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Japanese Tax Authority's Ruling Released: No PE Arising from Registration in Japan as Foreign Company

Yushi Hegawa

Background

The Tokyo Regional Taxation Bureau (the "TRTB") has [released an advance written ruling dated February 22, 2023](#) issued to the requesting taxpayer (which is an Ireland-based IT services provider) (the "**Ruling**"). The Ruling holds that, under the facts presented, no permanent establishment in Japan will arise from an appointment of a representative in Japan of the taxpayer and a registration of the taxpayer as a foreign company under the Companies Act of Japan.

There has been a controversial issue pending among foreign-based IT companies doing business with Japanese customers - whether an appointment of a representative in Japan and a registration as a foreign company will result in having a permanent establishment in Japan for Japanese tax purposes and being subject to the full Japanese income taxation.

This issue arose from an initiative of the Ministry of Justice of Japan around one year ago, which effectively mandated foreign-based IT companies to undergo a registration as a foreign company by appointing a representative in Japan under the Companies Act. The initiative intended that Japanese customers of such foreign-based IT companies could more easily bring claims against them in Japanese courts through such representative in Japan.

However, no tax aspects were taken care of by any Japanese government agencies at that time. That unfortunate situation has prompted us to devise a solution, on which we articulated in our previous newsletter "[Japanese Tax Considerations of Registering "Representative in Japan" of Foreign Company: To Mitigate Permanent Establishment Exposure](#)" (June 2022).

Now, the Ruling sets a final official answer to that issue, in favor of the requesting taxpayer, fully respecting [our devised solution](#).

In securing the Ruling, we acted as tax counsel to the requesting taxpayer, assisting it in all aspects of the Ruling including preparation of the application documents and negotiation with the TRTB.

An unofficial English translation of the Ruling is attached at the bottom of the pdf copy for your ease of reference.

The Ruling

The hallmark of the Ruling is that it holds, under the facts presented, that the representative in Japan of the taxpayer will not constitute an agent PE (under Article 6(5) of the Japan-Ireland Tax Treaty) of the taxpayer.

In accordance with our proposed solution, the taxpayer has entered into a service agreement with an external third-party attorney-at-law in Japan governing the terms of the appointment as a representative in Japan, and thereby has limited the otherwise comprehensive representative authority of the representative in Japan (Section 817(2) of the Companies Act) to accepting service of process of court documents on behalf of the taxpayer.

By doing so, the representative in Japan will have no authority to conclude contracts on behalf of the taxpayer in relation to its business or to otherwise engage in or be involved in its business. Such limitation on the comprehensive representative authority of the representative in Japan should be considered valid as a matter of the Companies Act as between the taxpayer and the representative in Japan.

The Ruling does not fully articulate on the reasoning; however, it is clear that its conclusion is predicated on the construction that such limitation on the comprehensive representative authority of the representative in Japan will be respected for the purpose of finding an agent PE under Japanese tax law and treaties as well.

The Ruling also confirms that the taxpayer will not have a branch PE (under Article 6(1) of the Japan-Ireland Tax Treaty), based on the above service agreement providing that the taxpayer has no authority to use for its own business the premise in which the representative in Japan works to accept the service of process of court documents (i.e., the law office of the attorney). This is in line with the OECD Commentary, which requires that the place be “at its disposal” for such place to constitute a branch PE of a taxpayer.

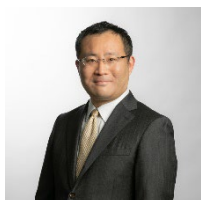
Significance

The Ruling effectively eliminates PE risk concerns associated with the registration as a foreign company, which were a headache for similarly situated foreign-based IT companies. They may wish to rely on the Ruling as a leading precedent and as a safe harbor. At the same time, thanks to the benefit of this Ruling addressing the tax aspects, the initiative of the Ministry of Justice should be more coherent as a whole government’s action.

The Ruling demonstrates that a well-devised planning solution does work here in Japan as well. We, as a leading Japanese tax law counsel in the forefront of practice, are pleased with this outcome, and are committed to contributing to the non-Japanese taxpayers community in securing foreseeability in the tax law enforcement in Japan and achieving optimal results.

[End]

[Author]



Yushi Hegawa (Nagashima Ohno & Tsunematsu Partner)

yushi_hegawa@noandt.com

As a specialist in tax law, Mr. Hegawa advises as tax counsel on the tax law aspects of various corporate, finance and commercial transactions handled by the firm, and represents taxpayers in a number of tax audit and controversy cases. He has particular expertise in tax law matters relating to international transactions or involving unprecedented legal issues, and is committed to providing tax law advice of quality equivalent to that of leading North American and European tax lawyers.

Mr. Hegawa is highly regarded by many prestigious Japanese and foreign publications. He is ranked No. 1 by Nikkei’s Best Performing Lawyers Survey in Taxation in 2021, by both client and peer vote. He is also ranked at Band 1 and its equivalent in the area of Japanese taxation by Chambers Asia-Pacific, Legal 500, and Best Lawyers.

Mr. Hegawa received an LL.B. from the University of Tokyo in 1997 and an LL.M. from Harvard Law School in 2004. From 2004 to 2005, Mr. Hegawa engaged in U.S. federal income tax law practice at Alston & Bird LLP (Washington, D.C.). Mr. Hegawa is admitted to the bar of Japan (1999). He became a partner in 2007.

In the area of tax law academics, Mr. Hegawa served as an Adjunct Professor of Law or Adjunct Associate Professor of Law at Sophia Law School from 2007 through 2017, and currently serves as an Adjunct Professor of Law at The University of Tokyo School of Law. He is a member of the Supervisory Board of the International Fiscal Association (IFA) Headquarters, and is a Chair of the Management Committee of IFA Japan Branch.

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[Unofficial English Translation for Information Purposes Only]

[Ruling]

Ruling Request: As attached below

Date of Ruling: February 22, 2023

Official in Charge of Ruling: Director, Rulings and Legal Affairs Division, Tokyo Regional Taxation Bureau

Body of Ruling: We will not challenge the position described in the Ruling Request, solely based upon the facts presented in the Ruling Request.
We note, however, the following: (1) different tax consequences may arise if the facts were different from those presented in the Ruling Request or new facts were discovered, and (2) this Ruling is the position of the Tokyo Regional Taxation Bureau and is not binding upon the reporting position of the requesting taxpayer.

[Ruling Request]

Re: Whether or not a permanent establishment will be found in the case where a corporation headquartered in the Republic of Ireland appoints a representative in Japan and is registered as a foreign company under the provisions of the Companies Act of Japan and the representative in Japan engages in certain acts in Japan

1. Background and Summary

Our company (the "Company") is a corporation incorporated under the laws of the Republic of Ireland, and is a foreign corporation as defined in Section 2(iv) of the Corporation Tax Act of Japan (the "Corporation Tax Act"). The Company is also a resident as defined in Article 4(1) of the Convention between Ireland and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the "Japan-Ireland Tax Treaty") and thus the Japan-Ireland Tax Treaty applies to the Company.

The Company conducts the business of operating online market places (the "Business"). The Business as conducted by the Company towards customers in Japan would likely fall under a telecommunication business as defined under the Telecommunication Business Act of Japan; accordingly the Company has filed a notification pursuant to Section 16(1) of the Telecommunication Business Act.

The Company has been requested by the Ministry of Justice of Japan to consider if it should appoint a representative in Japan pursuant to Section 817(1) of the Companies Act of Japan (the "Companies Act") and file a commercial registration as a foreign company pursuant to Section 933(1) of the Companies Act. This request was based on the ground that the Company conducts, on a continuous basis, the Business that was the subject of the above notification of a telecommunication business being conducted in Japan and thus the Company would likely satisfy the condition "where a foreign company engages in transactions in Japan on a continuous basis" as provided in Section 817(1) of the Companies Act.

With that background, the Company has entered into a service agreement (the "Service Agreement") with an external attorney-at-law of Japan (the "Attorney"), appointed the Attorney as the representative in Japan of the Company and completed the registration as a foreign company (the "Registration").

Based upon the foregoing facts, the Company hereby seeks an advance ruling as to whether the Japanese tax authority respects the Company's tax position that it will not have a permanent establishment in Japan under the Japan-Ireland Tax Treaty, where the Company has appointed the Attorney as the representative in Japan of the Company and completed the Registration and the Attorney provides the Company with the services pursuant to the Service Agreement.

For this purpose, it is assumed that the Company did not have any permanent establishment in Japan as defined in Article 6(1) of the Japan-Ireland Tax Treaty prior to the Registration and that there is no change to the substance of the Business before and after the Registration.

2. Facts

The Service Agreement entered into between the Company and the Attorney contains the provisions of (1) and (2) below. Pursuant to the Service Agreement, the Attorney shall only have the authority to conduct the acts of (2), and in fact only conducts the acts of (2).

(1) The Company and the Attorney acknowledge and agree to the following:

(a) Based upon the request of the Ministry of Justice of Japan, the Company appoints the Attorney as a representative in Japan and is registered as a foreign company.

(b) The Attorney has never engaged in or otherwise been involved in the operation of the Business to date, and shall not, or shall not be given any authority to, engage in or otherwise be involved in the operation of the Business.

(2) If service of process of court documents where the Company is named as a party has been made to the attention of the Attorney, the Attorney shall notify the Company or its designee of that fact and deliver a copy of such court documents to the Company or its designee (these acts are hereinafter collectively referred to as the "Delivery Affairs").

In addition, the Company has no authority to use, for the Company's business, the premise in which the Attorney performs the Delivery Affairs pursuant to the Service Agreement.

3. Legal Analysis

(1) Law

a. A permanent establishment under Japanese domestic tax law means the ones as enumerated in items (a) through (c) of Section 2(xii-xix) of the Corporation Tax Act. However, if a tax treaty entered into by Japan provides otherwise than such items (a) through (c), in relation to a foreign corporation to which the tax treaty applies, a permanent establishment under Japanese domestic tax law shall be redefined to mean the ones that are defined as a permanent establishment under the tax treaty (proviso of Section 2(xii-xix) of the Corporation Tax Act).

b. The Japan-Ireland Tax Treaty does provide otherwise than items (a) through (c) of Section 2(xii-xix) of the Corporation Tax Act; so whether or not the Company will have a permanent establishment shall be determined based upon the relevant provisions of the Japan-Ireland Tax Treaty.

c. Article 6(1) of the Japan-Ireland Tax Treaty provides "the term 'permanent establishment' means a fixed place of business in which the business of the enterprise is wholly or partly carried on."

d. Article 6(5) of the Japan-Ireland Tax Treaty provides "a person acting in a Contracting State on behalf of an enterprise of the other Contracting State shall be deemed to be a permanent establishment in the first-mentioned Contracting State," if "he has, and habitually exercises in that Contracting State, an authority to

conclude contracts in the name of the enterprise (unless his activities are limited to the purchase of goods or merchandise for the enterprise)” or if “he maintains in that Contracting State a stock of goods or merchandise belonging to the enterprise from which he regularly fills orders on behalf of the enterprise.”

(2) Analysis and Application

a. Assuming, per paragraph 2 above, that the Company has no authority to use, for the Company’s business, the premise in which the Attorney performs the Delivery Affairs pursuant to the Service Agreement, such premise will not constitute “a fixed place of business in which the business of the enterprise is wholly or partly carried on” as referred to in paragraph (1) c. above.

b. With respect to whether the Attorney constitutes a permanent establishment as being a person acting on behalf of the Company as a result of the Attorney being appointed as the representative in Japan of the Company by the Registration, the Attorney will not satisfy the condition that “he has, and habitually exercises in that Contracting State, an authority to conclude contracts in the name of the enterprise” or “he maintains in that Contracting State a stock of goods or merchandise belonging to the enterprise from which he regularly fills orders on behalf of the enterprise” as referred to in paragraph (1) d. above, assuming that, as set forth in paragraph 2 above, the Attorney, pursuant to the Service Agreement, shall not engage in or otherwise be involved in the operation of the Business and shall only have the authority to perform the Delivery Affairs, and in fact the Attorney only performs the Delivery Affairs and does not conduct any other acts.

For the foregoing reasons, the Company will not have a permanent establishment in Japan under Article 6(1) or Article 6(5) of the Japan-Ireland Tax Treaty, where the Company has appointed the Attorney as the representative in Japan of the Company and completed the Registration and the Attorney performs the Delivery Affairs for the Company.

[End]

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NAGASHIMA OHNO & TSUNEMATSU

www.noandt.com

JP Tower, 2-7-2 Marunouchi, Chiyoda-ku, Tokyo 100-7036, Japan
Tel: +81-3-6889-7000 (general) Fax: +81-3-6889-8000 (general) Email: info@noandt.com



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