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Tax Controversy

Japan
Nagashima Ohno & Tsunematsu

chambers.com

2019

Law and Practice

Contributed by Nagashima Ohno & Tsunematsu

Contents

Nagashima Ohno & Tsunematsu has almost 50 years of experience in dealing with tax matters. Four partners and one counsel are dedicated to tax issues, including one senior partner and three seasoned partners. The firm also has as advisers Mr Mamoru Toba, a former director-general of the Tokyo Regional Taxation Bureau, and Mr Hiroshi Kaneko (not admitted to Bar), the foremost authority on Japanese tax law. Key practice areas are tax advice and planning (for all types of commercial transactions, particularly those involving M&A, financing and capital markets), and tax disputes (including tax audits, administrative appeals and court proceedings).

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1. Tax Controversies

1.1 Tax Controversies in this Jurisdiction

As a procedural legal matter, a tax controversy will arise when and if (i) a formal tax assessment has been issued upon a taxpayer and (ii) the taxpayer initiates the procedure to dispute the assessment, as discussed below. However, because a formal tax assessment is made only if the difference of views between the taxpayer and the tax authority was not resolved in the stage of the preceding tax audit, as a matter of fact and practice, a tax controversy would begin at the tax audit.

1.2 Causes of Tax Controversies

Every type of Japanese tax would give rise to tax controversies. However, in practice, a significant majority is income tax. Among income tax, for sophisticated corporate taxpayers, corporation tax (ie, national corporate income tax) and withholding tax are major ones. Also, for high net worth individuals, individual income tax as well as inheritance and gift taxes are a major source of tax controversies. Tax controversies relating to consumption tax – ie, value-added tax (VAT) – and fixed property tax are also common. While being rare, transactional taxes such as stamp duty and liquor tax may also be litigated.

As to the value, there is no threshold for taxpayers to dispute a tax assessment. Sometimes, aggravated and upset individual taxpayers will dispute even if the amount of tax at stake is very small. However, for sophisticated corporate taxpayers, many will weigh the benefit of disputing against the associated time and costs; so it is not common for such sophisticated corporate taxpayers to dispute the tax assessment if the amount of tax at stake is small. The only exception may be an assessment of heavy penalty tax (along with the principal tax at hand), because an imposition of heavy penalty tax means that the taxpayer committed fabrication or concealment of facts, which is generally viewed among the public as indicating an attitude of non-compliance of the taxpayer. So, especially when the taxpayer is a well-known corporate taxpayer who is conscious of public reputation, it sometimes disputes the assessment of heavy penalty tax no matter what the amount of tax at stake is.

1.3 Avoidance of Tax Controversies

Because a tax controversy arises when there arises a difference of views in tax audits, it logically follows that such difference of views would not arise if the taxpayer had confirmed the view of the tax authority in advance with respect to the tax treatment of a particular transaction. This can formally be made by way of seeking a written formal advance ruling with the tax authority; however, because this formal procedure usually takes three to six months in practice, this is not very popular. Instead, many taxpayers use an informal confirmation with the tax authority on a verbal basis, which is much easier than a written formal advance ruling and, solely as a practical matter, the effect would not be significantly different from a written formal advance ruling; that is, even a verbal confirmation is well reviewed and respected within the tax authority in practice.

It should be noted that even if the taxpayer secures a written formal advance ruling or a verbal informal confirmation, a tax controversy in the tax audit (and then in the administrative and judicial procedures) could still arise, if the tax authority finds that the facts as represented by the taxpayer at the time of the ruling or confirmation turned out to be inaccurate or misleading. A representative case of this kind is the Shionogi case, which is now pending at the court.

Also, in the transfer pricing area, an advance pricing arrangement (APA) is available, in order to avoid the tax controversy relating to an arm's-length price of a controlled transaction.

1.4 Efforts to Combat Tax Avoidance

To date, Japan has implemented the following Base Erosion and Profit Shifting (BEPS) Actions of the Organisation for Economic Co-operation and Development (OECD) by amending its domestic tax law or tax treaties.

- Action 1 – Japan has amended the consumption tax law to impose tax upon digital or electronic services transactions conducted by foreign enterprises having no base in Japan.
- Action 2 – Japan has amended the corporation tax law so that Japan's foreign dividend exemption system does not apply to dividends that are deductible under the local tax law of the jurisdiction of the foreign subsidiary (eg, Brazil), in order to prevent a D/NI (deduction/non-inclusion) outcome.
- Action 3 – Japan has overhauled its current controlled foreign corporation (CFC) regime by amending the income tax law and the corporation tax law by the 2017 annual tax reform, in line with BEPS Action 3, to give more focus upon the substance of the business conducted by the CFC.
- Action 4 – Japan has tightened, by the 2019 annual tax reform, the earnings stripping rules, in response to BEPS Action 4, by including interest payable to third parties (unless the interest is taxed in Japan at the recipient level) and lowering the threshold percentage rate from 50% to 20%.
- Action 5 – in response to BEPS Action 5, Japan has implemented measures to ensure spontaneous exchange of information on tax rulings.
- Action 6 – Japan has incorporated in its tax treaties, particularly with advanced countries (such as the USA, the UK, the Netherlands, Switzerland and Germany), various anti-abuse measures suggested by BEPS Action 6, such as the limitation on benefits (LOB), the principal purpose test (PPT) and the beneficial owner concept.
- Action 7 – Japan has amended the definition of a permanent establishment in the income tax law and the corporation tax law by the 2018 annual tax reform, in response to BEPS Action 7, so as to define more properly an agent permanent establishment to prevent avoidance of an agent permanent establishment through artificial measures.
- Actions 8-10 – Japan has incorporated, by the 2019 annual tax reform, the so-called commensurate with income standard, as well as the discounted cash flow (DCF) method, in order to value so-called hard-to-value intangibles, by amending its transfer pricing regulations, in line with BEPS Actions 8-10.
- Action 13 – Japan has amended its transfer pricing documentation rules to introduce the master file, the country-by-country reporting and the local file, in line with BEPS Action 13.
- Action 15 – Japan has signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and has recently completed the ratification procedures. As a result, the MLI has taken effect on 1 January 2019, first with respect to the existing tax treaties with Israel, the UK, Australia, Sweden, Slovakia, New Zealand, France and Poland.

In any event, as these BEPS measures are relatively new, at present we do not see a meaningful increase or decrease in tax controversies owing to these measures. However, as these measures generate new issues of interpretation, we expect that tax controversies would rather increase in the future.

1.5 Additional Tax Assessments

Under the Japanese legal system, even if a taxpayer disputes a tax assessment, in principle it must first pay the assessed tax. The only exception is a transfer-pricing assessment, where the taxpayer will file an application for a mutual agreement procedure. In that case, upon request, the taxpayer may be given a grace period for the payment until the resolution of the case via the mutual agreement procedure. However, the taxpayer must provide collateral to secure the payment of the assessed tax.

In terms of a type of administrative disposition relating to a tax assessment, when a tax return is filed but the tax authority finds an under-reported tax as a result of the tax audit, a

reassessment (*kohsei*) will be made. When a tax return is not filed at the outset and the tax authority finds any amount of tax due, a determination (*kettei*) will be made. As for withholding tax, a notice of collection (*nozei kokuchi*) will be made. As for taxes that do not require a filing of a tax return (other than withholding tax), an assessment determination (*fuka kettei*) will be made. Another kind of administrative disposition is a tax assessment to reject the taxpayer's request of downward adjustment of the tax amount from that as reported by the originally filed tax return. However, the required procedures to dispute these assessments are substantially the same.

2. Tax Audits

2.1 Main Rules Determining Tax Audits

There is no formal rule under Japanese tax law to determine whether and when a tax audit should be made. It is totally up to the discretion of the tax authority. Having said that, in practice, many corporate taxpayers are audited every three to five years and certain very large corporates are audited every one to two years. It should be noted that the tax authority has launched a 'corporate governance in tax' programme for certain very large corporates, whereby certain highly compliant taxpayers will receive a benefit of prolonging the audit cycle by one year. On the other hand, the tax authority has recently launched a programme to monitor high net worth individuals and if the tax authority determines that he or she needs close scrutiny, a tax audit may be launched, particularly with regard to individual income tax, and inheritance and gift taxes.

2.2 Initiation and Duration of a Tax Audit

There is no formal rule under Japanese tax law that would limit the duration of tax audits. In practice, it varies; some are finished in a few days, whereas, in the case of very large corporates, the audit may last for a few months. Moreover, transfer-pricing audits can last for one or two years, depending upon the circumstances.

Japanese tax law has a statute of limitation of generally five years from the original statutory due date of the return filing (which will be extended to seven years when the issue involves fabrication or concealment of facts). This statute of limitation is not suspended or interrupted by a tax audit; so expiry of the statute of limitation period will prevent a tax audit.

2.3 Location and Procedure of Tax Audits

In practice, in most cases, tax audits are conducted at the premises of the taxpayer. The accounting books and records as well as the minutes of the board of directors and other corporate documents will first be examined in practice. If the taxpayer prepares the accounting books and records in paper form, the paper form will be reviewed and if the taxpayer prepares them electronically then the electronic data will be examined. Moreover, in recent practice, external and internal email communications of the taxpayer are frequently examined, where evidence favourable to the tax authority can often be found.

2.4 Areas of Special Attention in Tax Audits

This varies depending upon the type of tax to be examined. For example, in the case of a corporation tax audit, major issues include (i) timing differences of income recognition and cost deduction, (ii) tax-free reorganisations, (iii) deductibility of officers' remunerations, (iv) whether the deducted payments are non-deductible donations and (v) various international tax regimes (CFC, transfer pricing, etc).

2.5 Impact of Rules Concerning Cross-border Exchanges of Information and Mutual Assistance Between Tax Authorities on Tax Audits

Due to the prevalence of information exchanges, in some audits, particularly those of high net worth individuals, the tax authority had in advance gained sufficient information on the foreign bank accounts of the taxpayer, which presumably were brought to the tax authority by way of the common reporting standard. In addition, there appear to be more tax audit cases where the tax auditors say that the tax authority will request information regarding the relevant foreign jurisdiction by way of an information exchange under the tax treaty and more tax controversy cases where the Japanese government submits as evidence the result of the tax audit conducted by the foreign tax authority pursuant to the request from the Japanese tax authority.

2.6 Strategic Points for Consideration During Tax Audits

If the taxpayer expects that the issue being audited may develop into a tax controversy, it is very important to manage the submissions to be made to the tax authority properly, particularly the external and internal email communications of the taxpayer mentioned above. For example, a situation should be avoided where email communications critically adverse to the position of the taxpayer will be inadvertently brought to the hands of the tax authority. Under Japanese tax law, while the tax authority cannot physically force the taxpayer to submit the requested information and document, it can do so somewhat indirectly, via enforcing criminal penalties where the taxpayer refused to submit the requested information and document while the taxpayer is obliged to do so under law. Under the controlling Supreme Court decision, a taxpayer is obligated to respond to the information and document request of the tax authority, so long as (i) there is an objective necessity to examine the requested information and document in light of the issue being examined, (ii) the necessity outweighs the privacy of the taxpayer and (iii) the discretion of the tax auditor to make such a request is considered reasonable. Taxpayers may want to argue that, for example and where feasible, there is little

necessity to examine the requested email communications in light of the issue being examined, so that it may lawfully avoid the submission.

Because no ADR mechanism is available for tax purposes in Japan and no settlement is allowed in administrative or judicial tax litigation as mentioned later, in practice, the taxpayer and the tax authority will often cut a deal effectively to settle the issue, at the stage of the tax audit. In other words, the tax audit is practically the only stage where an effective settlement can be made. Accordingly, the taxpayer is expected to form a decision, at the tax audit, on whether to try to settle; if not, the taxpayer must continue the tax litigation process mentioned later, spending substantial time and cost, until the final decision or until the taxpayer gives up.

3. Administrative Litigation

3.1 Administrative Claim Phase

A formal notice of tax assessment will be served upon a taxpayer once (i) the tax audit has been concluded, (ii) the taxpayer has made it clear that it will not file an amended tax return to admit the position of the tax authority voluntarily and (iii) the tax authority's internal approval procedures for issuing the tax assessment have been completed. As a legal matter, the tax assessment takes effect upon being served upon the taxpayer and will continue to be effective unless cancelled by the ensuing tax controversy procedure.

In order for the taxpayer's claim to be heard before the court, an administrative procedure is mandatory. That is, within three months of receipt of the formal notice of tax assessment, the taxpayer must file a Request for Reconsideration with the National Tax Tribunal, which is an administrative but quasi-judicial body to review taxpayers' claims. Then, in principle, if the taxpayer's Request for Reconsideration is dismissed by the formal decision of the National Tax Tribunal, the taxpayer can, within six months of the receipt of the decision, initiate a lawsuit to request cancellation of the subject tax assessment with the competent District Court. Alternatively, before filing a Request for Reconsideration with the National Tax Tribunal, where appropriate, the taxpayer may elect to take one additional step of filing a Request for Reinvestigation with the director of the competent Regional Taxation Bureau; however, this Request for Reinvestigation is not very often used in practice in terms of cost-benefit. No filing fees are required for a Request for Reconsideration or a Request for Reinvestigation.

The National Tax Tribunal will review the taxpayer's Request for Reconsideration by designating a panel of administrative judges, consisting of three administrative judges. The administrative judges include attorneys and tax accountants who used to be in private practice, as well as incumbent officials of the tax authority. There, like in a court litigation, the taxpayer and the tax authority will submit and exchange their respective arguments and evidence. Once the panel determines that the review is mature, the National Tax Tribunal will render a decision, dismissing, or entirely or partially admitting, the taxpayer's Request for Reconsideration. The entire process at the National Tax Tribunal will generally take one year.

One of the most important functions of the Request for Reconsideration process from the taxpayer's viewpoint is to gather documentary evidence that was submitted by the tax authority, bearing in mind the future judicial tax litigation. Upon request, the National Tax Tribunal will allow the taxpayer to take copies of the documentary evidence that was submitted by the tax authority. This process is literally indispensable for preparing for the future judicial tax litigation, in order to assess how strong the taxpayer's and the tax authority's arguments are in light of this documentary evidence.

3.2 Deadline for Administrative Claims

As mentioned above, within three months of receipt of the formal notice of tax assessment, the taxpayer must file either a Request for Reconsideration with the National Tax Tribunal or a Request for Reinvestigation with the director of the competent Regional Taxation Bureau. This deadline is absolutely mandatory save for extremely exceptional cases and not complying with the deadline makes the claim be dismissed without considering merits.

If the taxpayer's Request for Reconsideration is entirely or partially dismissed by the decision of the National Tax Tribunal, the taxpayer may, within six months of the receipt of the decision, initiate a lawsuit to request cancellation of the subject tax assessment with the competent District Court. This deadline is also absolutely mandatory save for extremely exceptional cases. Also, even before the decision of the National Tax Tribunal is rendered, the taxpayer can proceed to initiate a lawsuit, so long as three months have passed since the filing of the Request for Reconsideration, thereby effectively bypassing the procedure at the National Tax Tribunal. Such bypassing is often used in practice, where the nature of the issue indicates that it may be difficult to obtain a favourable decision from an administrative body like the National Tax Tribunal.

Unlike judicial tax litigation discussed below, if the taxpayer prevails at the National Tax Tribunal, the tax authority cannot appeal and the decision in favour of the taxpayer will be final. No settlement is available at the National Tax Tribunal.

4. Judicial Litigation: First Instance

4.1 Initiation of Judicial Tax Litigation

Judicial tax litigation is initiated by the taxpayer as petitioner by filing a complaint, against the Japanese government as

respondent, by the deadline discussed above. The complaint will identify the subject tax assessment to be cancelled, and the reasons for the cancellation or the taxpayer's position, and will accompany supporting exhibits as documentary evidence. The taxpayer needs to pay court filing fees (for example, if the amount of tax to be cancelled and refunded is JPY100 million, the court filing fees are around JPY320,000). Once the court has reviewed and approved the formality of the complaint, it will be served upon the respondent.

In Japan, there is no special judicial court for tax litigation, which at the first instance is heard by general District Courts along with other general civil and criminal cases. However, in the case of large cities such as Tokyo and Osaka, there are special divisions for handling administrative law matters and tax litigation will be assigned to one of such administrative law divisions. The administrative law divisions are not special to tax matters but handle other administrative matters such as immigration and social security, but the judges within the administrative law divisions generally are even more familiar with technical tax matters as compared to other general civil divisions. In the case of the Tokyo District Court, there are four administrative law divisions; ie, the 2nd, 3rd, 38th and 51st civil divisions. The taxpayer is not allowed to cherry-pick the division for its case to be assigned to, but the assignment will be made at random pursuant to the predetermined rules within the District Court. In practice, the presiding judge of the administrative law division, generally with 25 to 35 years of experience as a professional judge mainly in the area of administrative law, is regarded as an 'elite' within the Japanese judicial branch. The panel consists of three judges including the presiding judge and two associate judges, each of them is a professional judge (ie, not from the private sector).

4.2 Procedure of Judicial Tax Litigation

The first hearing session will in general be held within a few months from the filing of the complaint. By that time, the respondent should have submitted an answer to the complaint; however, due to the time constraints, it is more common that the answer does not contain substantive arguments regarding the issue of the case. Then, the petitioner and the respondent will exchange briefs and evidence to establish their respective positions and rebut the other party's position. In doing so, the court will, as appropriate, instruct each party to elaborate on a particular point that the court considers important. At the District Court level, in many cases exchanges of briefs will take place four to six times and the hearing sessions will be held accordingly. In some complicated cases, the exchange may be made ten or more times. In practice, the interval of each hearing session is generally two to three months, during which either party having the ball will prepare its brief.

After these exchanges, if the court considers that the review is mature, and if each party has no intention to submit further arguments, the hearing session will be concluded. Then, a court decision will be rendered in a few or several months. Judicial tax litigation is always concluded by a court decision and no settlement is available.

The entire procedure at the District Court level up to the decision will generally take one to two and a half years.

4.3 Relevance of Evidence in Judicial Tax Litigation

In judicial tax litigation, most of the evidence is documentary and it is rare that a witness is called upon, either by the petitioner or by the respondent. This is partly because it is not often that there is a dispute over finding of 'bare' facts (eg, whether someone signed the document), but the key issues in judicial tax litigation are interpretation of tax law as well as how the court should view or characterise the proved facts. From the petitioner's perspective, key documentary evidence should be submitted at the early stage of the litigation; ie, with the complaint or the petitioner's first brief, with a view to persuading the court at the outset of the litigation.

4.4 Burden of Proof in Judicial Tax Litigation

The general rule is that the Japanese government or the respondent will owe the burden of proof to establish that the amount of the assessed tax by the subject tax assessment is correct. However, with respect to a few items such as existence and amount of deductible expenses, the taxpayer or the petitioner will owe the burden of proof. Also, setting aside ordinary reassessments (*kohsei*) or determinations (*kettei*), if the subject tax assessment is the one rejecting the taxpayer's request of downward adjustment of the tax amount from that as reported by the originally filed tax return then the taxpayer will owe the burden of proof to establish that such adjusted tax amount as asserted by the taxpayer is correct.

4.5 Strategic Options in Judicial Tax Litigation

As discussed above, from the petitioner's perspective, key documentary evidence should be submitted at the early stage of the litigation – ie, with the complaint or the petitioner's first brief – with a view to persuading the court at the outset of the litigation. As the litigation progresses, where the petitioner thinks that the counter-argument of the respondent is not clear, it often requests a clarification of that counter-argument through the court and will accordingly rebut such argument.

It often happens that some facts that the petitioner asserts (eg, courses of negotiation and planning of the subject transaction) cannot be supported or established by available documentary evidence. In such case, it is very common in practice that the petitioner will submit as evidence a written statement describing the relevant facts authored and signed by a person involved in and responsible for that matter, instead of calling him or her as a witness. In other words, it is very common in practice to 'substitute' witnesses with such written statements. The court will generally prefer

that approach, as it is more time-efficient and easy to understand for the judges, as such written statements are usually first drafted by the petitioner's counsel, bearing in mind the logical and chronological order of the facts as well as the implication of the facts upon the issue of the case.

Also, as to the matter of interpretation of tax law, it is recent common practice that the petitioner, or in some cases the respondent, will submit an expert opinion of a tax law academic to support its own interpretation of the issue of the case. Petitioners will generally select highly regarded tax academics in the given field of tax law.

4.6 Relevance of Jurisprudence and Guidelines to Judicial Tax Litigation

The Supreme Court, the highest court of Japan, expressly recognises by its decision that the Commentary to the OECD Model Tax Convention can be supplementary measures in interpreting tax treaties. However, it is not very common that Japanese courts refer to the jurisprudence or doctrine formed in a foreign jurisdiction in its decision.

5. Judicial Litigation: Appeals

5.1 System for Appealing Judicial Tax Litigation

If the decision of the District Court entirely or partially dismisses the petitioner's claim, the petitioner is entitled to appeal up to the competent High Court (for example, the Tokyo High Court has corresponding jurisdiction over the Tokyo District Court). The appeal period is two weeks from receipt of the official copy of the decision (which is absolutely mandatory save for extremely exceptional cases); by that deadline, the petitioner must submit a statement of appeal. Then, within 50 days of the submission of the statement of appeal, the petitioner must submit the reasons for appeal, describing the substantive arguments for the appeal. At the High Court level, there is no restriction on the causes of appeal; ie, the High Court is still a trial court and its role is not limited to legal review. The court filing fees for the appeal are one and a half times the amount at the District Court level. Even if the petitioner prevails at the District Court, the Japanese government or the respondent is also entitled to appeal; it is very common for the Japanese government or the respondent to appeal if it lost at the District Court.

Some appeal cases will be concluded at the first hearing session; ie, only with one session. Some will be reviewed by a few or several ensuing hearing sessions. The entire procedure at the High Court level up to the decision will generally take six months to one and a half years.

Unlike the District Court mentioned above, the judges of High Courts are generally not specialists of tax law or administrative law, but tax cases are heard at the general civil divisions along with general civil cases such as contract and tort. The panel consists of three judges including the presiding judge and two associate judges; at High Courts, even associate judges generally have more than ten years' experience. In practice, it is a challenge for the counsel how best to persuade such judges in complicated and technical tax matters.

5.2 Stages in the Tax Appeal Procedure

If the decision of the High Court entirely or partially dismisses the petitioner's appeal, the petitioner is entitled to appeal up to the Supreme Court under certain limited circumstances, within two weeks from receipt of the official copy of the decision (which is absolutely mandatory save for extremely exceptional cases); by that deadline, the petitioner must submit an application for writ of certiorari. Then, within 50 days of the receipt of notice from the Supreme Court (which is absolutely mandatory save for extremely exceptional cases), the petitioner must submit the reasons for application for writ of certiorari, describing the substantive arguments for the appeal. In the context of tax litigation, practically, the appeal is limited to, or writ of certiorari is only granted, where the issue at hand involves an important question of law. As such, the reasons for application for writ of certiorari have to persuade the Supreme Court that there indeed exist important questions of law.

If the Supreme Court decides that the condition is not met then it will dismiss the appeal without considering merits. On the other hand, if the Supreme Court decides otherwise, it will accept the appeal and grant a writ of certiorari, and will enter into substantive review. This review is technically made solely within the Supreme Court and neither party is required to submit arguments or evidence until requested by the Supreme Court; however, in practice, the parties will voluntarily do so to do their own best. As a result of the substantive review, the Supreme Court will render a decision, either dismissing the appeal, reversing the High Court decision and deciding on its own, or reversing the High Court decision and remanding the case to the lower courts. Except for the case of remand, the decision of the Supreme Court will be final.

The entire procedure at the Supreme Court up to the final result will generally take six months to several years.

6. Alternative Dispute Resolution (ADR) Mechanisms

6.1 Mechanisms for Tax-related ADR in this Jurisdiction

No ADR mechanism is available for tax purposes in Japan.

6.2 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests

A written formal advance ruling is available under somewhat narrow circumstances and subject to certain conditions (eg, publication of the ruling in an anonymised form). A written formal advance ruling is not technically legally binding, but it is considered that, under the general principles of good faith and estoppel, the tax authorities are not allowed to issue a tax assessment that is inconsistent with the issued advance ruling, as long as the relevant information provided to the tax authorities in the ruling process remains accurate. For transfer-pricing matters, APAs are commonly used measures to ensure certainty. See also **1.3 Avoidance of Tax Controversies**.

7. Administrative and Criminal Tax Offences

7.1 Interaction of Tax Assessments with Tax Infringements

Procedures for tax assessment and criminal tax cases are separate and independent from each other, and thus, the former procedure would not automatically initiate the latter procedure. A criminal case would be initiated when the criminal investigation division of the tax authorities has become aware of any potential tax crime. The taxation division of the tax authorities shares its information with the criminal investigation division under certain circumstances.

Generally speaking, in practice, a criminal case would be initiated only where the taxpayer wilfully conducted fabrication or concealment of facts or numbers, or wilfully failed to submit tax returns. Application of general anti-avoidance rules (GAAR) or specific anti-avoidance rules (SAAR), or tax assessments arising from a difference of views between the taxpayer and the tax authority, will in general not develop to a criminal case in practice. It is very rare that tax controversy cases of a sophisticated corporate taxpayer will develop to a criminal case.

7.2 Relationship Between Administrative and Criminal Processes

The procedures for tax assessment and criminal tax cases are separate and independent from each other, and there is no legal requirement that one procedure must be suspended while the other procedure is pending. Similarly, once the criminal tax case is initiated, the taxpayer may be indicted and tried at a criminal court, even if he or she voluntarily admits the position of the tax authority, files an amended tax return and pays the assessed tax in full together with penalties.

7.3 Initiation of Administrative Processes and Criminal Cases

A criminal tax case would be initiated when the criminal investigation division of the tax authorities has become aware of any potential tax crime; eg, the fact or suspicion that the taxpayer wilfully conducted fabrication or concealment of facts or numbers, or wilfully failed to submit tax returns.

7.4 Stages of Administrative Processes and Criminal Cases

The criminal investigation division of the tax authorities first conducts its investigation and if it considers that evidences sufficient for the prosecutor's consideration have been collected, it makes a criminal accusation with the prosecutor. The prosecutor will then conduct its investigation and if he or she considers that evidences sufficient for prosecution have been collected, he or she institutes prosecution at the court. The general criminal division of the court will review the criminal tax case, but large District Courts such as Tokyo and Osaka have a specialised criminal tax division. In contrast, the legality of the tax assessment will be reviewed by the general civil division of the court (see **4.1 Initiation of Judicial Tax Litigation**).

7.5 Possibility of Fine Reductions

Upfront payment of the tax assessment could be taken into account by the judge as one of the mitigating factors in determining the amount of fines or the period of imprisonment, but there is no legal system that requires reduction in potential fines or the period of imprisonment in the corresponding criminal case.

7.6 Possibility of Agreements to Prevent Trial

Under a criminal proceeding bargaining system, a prosecutor and a taxpayer can enter into an agreement under which the prosecutor agrees to not institute or to withdraw prosecution of the taxpayer on the condition that the taxpayer provides testimony or evidence or otherwise co-operates with the prosecutor's investigation of a certain crime of another person (but not the taxpayer himself). This system became effective in June 2018 and at this stage the authors are not aware of any cases in which this system was used for tax crime.

7.7 Appeals Against Criminal Tax Decisions

There is only one route to appeal against the decision of the District Court; that is, first to the High Court and then to the Supreme Court. Both the taxpayer (if convicted) and the prosecutor (if the taxpayer was acquitted or the amount of fines or the period of imprisonment sentenced at the first instance was considered insufficient from the prosecutor's perspective) are able to make an appeal to the higher court. The prosecutor's appeal is permitted as not contravening the constitutional principle of prohibition against double jeopardy.

7.8 Rules Challenging Transactions and Operations in this Jurisdiction

Under Japanese tax law, the SAAR, transfer pricing rules and anti-avoidance rules are for tax assessment purposes only and hence, tax assessment under these rules generally would not give rise to criminal tax cases, unless the taxpayer also committed tax evasion or another tax crime. At this stage, Japanese tax law has no GAAR that could be applied without any particular restriction on scope.

8. Cross-border Tax Disputes

8.1 Mechanisms to Deal with Double Taxation

For transfer pricing cases, it is common to use the mutual agreement procedure, if available under the applicable double tax treaty, to avoid the risk of economic double taxation. In fact, Japan had 117 pending mutual agreement procedure cases as of the end of 2017, of which 106 cases (approximately 90%) are on transfer pricing-related matters. For the other cases, it is common to use domestic litigation against any such administrative decision.

8.2 Application of GAAR/SAAR to Cross-border Situations

While the definitions of GAAR and SAAR would vary depending on commentators, Japanese tax law has no GAAR that could be applied without any particular restriction on scope. There are (i) a few targeted anti-avoidance rules (TAAR) that are applicable to certain situations in rather general terms (eg, closely held corporations and corporate reorganisations), and (ii) other more specific SAARs, including the CFC rules that apply in cross-border situations. The validity of the CFC rules was challenged in the past and the Supreme Court held that taxation under the CFC rules does not contravene the applicable double tax treaty.

8.3 Challenges to International Transfer Pricing Adjustments

Generally speaking, taxpayers often prefer to challenge transfer-pricing adjustments via a mutual agreement procedure under the existing double tax treaties mechanism, in order to avoid the economic double taxation. Where a solution through mutual agreement procedures is not available (including where the negotiation under the mutual agreement procedure was not successful), taxpayers would challenge by the domestic tax controversy procedure.

8.4 Unilateral/Bilateral Advance Pricing Agreements

Bilateral APAs are a common mechanism to avoid or mitigate the risks of future tax assessment on transfer pricing matters. Unilateral APAs are also used, for example, where the potential tax risks are considered as rather small, or bilateral APAs are not available in relation to particular jurisdictions. Information on unilateral APAs would be exchanged with relevant jurisdictions under the framework for spontaneous exchange of information in accordance with the BEPS Action 5.

As to the main stages of APA procedures, after conducting preliminary economic analysis of the transaction in question, a taxpayer would normally have preliminary consultation with the tax authorities to discuss the possibility of an APA as well as the agreeable approach for economic analysis. Based on the result of such preliminary consultation, the taxpayer would conduct detailed economic analysis and prepare an application for an APA. After the application is filed with the tax authorities, the application will be first reviewed by the tax authorities and then, where relevant, a mutual agreement procedure between the competent authorities of Japan and the other relevant jurisdiction(s) would commence.

8.5 Litigation Relating to Cross-border Situations

During the past several years, CFC and transfer pricing matters have generated more litigation. There are only a few cases under which existence of a permanent establishment (PE) was litigated at the court.

In order to mitigate the risk of litigation, it would be advisable to seek advice from tax advisers at the planning stage and structure transactions in a manner less susceptible to challenges by the tax authorities. For transfer pricing matters, the use of APAs is a common approach among Japanese taxpayers.

9. Costs/Fees

9.1 Costs/Fees Relating to Administrative Litigation

Aside from actual fees for copying the record, there will be no costs/fees that a taxpayer has to pay to the tax authorities or National Tax Tribunal. See **3.1 Administrative Claim Phase**.

9.2 Judicial Court Fees

A taxpayer has to pay court filing fees by way of revenue stamps at the time of filing its complaint with the District Court. The amount of such fees will be calculated in accordance with certain formula prescribed in the law. For example, where the amount in dispute is JPY100 million, the amount of such fees is JPY320,000.

At the second and third instances (ie, hearing on appeal and hearing on final appeal), the appealing party has to pay the fees when filing its appeal. The amount of such fees at each instance is an amount equal to the amount of fees at the first instance multiplied by one and a half or two respectively.

Where a taxpayer ultimately prevails, it can demand that the Japanese government pay the fees back to the taxpayer, but not the attorneys' fees.

9.3 Indemnities

No such indemnity is available under Japanese tax law. Where a taxpayer suffered damage that was unlawfully inflicted by a public officer intentionally or by negligence, the taxpayer can request indemnity under the State Redress Act. Generally speaking, however, the requirements for such indemnity are rather strict and taxpayers can receive such indemnity in very limited circumstances.

9.4 Costs of Alternative Dispute Resolution

No ADR mechanism is available for tax purposes in Japan.

10. Statistics

10.1 Pending Tax Court Cases

According to the latest statistics published by the National Tax Agency (the NTA Statistics), the total number of tax court cases pending at the end of the FY 2017 (1 April 2017 to 31 March 2018) is 199. The breakdown by each instance is 157 cases at the first instance, 23 cases at the hearing on an appeal and 19 cases at the hearing on final appeal.

Information on the amount of tax in dispute is not available.

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10.2 Cases Relating to Different Taxes

According to the NTA Statistics, the total number of cases that commenced in FY 2017 is 199. The breakdown by the types of taxes is 30 cases on corporate income tax, 54 cases on individual income tax, 14 cases on VAT, 28 cases on property tax and 73 cases on other tax or tax-related matters.

The total number of cases that closed in FY 2017 is 210. The breakdown by the types of taxes is 35 cases on corporate income tax, 67 cases on individual income tax, 4 cases on VAT, 27 cases on property tax and 77 cases on other tax or tax-related matters.

Information on the amount of tax in dispute is not available.

10.3 Parties Succeeding in Litigation

According to the NTA Statistics, taxpayers prevailed in 21 cases (10.0% of the total 210 cases that closed in FY 2017). To be more precise, taxpayers fully prevailed in 11 cases and partially in 10 cases. While this percentage of taxpayers' success in tax litigations may appear to be rather low, the denominator seems to include cases that had slim chances of success at the outset.

11. Strategies

11.1 Strategic Guidelines in Tax Controversies

The importance of taking appropriate actions at each stage of a tax controversy cannot be emphasised enough. At the stage of planning, well-advised tax planning (including making use of an advance ruling or APA, where available and appropriate) would reduce the future risks of challenges by the tax authorities. At the stage of tax audit, while the tax authorities sometimes stick to their own interpretation of tax laws, making an argument based on actual facts and evidences at an early stage would often prevent the tax authorities from issuing a tax assessment. At the same time, flexibility on the side of the taxpayer may be needed to try to settle the case effectively, when the taxpayer's position is not very robust, in light of the time and cost that may be required for the future tax litigation proceedings. At the stage of litigation, effective presentation of complicated tax matters on both factual and legal aspects would increase the chance of success.