Tax Reform to Improve Tax Compliance

Recent Developments in Tax Reform

the National Tax Agency (NTA), Japan

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Topics Covered

- Recent Developments in Tax Reform

(Reference)

- Key Tax Rules to Ensure Tax Compliance

□ Recent Developments in Tax Reform

I. Tax Reforms relating to BEPS Action Items
II. Introduction of Reporting System in accordance with Common Reporting Standard (CRS) of Automatic Exchange of Information
III. Introduction of Foreign Asset Reporting (FAR) System
IV. Introduction of the Social Security and Tax Number System

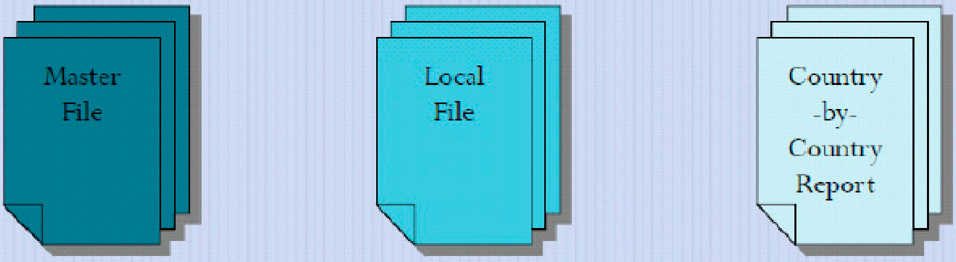
Recent Developments in Tax Reform

I. Tax Reforms relating to BEPS Action Items

- Action 13: Establishment of a reporting system concerning information on multinational companies, etc. (FY2016 Tax Reform)
- Action 1: Revision of consumption taxation on cross-border supplies of services (FY2015 Tax Reform).
- Action 2: Revision of foreign dividend exclusion system (FY2015 Tax Reform).

Recent Developments in Tax Reform

I. Tax Reforms relating to BEPS Action Items: Action 13



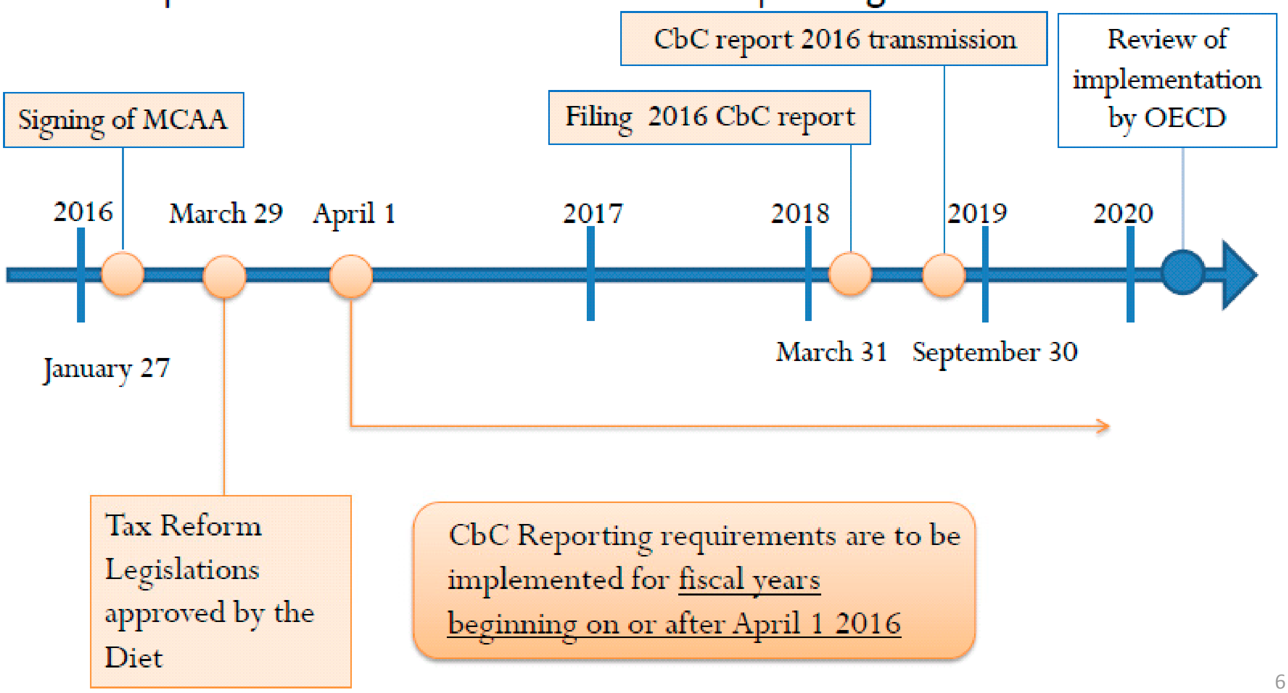
- Overview of the MNE group business
- More detailed information relating to specific intercompany transactions
- Aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, etc.

Contents of revised TP documentation reflects effort to balance tax administration information needs, concern about inappropriate use of information and compliance cost/burdens imposed on businesses

Recent Developments in Tax Reform

I. Tax Reforms relating to BEPS Action Items: Action 13

- Implementation Schedule of CbC Reporting



Recent Developments in Tax Reform

II. Introduction of Reporting System in accordance with CRS of Automatic Exchange of Information

- Introduce a reporting system to obligate financial institutions to submit non-residents account information to tax offices.
- New provisions in the domestic law to implement the provisions of tax conventions (approved by National Diet on March 31, 2015).
- Applicable to transactions entered on and after January 1, 2017.
- The NTA expects to exchange collected data between other tax authorities through Tax Treaty channels in 2018.

Recent Developments in Tax Reform

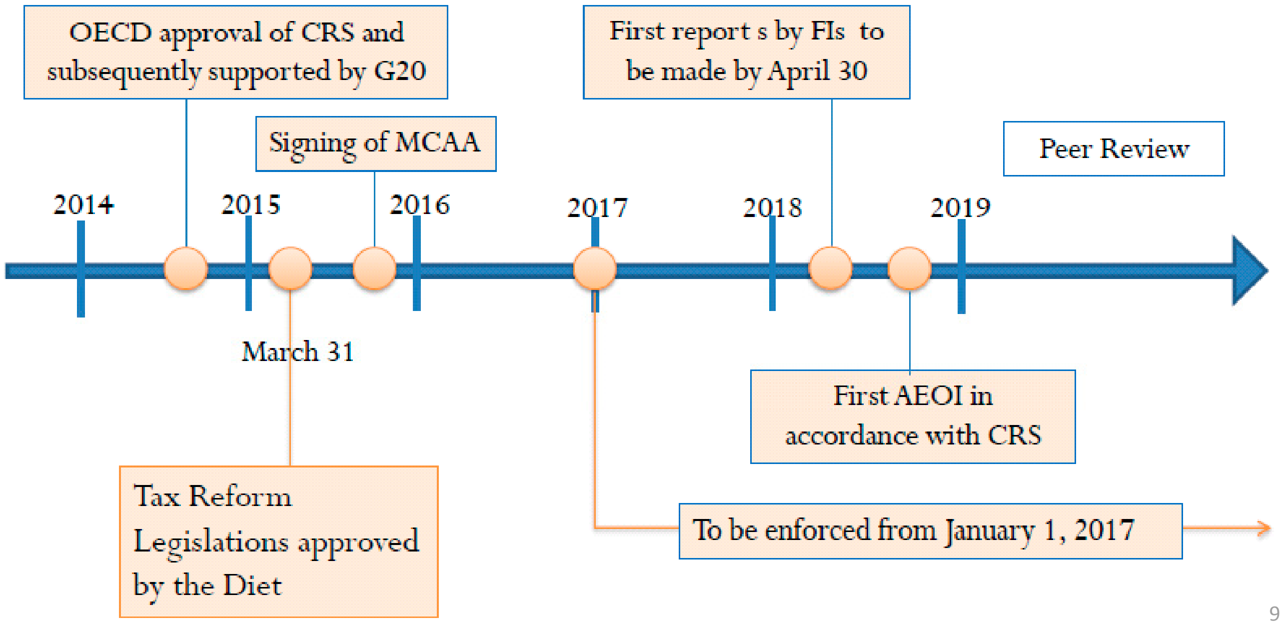
II. Introduction of Reporting System in accordance CRS of Automatic Exchange of Information (Cont.)

- Submission of a statement by taxpayers to financial institutions (FIs):
  - ✓ Name, address, date of birth, state of residence, TIN, etc.
- Identification by FIs of resident states of taxpayers
- Information reporting by FIs to tax offices
  - ✓ Value of the assets in relevant accounts
  - ✓ Annual income earned from the assets in the accounts
- Penalties for non-compliance

Recent Developments in Tax Reform

II. Introduction of Reporting System in accordance with CRS of Automatic Exchange of Information (Cont.)

- Implementation Schedule of CRS



Recent Developments in Tax Reform

III. Introduction of FAR System

- Enforced from January 1, 2014 as a measure to require taxpayers themselves to declare their assets held overseas in order to secure proper taxation of income tax and inheritance tax on them.
- Requirement to disclose all foreign assets, including but not limited to financial assets, when the total value exceeds 50 million yen.
- Additional taxes on underreported income will be assessed depending on whether or not FAR statements are submitted.
- Penalties for non-compliance.
- By matching the data of CRS and those of FAR, the NTA could have better picture of assets held abroad.

Recent Developments in Tax Reform

III. Introduction FAR System (Cont.)

	CRS	FAR
Enforcement	First exchange in 2018	From 2014 onward
Reporter	Financial institutions	Residents with foreign assets of more than about $500,000
Object	Financial accounts held by non-residents	Foreign assets held by residents
Information Content	Account balance, annual interest, dividends, etc.	All foreign assets - type, quantity, value and place
Submission method	Electronic	Paper or electronic

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III. Introduction of FAR System (Cont.)

- Outline of FAR Submission in 2014 and 2015

	2014		2015		% change
The number of submissions	5,539		8,184		47.8
Types of Assets	Value (Billion JPY)	Share (%)	Value (Billion JPY)	Share (%)	
Securities	1,560	62.1	1,685	54.1	
Deposits	377	15.0	540	17.3	
Buildings	185	7.4	284	9.1	
Land	82	3.3	116	3.7	
Loans	69	2.8	107	3.4	
Others	239	9.5	383	12.4	
Total	2,514	100.0	3,115	100.0	23.9

Recent Developments in Tax Reform

III. Introduction of FAR System (Cont.)

- In comparison with 2014, 2015 records 47.8% increase in the number of submissions and 23.9% increase in the value of reported assets.
- Positive implication of enhanced awareness and compliance among taxpayers.

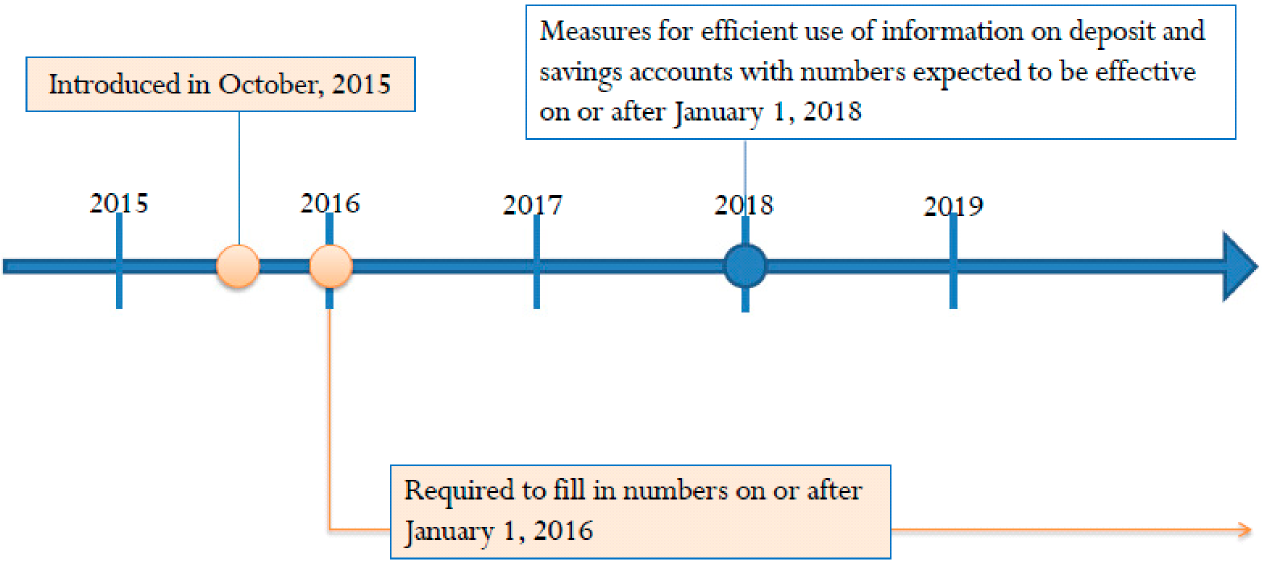
Recent Developments in Tax Reform

IV. Introduction of the Social Security and Tax Number System

- Introduced from October 2015 and effective from January 2016.
- Numbers will be required on documents such as declaration form and statutory statements.
- Expects that name-based aggregation of statutory statements and matching with declaration form will become more accurate and efficient, and, in turn, income will be recognized more accurately.

Recent Developments in Tax Reform

- Implementation Schedule of the Social Security and Tax Number System



☐ Key Tax Rules to Ensure Tax Compliance

I. Tax Examination and Statute of Limitation

II. Penalties

III. Data and Information Collection

IV. Criminal Investigation

V. Program to Enhance Corporate Governance

Key Tax Rules to Ensure Tax Compliance

I. Tax Examination and Statute of Limitation:

- Examination procedure is regulated by the Act on General Rules for National Taxes.
- In order to promote proper and fair taxation under self-assessment system, the NTA may conduct tax examinations and make any necessary adjustments within the following statute of limitations:

Type of Case	Statute of Limitation
Regular case	5 years
Fraud case	7 years
Excess loss adjustment case*	9 years
Transfer Pricing case*	6 years

* Corporation tax purposes only. Statue of limitation of a excess loss adjustment case is to be extended to 10 years for loss that arises in the business years starting on or after April 1, 2017.

Key Tax Rules to Ensure Tax Compliance

II. Penalties:

- To encourage taxpayers to properly file tax returns and pay taxes, delinquent tax may be imposed in addition to originally payable national taxes, if tax returns are not properly filed or taxes are not paid by the due date.
- There are also cases where an additional tax for a deficient return, or for no return, or an additional tax for fraud are imposed.

Key Tax Rules to Ensure Tax Compliance

II. Penalties (Cont.):

(In the case of 2015)

		Regular case	Fraudulent concealment case
Additional Tax	Returns are filed by the due date, but tax amount is understated.	Additional tax for deficient returns (10% or 15%)	Additional tax for fraud case (35%)
	Returns are not filed by the due date	Additional tax for no return (15% or 20%)	Additional tax for fraud case (40%)

Delinquent Tax	Up to two months from the day after the due date for tax payment	Annual rate of 2.8% (Special Standard Rate*+1.0%)
	Starting on the date two months from the day after the due date for tax payment	Annual rate of 9.1% (Special Standard Rate*+7.3%)

* "Special Standard Rate" is a rate announced by the Minister of Finance by December 15 of the previous year as the rate obtained by dividing the total amount of average contractual interest rates on bank short-term loan of each month from October of the second preceding year to September of the previous year by 12, plus 1 % per annum.

Key Tax Rules to Ensure Tax Compliance

III. Data and Information Collection:

- The NTA, through every occasion, collects a variety of information such off-the-books and fake transactions as found in the course of tax examinations, in addition to the withholding records of employment income, payment records of dividend, etc under mandatory submission rules.
- The NTA uses such information for accurate guidance as well as tax examinations.

Key Tax Rules to Ensure Tax Compliance

IV. Criminal Investigation:

- Criminal Investigation procedure is regulated by the National Tax Violations Control Act.
- Criminal investigation pursues criminal responsibility of malicious tax evaders and aims to contribute both to realizing proper and fair taxation and to maintaining the self-assessment system through the effect of "punishing one to serve as a warning to all".
- Criminal Penalty (maximum): 10 years imprisonment and/or 1,000 million yen fine

Key Tax Rules to Ensure Tax Compliance

IV. Criminal Investigation (Cont.):

- To this end, the NTA, apart from general tax examination, not only imposes correct taxes on taxpayers who intentionally evade taxes through fraudulent acts or other offenses, but also investigates them with the exercise of compulsory authority, which is equivalent to normal criminal investigation.
- Based on the investigation results, the NTA files accusations to prosecutors and seeks for the institution of prosecution.

Key Tax Rules to Ensure Tax Compliance

V. Program to Enhance Corporate Governance:

- The NTA has been implementing a program to enhance corporate governance to ensure tax compliance for more than three years.
- The process of the program includes:
  - ✓ dialogue with corporate executives
  - ✓ evaluation on corporate governance made by tax auditors during tax audits
  - ✓ feedback to corporate top management
- Corporations with robust governance agreeing to disclose risky transactions will be audited less frequently in the future.

Key Tax Rules to Ensure Tax Compliance

V. Program to Enhance Corporate Governance:

From 2012 onward, some corporations with robust corporate governance which voluntarily disclose high risk transactions such as business restructuring or those Incurring extraordinary losses are audited less frequently.

Year 1 Field audit

Year X Field audit

Year Y Field audit

Extension of an audit interval when the above disclosure is confirmed and review of tax filing does not bring any problem.

The program aims at:

- reducing compliance burden on corporations, and
- focusing resources of tax administration on less compliant corporations