A Japanese Response to the OECD's Base Erosion and Profit Shifting Project

Focusing on its Status as a Jurisdiction Without a Statutory GAAR Provision

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I. Japanese Perspective and Reactions to the BEPS Recommendations

1. Background Situation

Japan is an aging country, and is expected to undergo a more drastic decrease in population in the coming decades. This situation has pushed Japanese multi-national enterprises (MNEs) to focus on the foreign market rather than the domestic one, and now the majority of their new investments are out-bound. High domestic production costs (including taxes) are another reason for them to shift their production bases to foreign countries. In addition, Japan's geographic location has helped them to gain access to promising emerging economies in Asia, such as China, the ASEAN countries, and India. Thus, Japanese MNEs, which were already exporting a variety of consumer goods and technology products to the US and EU mar-

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kets, have started marketing to foreign clients in Asia. Through those activities, they have expanded their subsidiaries' networks worldwide so that their supply chain could be managed more effectively. Under such circumstances, the volume of foreign direct outbound investment has been more than ten times the inbound volume. At the same time, from foreign investors' perspective, Japan has gradually lost its attractiveness as an economic hub in the region. Many foreign MNEs have shifted their regional centers from Tōkyō to other cities such as Singapore, Hong Kong, and Bangkok, where tax policies are more investor-friendly than in Japan.[1]

2. International Tax Policy in Japan

These situations have forced the government to concentrate its international tax policy on outbound investments. The main objective is to secure double taxation relief for domestic taxpayers and to protect its right to tax the domestic source income generated by foreign investors as well as the world-wide income of resident taxpayers. Thus, in addition to the foreign tax credit system and the exemption of foreign subsidiaries' dividends, Japan has developed a variety of targeted anti-avoidance rules (TAARs)[2] to secure its proper revenue. For example, there has been legislation on transfer pricing, controlled foreign corporations (CFC), and thin capitalization, all of which is in accordance with the OECD standard. This legislation has a long history in protecting the tax base from activities shifting profit outwards as conducted by any business. Furthermore, recently the government has also addressed the effective rate of corporate income tax in order to stop so-called corporate inversion arrangements.[3] However, a General Anti-Avoidance Rule (GAAR) has not yet been introduced for domestic and international tax avoidance schemes.

Under these circumstances, the recommendations of the Base Erosion and Profit Shifting (BEPS) project, which are prescribed to stop double non-taxation caused by aggressive tax avoidance schemes, have encouraged the government to go forward with a drastic reform of its international tax policy. In the past three years, many fundamental changes have been intro-

1 Their corporate tax rates are low, and they usually provide foreign investors with tax holiday-style treatment.

2 For the purpose of domestic taxation, the majority of the TAARs have been legislated into the income tax, corporate tax and inheritance tax codes, such as realization of income through free transactions between corporations and their employees, limitation of directors' salaries, assumed-gift taxation when a contribution to a non-profit organization gives any specific benefit to a person related to the donor, etc.

3 Japan has gradually cut its national corporate income tax rate from 37.5% (1990) to 23.2% (2018).

duced to the ongoing rules, such as rules on transfer pricing, CFC rules, and interest deductibility rules.

One of these measures, the Principal Purpose Test (PPT) included in the MLI,[4] is considered to be a treaty version of a GAAR, and has attracted special attention among academics and practitioners. To supporters of introducing a domestic GAAR statute into tax codes, it looks like a good occasion to test its administrability,[5] while opponents are still skeptical about its administrative effectiveness.[6] These debates will be discussed further in sections II and III.

In the next section, I will briefly present the administration's efforts to battle tax avoidance and then describe the recent main tax law reforms that reflect the BEPS recommendations.

3. *Administration Efforts to Fight Against the International Tax Avoidance Scheme*

Without a GAAR in tax codes, the National Tax Agency (NTA) has been struggling in its fight against a variety of sophisticated tax avoidance schemes, which circumvent the current international tax rules.[7] Under these circumstances, the NTA has sometimes tried to make assessments by interpreting tax codes in reference to their original objectives or restructuring any legal form of taxpayer transaction in accordance with its economic substance. However, in Japan, it is rare for the legislature's objective to be clearly expressed during Diet debates, so judges sometimes have difficulties in identifying which side is more persuasive in such disputes. Thus, those assessments have frequently faced court decisions which favored taxpayers' arguments that were in line with the statutory interpretation of tax legislation.[8]

4 This MLI (Multinational Instrument) is officially known as the "Convention to Implement Measures to Prevent BEPS," Ministry of Finance website, Japan

5 For example, see S. MORINOBU, BEPS and Response to Tax Avoidance – Japan Should Introduce a General Anti-Avoidance Rule (GAAR) –, in: Ministry of Finance (ed.), Financial Review, No. 126 (2016) 5.

6 It seems that the majority of academics are against the introduction of a GAAR, for example, S. TANIGUCHI, *Sozei kaihi-ron* [The Theory on Tax Avoidance] (Tōkyō 2014).

7 The Diet usually accepts proposals for new targeted anti-avoidance rules when the Tax Bureau of the Ministry of Finance, a tax policy department in charge of drafting the annual tax law reform, provides enough proof of the necessity of their introduction. But there is usually a substantial time lag, which enables the original scheme-makers or marketers to retrieve large untaxed excess profits.

8 One good example was the *Takefuji* case, Supreme Court, 18 February 2011, Hanrei Jihō 2111, 3, where the Supreme Court judges approved the taxpayer's argument regarding whether he was a Japanese resident, based upon the interpretation of "residence." The Japanese Civil Code defines it as a center of living, so the decision

However, the NTA has not been simply defensive.[9] It usually has information on what kind of effect the relevant arrangements have on BEPS and on how large the scale of tax loss potentiality is. It has asked the legislature to make more sources of information available. In this decade, some new obligations for disclosure of taxpayer data have been introduced or strengthened.[10] Based upon those new data, the NTA drafted and disclosed a "Total Plan for an International Taxation Strategy"[11] and has concentrated its professional resources on the fight against international tax avoidance.

4. *Major Items of Recent International Tax Law Reforms*

Listed below are the major reforms to international tax policy based upon or in reference to the BEPS project. Most of them are expected to address specific and sophisticated tax avoidance schemes, so they are basically categorized as TAARs.

a) *Limitation of Deductibility on Excessive Interest Payments*

In 2012, Japan introduced a new restriction on the deductibility of excessive net interest payment in addition to the thin capitalization rule.[12] In introducing the system, the Ministry of Finance explained its objectives: "with a view to preventing tax avoidance planned by excessive interest payments, the amount of net interest paid to affiliated persons exceeding 50% of adjusted income is not deducted in the financial year."[13] Here Japan was referring to the US anti-earnings-stripping regime, which employed the threshold of 50%. However, this legislation was approved well before the BEPS final report, so in December 2018 the government proposed further reform to comply with the BEPS recommendations.[14]

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said that the transplanted concepts from the Civil Code should be interpreted in just the same manner as the original code, regardless of whether a change of residence is motivated by tax avoidance purposes.

9 Popular incidents such as the "Panama Papers" and "Paradise Papers" have pushed them to move forward.

10 Disclosure of remittance of money, disclosure of foreign assets, disclosure of balance sheets of rich individual taxpayers, etc. In addition, based upon a Global Forum agreement, automatic exchange of information on bank deposits started in 2018.

11 It was announced in 2016 and has been revised repeatedly. It focuses on rich taxpayers' outbound transaction avoidance schemes as well as MNEs' tax planning.

12 The thin capitalization rule was introduced in 1992. The two systems work together simultaneously, but only the larger amount calculated can be applied as a limitation measure.

13 Ministry of Finance website, *https://www.mof.go.jp/english/tax_policy/tax_reform/index.html*.

b) Application of the Attribution Principle to the Income Allocated to PEs

Japan[14] has had an entire income principle for the allocation of domestic source income to permanent establishments (PEs) in domestic legislation. However, in its treaties, Japan adopted the attribution principle for PEs, so the entire income approach prevailed only between non-treaty jurisdictions. In 2014, Japan changed domestic law towards the attribution principle when the G20/OECD studied some models of how to implement the attribution principle for the global value chain operation. At that moment, commissionaire arrangements were at the center of interest not only for developed countries but also for developing countries. The administration faced some important cases [15] concerning disputes about whether commissionaires or multi-functional warehouses at issue constituted PEs and, if so, how much profit should be attributed to them. The guidance from the BEPS reports offered helpful instruction in interpreting the attribution principle for current business models. Thus, the 2014 reform fully reflected the OECD standard and could welcome the substantial fruits that the BEPS projects added to it. At the same time, since the legislature was concerned about the abuse of that principle in such a manner that taxpayers minimized their tax burden, they added a SAAR (Specific Anti-Avoidance Rule) clause in the statutes.[16]

c) Transfer Pricing and CFC Rules

Domestic TAARs in these categories were also reformed in a coordinated way with the BEPS recommendation.

As for transfer pricing, country-by-country reporting (2016) and valuation of hard-to-value intangibles (2019 proposal) are major reforms, and as for CFC rules, the rules based on an entity approach with the incorporation of an income approach (2017) are a fundamental reform. All of them follow BEPS recommendations, but the compliance burden for businesses has been addressed effectively.

d) Treaty

The biggest event was the conclusion of the Multilateral Instrument on BEPS. Japan welcomes the Principal Purpose Test (PPT) rule as a general

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14 In this proposal, the net interest payment includes third party interest, and adjusted income excludes exempted dividends received, and the threshold is changed from 50% to 20%; all of these changes are in accordance with the BEPS recommendations.

15 For example, *Adobe* case, Tōkyō High Court, Zeishi 256 (2008) 11061, for allocation of profit to commissionaire arrangements

16 There were strong arguments against the addition of a SAAR clause; see M. NAKAZATO, *Saikin no kokusai kazei seido no nagare* [Recent Trends in International Taxation Systems], Jurisuto 1468 (2014) 12.

anti-treaty-shopping measure. But before the MLI, Japan had already adopted the PPT tests on certain types of income in several bilateral treaties and the general PPT test on all income in other treaties,[17] most of which have been recently reformed.

In short, the PPT has been identified as an exceptional anti-avoidance measure for Japanese jurisprudence, with similar characteristics to a GAAR. So far, there is little experience of its application.

II. The Japanese Legislative and Judicial Interpretative History of the Fight Against Tax Avoidance Schemes

1. *Historical Developments in Japanese Anti-Avoidance Statutes*

a) *SAARs' history in Japan*[18]

Japan has had a long history of the application of the specific anti-avoidance rule (SAAR)[19] focused on family corporations. In 1923, tax codes imported it on behalf of individual income tax, corporate income tax and inheritance tax, on the grounds that taxpayers frequently tried to minimize their tax burden by taking advantage of manipulable transactions with their family corporations. Since more than 95% of corporate taxpayers are still categorized as family corporations in Japan, the NTA was focusing on how to implement that rule when it fought against the profit shifting schemes planned by family corporate owners. Thus, this rule also served as a pilot function for the later domestic legislation of many TAARs.[20]

In 2001 and 2002, Japan introduced taxation rules on corporate reorganization and a consolidated tax filing system. This time, the legislature was careful about possible tax avoidance schemes, which might also be used by big listed corporations. The same SAARs as those used in the family corpora-

17 Partial application with the UK, France, and Australia, and general application with Germany, Portugal, etc. In the early 2000s, Japan started to include Limitation on Benefit (LOB) clauses for treaty shopping, but with European partners, PPT rather than LOB prevailed.

18 For the outlook for Japanese anti-avoidance rules, see T. OKAMURA, The Japanese Tax System: Due Process and the Taxpayer, International Tax and Business Law 1993, 134.

19 In this article, an anti-avoidance rule that denies or restructures any transaction of taxpayers under specific circumstances if it constitutes improper tax avoidance is referred to as a SAAR.

20 When a certain type of tax-avoidance case, in which the family corporation rule is successfully applied, has accumulated in the administration, the legislature is willing to accept a proposal for a new TAAR which establishes targeted taxing conditions for it.

tion rule were incorporated into corporate income tax law to address abusive tax planning on restructuring and consolidated filing, followed by the aforementioned rule on the attribution of profit to the permanent establishment. Thus, currently we have four SAARs in total, but still do not have a GAAR.

b) *Government proposal of GAAR in 1962*

The government missed one chance to introduce a GAAR in 1962. This story was one of the most memorable events in the history of Japanese tax legislation.[21] When the government proposed the introduction of the General Law of National Taxes,[22] the Tax Commission which is a policy advisory council to the Prime Minister, advised him to include a GAAR[23] in its statutes. By the time the issue was about to be brought to the Diet the opponents had gained wide public support. At that moment, the NTA's active field examinations and tax assessments thereby caused many disputes, mainly concerning whether these actions were within the boundaries of legitimate discretion in accordance with tax codes. On some occasions, the administration stuck to economic substance rather than legal form in order to maintain equity between taxpayers; however, the public was skeptical about the legitimacy of such assessments. Predictability, or legal certainty, should be assured by the concrete description of taxable conditions in the statute, and it was considered to be an essential requirement of Article 84 of the Japanese Constitution, which declares statute-based taxation.[24] In the end, the government gave up on including the GAAR in that new law. The main reason for the GAAR's unpopularity at that moment was that people did not welcome the discretionary powers which the GAAR might have provided for tax authorities.[25] Most academics also supported clear and ex ante rules for any anti-avoidance statute.

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21 T. HONJO, Trends in Tax Avoidance Provisions and Doctrines in Japan, Bulletin for International Taxation 61.9 (2007) 432.

22 It deals with common measures that are applied to all national taxes.

23 The proposed GAAR was a general anti-avoidance provision based on economic substance.

24 It says that no new taxes shall be imposed and no existing ones modified except by law or under such conditions as law may prescribe.

25 In the 1960s and 1970s, tax administrations sometimes faced resistance, especially from small and medium-sized taxpayers, when tax examiners executed field audits and delivered presumptive taxation assessments. The condition for making use of this authority is that when examiners request the taxpayer to provide records, books, and copies thereof, the taxpayer does not provide the relevant materials in a timely fashion. But there have been cases in which taxpayers' compliance level was so behind "substantial materials" or "in a timely fashion" that they could not rebut such assessments effectively.

c) *Incremental reforms of anti-avoidance legislation*

After this incident, Japan welcomed decades of dramatic economic growth, during which its tax policy powerfully supported business activities, both on domestic and international markets. For the international arena, providing some special reserves on foreign investment or alternatively a flexible foreign tax credit system altogether stimulated active investment abroad. However, when it faced a stabilized growth period from the mid-1970s onward, the government also started to focus on the tax loss that might be generated by new sophisticated tax planning. During this period, which lasted through the rest of the 20th century, there were many important tax law reforms within the TAAR category, such as the introduction of CFC (1977), transfer pricing (1986), and present value appreciation rules on derivative transactions (2000).

In addition, in the 21st century, Japanese corporate tax law introduced a business restructuring regime (2001) and a consolidated tax filing system (2002) each with a SAAR provision, and thus the two-tier anti-tax avoidance regime (TAAR+SAAR) has been developed so widely that it has provided a kind of stability in implementing modern tax compliance from both authorities' and taxpayers' perspectives.[26] However, at the same time, many countries have accepted GAARs as effective measures to stop tax avoidance.

It was against such a background that we experienced the global financial crisis in 2008, and then the BEPS project started in 2012.

In my view, it can be reasonably concluded that Japanese anti-avoidance legislation, which is equipped with a rich network of SAARs and TAARs, has so far worked effectively. But in the modern economy, its ex post functions will face bigger challenges in the future. I will go into this discussion in Part III, but, before those analyses I want to present the judicial interpretation of statutes in some popular tax avoidance cases.

2. *Court Cases which Addressed Tax Avoidance Schemes*

a) *General observations*

Anti-tax avoidance legislation has been reformed incrementally in order to be adapted for newly developed schemes of modern businesses. But if we check court cases carefully, we find that when undecided issues have been brought to court, judges have sometimes tried to interpret the current tax codes at issue in accordance with their objectives or purposes and sometimes allowed the same

26 Before and just after the start of the BEPS project, many in Japan publically considered BEPS to be a special project for a battle against aggressive foreign tax-saving companies that took advantage of insufficient domestic rules and treaties, which was not the case with Japanese business.

outcome as if a GAAR were applied. This has actually deviated from the aforementioned popular "strict and literal interpretation approach." Thus, we should analyze some famous court cases and identify whether there is any judicial doctrine in them. I would like to pick up three cases for discussion.

b) Input tax credit case[27]

A carpenter received an examiner's field audit to check the availability of input tax credits for value-added tax (VAT). The Consumption Tax Act[28], which regulates VAT in Japan, requires the taxpayer to produce his accounting records on input taxable transactions in order to get such credits.[29] He failed to produce them to the examiner at that moment, which triggered the tax assessment to deny the availability of tax credit. At the last stage of the dispute at court, he finally produced the necessary reports; however, the Supreme Court judges decided against him, because they considered that even though the taxpayer had fulfilled the statutory threshold for input credit by keeping account books and their receipts, those documents should have been prepared in a manner that would have enabled him to produce those materials to tax examiners on a timely basis. According to this decision, the "keeping documents" requirement was interpreted in a narrow way that required taxpayers' preparation and timely disclosure to examiners, based upon the interpretation of objectives of such statutes.[30] Thus, the taxpayer's disclosure in a later stage of dispute does not constitute the qualified disclosure that Article 30 of the Consumption Tax Law requests from taxpayers. I think the tax statute needs a clearer delineation of procedures on this matter, especially when the VAT rate is expected to rise in late 2019. In any event, this first case represents one example of judicial interpretation dealing with the problem of non-compliant taxpayers, where judges focused on the legislature's objectives regarding the statute rather than its strict and literal interpretation.

c) Foreign tax credit case[31]

A Singapore branch office of a Japanese commercial bank entered into so-called back-to-back loan arrangements with two foreign investment institutions located in the Cook Islands (one of them was to raise and receive the funds from investors, the other was to manage the fund, and both of them were subsidiaries of a New Zealand corporation). Both investment corpora-

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27 Supreme Court, 16 December 2004, Minshū 58, 2458.

28 *Shōhi-zei-hō,* Law No. 108/1988.

29 We call this system the "accounting method" rather than "invoice method" in the EU.

30 See the case comment by N. IWASHINA, Jurisuto, Special Issue 228 (2016) 174.

31 Supreme Court, 19 December 2005, Minshū 59, 2964.

tions wanted to minimize the Cook Islands' burden of withholding tax on their revenue.[32] The Japanese bank was at that moment in an excess limitation position for foreign tax credit purposes. Thus, it considered the unused part of tax credit allowance could be effectively used for such intermediary financial services. Namely, the bank (the cash lender) received interest from the management company after the Cook Islands authorities collected the withholding tax (15%), while it paid interest on the bank account to the other fund company, which deposited cash to the bank. Fortunately, because Singapore's tax system is territorial, there was no withholding tax on the outbound interest payment. As is common in the banking business, the spread of the two interest rates was positive, but the cash flow for that bank during the transaction was negative (loss-making) because of the withheld tax on received interest. However, when the bank used the accumulated foreign tax credit limitation, the final cash flow would be positive. The bank applied the foreign tax credit in this case and wanted to draw back cash from the treasury, and the NTA denied this application.

The Supreme Court held that the taxpayer had abused the foreign tax credit system in a way that completely went against the original purpose of the statute. It clarified that the purpose of the statute was to prevent international double taxation on the same income which is earned by taxpayers themselves, and to maintain neutrality between domestic and international investment by businesses. Then it concluded that the taxpayer's arrangements at issue were economically equivalent to the deal that gives tax benefits to foreign investors (genuine beneficiaries of relevant income) at the cost of Japanese taxpayers' overall contribution.

According to the widely accepted commentary on this decision, the judges delivered a narrow interpretation based upon reference to the purpose of the system rather than statutory interpretation. Professor Kaneko commented that the foreign tax credit system is a special favor for international traders in calculating tax burdens from a specific tax policy perspective, so in interpreting those statutes that reduce tax liability, lawyers should apply a narrow interpretation with reference to its objective.[33] This second case is also an interesting judicial approach to countering tax avoidance.

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32 The originator corporation located in New Zealand set up operating subsidiaries in the Cook Islands because of the no corporate tax status guaranteed by the local authorities. One corporation collected money from investors, and the other invested it in Eurobonds. The only concern from this operation was that if the return on investment was transferred to the other corporation, it must owe the 15% withholding tax levied by the local authority.

33 H. KANEKO, *Sozei-hō* [Tax Law] (22nd ed., Tōkyō 2017) 131. He explains that this form of interpretation followed the US court decision in *Gregory v. Helvering* (the business purpose doctrine).

Most academics seems to support this decision, but there are still some questions about how to identify the intent of the legislature and about the range of application of this principle (abuse of law) in the future.[34] The Supreme Court did not disclose any substantial information which proved the original objectives of such statutes, perhaps because it was judged to be self-evident. However, as pointed out earlier, the objectives of specific tax statutes are usually difficult to identify by reference to the legislative documents. So I do not think that the Court will apply this abuse of law doctrine in order to interpret a wide range of statutes, even if they are categorized as rules that lower the tax burden for specific taxpayers or specific transactions.

d) Business restructuring case[35]

This case concerns the conditions for a tax-free acquisition and merger planned between two information technology giants. Both companies wanted to streamline their business, and they agreed to formulate a joint-venture-style operation. An acquired company, X, had a huge net operating loss, and if there were no counter profit in the future, it would lose big tax benefits thereof because of the statute of limitations. Under these circumstances, X divided its business in half and set up a subsidiary, X1, for joint venture purposes. An acquiring company, Y, bought all shares of X1 from X, and then merged X1. The first transaction, which reformed X1 as a 100% subsidiary of Y, produced substantial capital gains for X, which were used to offset a part of X's net operating loss, and Y treated the second transaction as a qualified merger on the grounds that the two companies were now in a 100% parent-subsidiary relationship and fulfilled all required legal conditions for a qualified restructuring.

Japanese corporate tax law allows tax-free mergers (no capital gains taxation on entities and their shareholders, carryover of the net operating loss to the merging company) if the merger is realized between parent and subsidiary companies under certain conditions. To be qualified, the new business should be substantially identical to the old business by reference to certain factors, or any board member of either one of the companies should take a high-ranking seat on the merging company's board. In this case, the latter issue was disputed. Before this merger, Y's CEO was appointed a vice chairman of X1 based upon the agreement; thus, Y insisted that it was a qualified merger with the effect of carrying over the net operating loss to Y.[36] The NTA invoked the SAAR and denied Y's claim.

34 See the case comment by T. OKAMURA, Jurisuto, Special Issue 228 (2016) 38.

35 Supreme Court, 28 February 2016, Minshū 70, 470.

36 Y's request on its tax return was (1) no capital gains taxation on this merger for Y or any involved taxpayers, (2) carryover of X1's unused net operating loss to Y.

The Supreme Court decision pointed out that the SAAR clause in the statutes of corporate restructuring is designed to prevent taxpayers from improperly reducing their tax burden by the application of the statutes, and "improperly reduce" means taxpayers' abusive application of the statutes, which seem to literally allow exemptions or deferral privileges, etc. In judging whether or not it is abusive, both objective and subjective tests should be undertaken. The former test is to examine whether the taxpayers' options of restructuring are abnormal, and whether they are form over substance. The latter test examines whether or not there is a reasonable business purpose.

In this case, the judges considered the CEO's short (three months) period of appointment as a vice-chairman of the acquired X1 and his almost entire lack of contribution to its management, etc. to be proof of abuse. They did not constitute normal conduct or conduct for business purposes, and Y did not prove the continuity of its old business.

This third case was an example of judicial interpretation of a newly introduced SAAR. In this case, the judges focused on the principle that even if taxpayers fulfil objective requirements written down in the specific statutes, each SAAR still could be invoked against any abusive activities.

e) *Interim summary*

There could be disagreement about these interpretations. Academics who stick to the rule-of-law principle might insist that if there is an exemption clause within the statutes, then taxpayers who follow these objective instructions should be protected from further intervention by the SAAR. However, the NTA has not taken that position and the courts have supported administrations. It is understood that SAARs are a sort of backstop for any type of avoidance. As pointed out earlier, Japan has accumulated a number of cases in which judges interpreted the SAARs' requirements for family corporations. Given that every SAAR has a similar formulation of its requirement, such as "if the taxpayers' option causes an improper reduction of the tax burden," judges have appeared to take common views of their interpretation. The core principle has been that (1) any SAAR can be invoked, regardless of whether the other objective conditions for a specific exemption are fulfilled, and, (2) to reach a conclusion, two tests should be done: an objective test of whether the transactions at issue are abnormal, and a subjective test of whether there is economic reasonableness for the taxpayer's choice. In addition, we found that judges are not necessarily reluctant to employ purposive interpretation to some cases.

Those findings showed us that in the absence of a GAAR, judicial interpretation has made up for Japanese anti-avoidance legislation to some extent, but there is still a substantial loophole open for sophisticated schemes.

III. Effects of BEPS Recommendations on Japanese Anti-avoidance Rules

1. New Environments

Japanese government statistics[37]currently reveal some important indications that MNEs might have tried to expand their international investment through conduit entities located in tax-favorable jurisdictions. For example, for stocks, Singapore, Hong Kong and the Cayman Islands are listed in higher positions as direct investment destinations than Germany. As for destinations of portfolio investment from Japan, the Cayman Islands, the Netherlands and Luxembourg are listed among the top 10, as is the US. It is easily assumed that those jurisdictions might have been performing a conduit function for international investment, since the size of each jurisdiction's GDP is not sufficient to support the domestic use of those funds. If so, the facts indicate there is an increasing BEPS risk to Japan.

If that is the case, Japan has to strengthen its international tax regime further by adhering to the BEPS proposals as soon as possible.

2. BEPS Effects

The legislature has been well aware of such situations and, as explained earlier, tax reform in every recent year has included several TAAR-style international anti-avoidance regimes in accordance with the BEPS recommendations. The addition to the domestic PE rules (2018) clearly addressed the risk of BEPS. If taxpayers intentionally divide one contract into two with a principal purpose of circumventing the PE qualification for building sites, then the terms of the two contracts should be put together. Although it is applied to specific transactions and a PPT clause constitutes a part of the conditions (thus categorized as a TAAR), the involvement of the PPT can be evaluated as one step forward towards a GAAR.

3. Future Issues

As of 1 January 2019, the PPT in the MLI has come into effect for some Japanese treaties. I think we will face two challenges during its early implementation stage.

Firstly, taxpayers will require intensive practical guidance on PPT with the NTA, because real cases include both business purpose and tax motives, which surely puts taxpayers in unstable positions. Thus, the guidance should

37 Ministry of Economy, Trade and Industry, White Paper on International Trade 2018 (Tōkyō 2018).

include helpful examples of exempted situations and of the reasonableness of procedures of the administrations' assessment, etc.[38] In this context, experiences of the PPT in EU countries might be helpful. Taking the Japanese history of anti-avoidance rules mentioned above into account, taxpayers may want the transparency of the procedure to be ensured. For example, an advisory council composed of tax professionals could be an option.

Secondly, when cases are brought to courts, judges have to interpret the PPT article in the MLI in order to check the legitimacy of the assessments. Without precedent, both parties may make reference to foreign cases. And those foreign cases may have reflected the interpretation of a domestic GAAR.[39] Thus, I think that, in a sense, disputes present a kind of trial for the availability of a GAAR, which might lay the groundwork for a second proposal of GAAR legislation in the future.

The above analyses are based upon the smooth coordination of global tax policy; however, international tax fora are still struggling with policy coordination on how to tax the digital economy. With unilateralism on temporary measures spreading globally, I am concerned that the well-accepted consensus on the PPT might be affected to some extent. The Inclusive Framework on BEPS is expected to produce coordinated prescriptions on this matter soon.

SUMMARY

This article is a summary of the Japanese discussion about the country's international tax policy which the author presented to the Symposium. In Part 1 of this article, the author analyzes the background of the Japanese domestic legislative initiative for an anti-avoidance regime before and after the publication of the OECD's Base Erosion and Profit Shifting (BEPS) project. As the effective rate of Japanese corporate income tax had been high compared with the average of the OECD countries, the BEPS risk is now perceived to be crucial to the Japanese economy. Thus, revisions to tax policy in recent years are a genuine reflection of the OECD's recommendations, which include the Principal Pur-

38 OECD Model Tax Convention (2017 version) Article 29's commentary raises thirteen examples, and nine of them are exempted cases. However, most of those results look rather self-evident.

39 Foreign countries' tax policy on GAAR has been discussed among Japanese academics actively, such as by TANIGUCHI on Germany, *supra* note 6, T. IMAMURA'S article on G8 countries and AOYAMA'S article on emerging economies, in: Ministry of Finance (ed.), Financial Review No. 126 (2016) 17 and 47 respectively.

pose Test (PPT)[40] *for cases of treaty abuse. However, as the PPT's function in ignoring or restructuring taxpayers' transactions can be assumed to be equivalent to that of a domestic General Anti-Avoidance Rule (GAAR),*[41] *it may look like a new measure in the Japanese tax law statutes to address abusive tax schemes. Then, in Part 2, the author turns to the legislative and judicial interpretative history of the fight against tax avoidance schemes in Japan, focusing on the statutory Specific Anti-Avoidance Rules (SAARs).*

Finally, based upon these analyses, the author addresses some issues which are relevant to the implementation of BEPS recommendations, mainly concerning the PPT, and concludes with comments on the possibility of introducing a domestic GAAR in the future.

ZUSAMMENFASSUNG

Der vorliegende Beitrag fasst die japanische Diskussion über die internationale Steuerpolitik des Landes zusammen, die der Verfasser auf dem Symposium vorgestellt hat. Der erste Teil des Beitrags befasst sich mit dem Hintergrund der japanischen Gesetzesinitiative für eine Regelung zur Bekämpfung von Steuerumgehung sowohl vor als auch nach der Veröffentlichung des Base Erosion and Profit Shifting (BEPS)-Projekts der OECD. Da der effektive Satz der japanischen Körperschaftsteuer im Vergleich zum Durchschnitt der OECD-Länder bislang hoch war, wird das BEPS-Risiko inzwischen als äußerst wichtig für die japanische Wirtschaft eingestuft. So spiegeln die Änderungen der japanischen Steuerpolitik in den letzten Jahren die Empfehlungen der OECD wider, die eine Regelung zur Prüfung des Hauptzwecks (Principal Purpose Test, PPT) für die Fälle eines Missbrauchs der internationalen Abkommen vorsehen. Da man davon ausgehen kann, dass die Funktion des PPT, missbräuchliche Gestaltungen der Steuerschuldner zu ignorieren oder umzustrukturieren, derjenigen einer inländischen allgemeinen Vorschrift zur Verhinderung von missbräuchlichen Gestaltungen (GAAR) entspricht, kann man die PPT-Regelung als eine neue Maßnahme der japanischen Steuergesetzgebung qualifizieren, die auf missbräuchliche Praktiken zur Steuerumgehung zielt.

Der zweite Teil des Beitrags beschäftigt sich mit der gesetzgeberischen und gerichtlichen Auslegungsgeschichte des Kampfes gegen Steuerumgehung in

40 The PPT was incorporated into the Multilateral Instrument (MLI) which Japan signed in 2017, for which it deposited the instrument of acceptance in 2018, and which will enter into force in 2019.

41 In this article, an anti-avoidance provision through which the legislature delegates a broad power to tax authorities to deny or prohibit tax avoidance is referred to as a GAAR.

Japan und konzentriert sich dabei auf die spezifischen Vorschriften zur Bekämpfung von Steuerumgehung (SAARs).

Abschließend wird auf der Grundlage dieser Analysen auf einige Fragen eingegangen, die für die Umsetzung der BEPS-Empfehlungen relevant sind, vor allem in Bezug auf die PPT-Regelung. Der Beitrag schließt mit Überlegungen zur Möglichkeit der zukünftigen Einführung eines inländischen GAAR.

(Die Redaktion)