria adopted by the Nagoya High Court for determining whether the entity falls within the category of corporations under Japanese tax laws are as follows:

a whether the entity has a 'legal personality' or 'juridical personality' under the governing law under which it is formed or established; and

b whether the entity is formed or established as an entity to which profits earned and losses incurred by it are attributed, considering matters provided for by the governing law.

On the other hand, the Tokyo High Court and the Osaka High Court held that a Delaware LP is to be treated as a corporation for Japanese tax purposes, on the grounds that Section 201(b) of the Delaware Revised Uniform Limited Partnership Act can be interpreted as providing that a Delaware LP has a 'legal personality' or 'juridical personality', given all of the following features:

a a Delaware LP can perform juridical (i.e., legal) acts, including entering into contracts in its own name, and have rights and assume obligations by itself;

b a Delaware LP owns its own property distinct from the personal property of its partners or members;

c a Delaware LP can sue or be sued in its own name;

d a Delaware LP is formed through the procedure of filing a certificate of limited partnership with the Office of the Secretary of State; and

e a limited partner of a Delaware LP is not liable for the obligations of a limited partnership unless he or she participates in the control of the business.

Appeals against all the decisions have been made to the Supreme Court. Considering the current uncertainty surrounding the tax treatment of foreign entities, it is expected that the Supreme Court, the tax authority or national legislation will provide clear criteria and guidance on how to address this issue.

ii Classification of foreign corporate reorganisations

The Japanese tax code provides special tax treatment for corporate reorganisations, which includes deferral of capital gains or losses at both shareholder and corporate levels, and succession of net operating loss, under certain conditions, at the time of execution of corporate reorganisations. As foreign corporate reorganisations do not always have the same legal nature as corporate reorganisations under Japanese corporation law, it is necessary to determine whether a foreign corporate reorganisation is classified as either

10 *Japan v. X,* unpublished (Nagoya High Ct., 24 January 2013), *Japan v. X*, unpublished (Tokyo High Ct., 13 March 2013), *X v. Japan*, unpublished (Osaka High Ct., 25 April 2013).

a corporate reorganisation for Japanese tax purposes, or another transaction to which special tax treatment for corporate reorganisations does not apply, irrespective of the legal term of the foreign corporate reorganisation in the foreign country. Although there is no judicial precedent for this issue, a research group organised by the Japan Tax Association consisting of tax professionals and academics released in April 2012 the results of a report that have attracted attention from the tax community. This report expresses the basic concept that the classification of foreign corporate reorganisations under Japanese tax law should be determined by whether the reorganisations have the same fundamental features as corporate reorganisations under Japanese law. Although this report does not have a legally binding nature as the tax treatment regarding foreign corporate reorganisations is currently uncertain, it has, to a certain extent, reference value for this issue.

XI OUTLOOK AND CONCLUSIONS

It is a reflection of the long-standing low economic growth in the Japanese economy that Japanese corporations are currently very eager to expand their areas of economic activity in foreign countries, especially those in South East Asia, where economies are growing rapidly. This will result in a growth in the number of tax disputes with the tax agencies of these countries, but it is difficult to resolve such tax disputes by MAPs (see Section VIII.ii, *supra*). In those cases, taxpayers must resort to domestic tax controversy proceedings to avoid double taxation and their importance will be much greater, reflecting the trends in economic activities of Japanese companies.

Appendix 1

ABOUT THE AUTHORS

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Akihiro Hironaka has been a partner of the dispute resolution group since 2007. He has extensive experience dealing with large-scale and complex litigation, including tax disputes. He represented Tokio Marine & Nichido Fire Insurance when it contested its tax assessment of complex reinsurance transactions, and he succeeded in recovering ¥6.7 billion for his client. While representing the Sumitomo Trust & Banking Corporation in challenging its tax assessment related to securities repurchase transactions, he succeeded in recovering ¥8 billion for his client. Mr Hironaka worked as a judge assigned to a special division that heard administrative litigation cases, including numerous tax disputes, during his judgeship at the Yokohama District Court from 1998 until 2000. He also worked at Arnold & Porter (Washington, DC) from 2003 until 2004. He has authored numerous publications, including *Treatise on Japanese Taxation* (co-author, Yuhikaku), *Frontiers of Transfer Pricing* (co-author, Yuhikaku), *Frontlines of International Tax Litigation* (co-author, Yuhikaku). He is a graduate of the University of Tokyo (LLB, 1993) and Harvard Law School (LLM, 2003), and is admitted to the bar in both Japan and New York. He has been an adjunct lecturer on international taxation at Hitotsubashi University, Graduate School of International Corporate Strategy since 2013.

MICHITO KITAMURA

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Michito Kitamura has been a partner with Nishimura & Asahi since 2011, working primarily in the firm's tax group. As a lawyer focusing on tax matters, Mr Kitamura has extensive experience dealing with tax planning, tax advice and tax disputes, including tax litigation. In particular, he has won judgments in the Tokyo and Nagoya district courts on behalf of individual investors in a tax litigation case involving an important legal issue regarding entity classification of Delaware limited partnerships, and is representing these clients in appellate courts. Mr Kitamura is also currently representing companies in a large-scale tax litigation case involving corporate restructuring matters, as well as counselling on tax planning regarding mergers and acquisitions and other international taxation matters. Prior to joining Nishimura & Asahi in 2000, he worked as a certified public accountant at one of the Big Four audit firms in Japan. Mr Kitamura has authored numerous tax-related publications, including *Frontiers of CFC Rule*s (co-author, Yuhikaku). He is a graduate of Keio University (1994), Georgetown University Law Center (LLM, 2006) and New York University School of Law (LLM in international taxation, 2007), and is admitted both to the Bar and as a certified public accountant in Japan.

MASAKI NODA

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Masaki Noda has been a partner at Nishimura & Asahi since 2013. His practice focuses mainly on corporate matters, especially mergers and acquisitions (M&A), and he has extensive experience in tax planning and structuring for complicated and sophisticated M&A transactions. Mr Noda also has experience advising companies that are subject to tax investigation, providing advice on international taxation and M&A taxation, allowing such companies to minimise their potential tax liabilities. He has authored numerous publications, including *Scheme and Taxation of M&A and Corporate Reorganization – the Leading Edge of Strategic M&A Tax Planning* (co-author, Okura Zaimu Kyoukai), *Handbook for Share Options* (co-author, Shoji Homu) and *The Practical Commentary on the Companies Act of Japan* (co-author, Yuhikaku). Mr Noda lectured in law (taxation) at Seikei University from 2006 to 2008, and also since 2012. He worked at Sullivan & Cromwell (New York) from 2009 to 2010, and at a Japanese IT-related company from 2010 to 2011. He is a graduate of the University of Tokyo (LLB, 2000 and LLM, 2001) and the University of Virginia School of Law (LLM, 2009), and is admitted to the Bar in both Japan and New York.

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