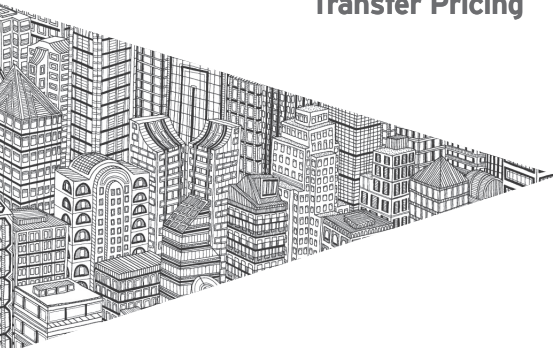


International Tax Alert

News and views from
Transfer Pricing



Japan's proposed 2011 tax reform follows revision of OECD transfer pricing guidelines

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On 16 December 2010, Japan's Tax Commission of the Cabinet Office released its tax reform proposal for 2011. The proposal includes a section specifically addressing transfer pricing, which is intended to provide greater clarity to multinational corporations on their transfer pricing in Japan. The proposal is currently under review at the National Tax Agency and may be adopted in phases starting as early as April 2011.

Three specific changes relating to transfer pricing are to be included in the tax reform package:

- ▶ **Elimination of Japan's hierarchy of transfer pricing methods:** the hierarchy is to be replaced with a "most appropriate method" analysis;
- ▶ **Amplification of the use of the arm's length range and the appropriate central measure:** the role of a range (rather than a single point) in determining the arm's length standard is to be confirmed, although the definition of the term range is not addressed. Further, where actual results fall outside the range, the proposed reforms authorize the use of a value other than the simple average of the data points constituting the full range in calculating the arm's length result if that alternative value is considered to be a more reliable measure than the average; and
- ▶ **Clarification of the use of secret comparables** (comparable data obtained from audits of third parties engaging in similar transactions): the specific situations in which secret comparables can be used are to be more clearly explained. When secret comparables are used, the authorities are to disclose as much non-confidential information as possible, while still maintaining third party confidentiality.

No specific details are discussed in the proposal package. However, these proposals are described as being based on the 2010 revision to the OECD transfer pricing guidelines.

In addition to these changes, the reforms will formalize the use of variations of the profit split method (i.e., the comparable, contribution,

and residual profit split methods) by clarifying them in the tax regulations. The proposed changes will also specify how arbitration will operate under Japan's tax treaties. Other, unspecified revisions to Japan's transfer pricing rules also are planned in order to bring the rules in-line with the revised OECD transfer pricing guidelines.

If these proposed reforms are passed, multinationals should have greater flexibility in managing their transfer pricing in Japan and should be able to pursue a more consistent global transfer pricing policy as Japanese transfer pricing rules move closer to the OECD standard.

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