Japan's DTA Strategy and its Implications to Developing Countries

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Table of Contents

- Role of DTA
- DTA strategy: basics JP and DC perspectives
- New initiatives
 - Growing focus on global approach (EOI, CRS)
 - Increasing importance of MAP/APA/Arbitration (BEPS)
 - DTA with potential investment partners
- DTA as part of basic economic infrastructure
- Balancing revenue and investment promotion

Role of DTA

- Eliminate double taxation
- Promote FDI
 - Offer lower taxes ⇔ tax incentives?
 - Avoid inadvertent excessive taxation (gross vs. net)
 - Provide legal certainty and predictability
 - Signaling effect
- Fight international tax evasion/avoidance (BEPS)
 - Avoid double no-taxation
 - Deter abusive use of [domestic laws/ DTA]
 - Avoid hosting BEPS (EOI, CRS)

JP DTA Strategy

- Basic DTA strategy
 - Actual needs based assessment
 - DTA follow investment flows
- Growing focus on global approaches
 - EOI network
 - BEPS focus (increasing importance of MAP)
 - Arbitration
- Preventing treaty abuse (LOB/PPT)

"Potential" investment partners?

Actual needs based assessment

- What can be done without DTA?
- What requires DTA?
- What needs to be avoided in concluding DTA?

• NB:

- Resource constraints in negotiating DTA
- Capacity constraints in negotiating DTA
- Multilateral instruments?

What can be done without DTA

- Unilateral measures by Residence country
 - Double taxation relief
 - Foreign tax credit (FTC) / exemption (territorial)
 - Limitation:
 - High source taxation (not really "double" taxation)
 - Indirect FTC (parent-subsidiary threshold)
- Unilateral measures by Source country
 - Align PE definition to international norm
 - Lower source taxation so that it does not exceed residence country taxation

What requires DTA

- Ensuring elimination of double taxation
 - Mutual Agreement Procedures (MAP)
 - Transfer pricing (corresponding adjustment)
 - Resolving differences in definitions, etc.
- Country-specific (targeted) measures
 - lowering source taxation only for selective countries
 - Adjusting FTC creditability
- Establishing trust in the tax system
 - Stability and predictability
 - Signaling effect
 - Exchange of information (EOI), assistance in collection

Pitfalls to avoid

- Trying to conclude as many DTAs as possible, hoping that more DTAs will result in more FDI
 - DTAs are like traffic lights: essential infrastructure for safe and smooth flow of traffic, but putting lights in the wilderness would not invite traffic there.
- Concluding a very unfavorable DTA with a country, without understanding the cost
 - Damages not limited to that particular DTA
 - The weakest link of DTA network matters

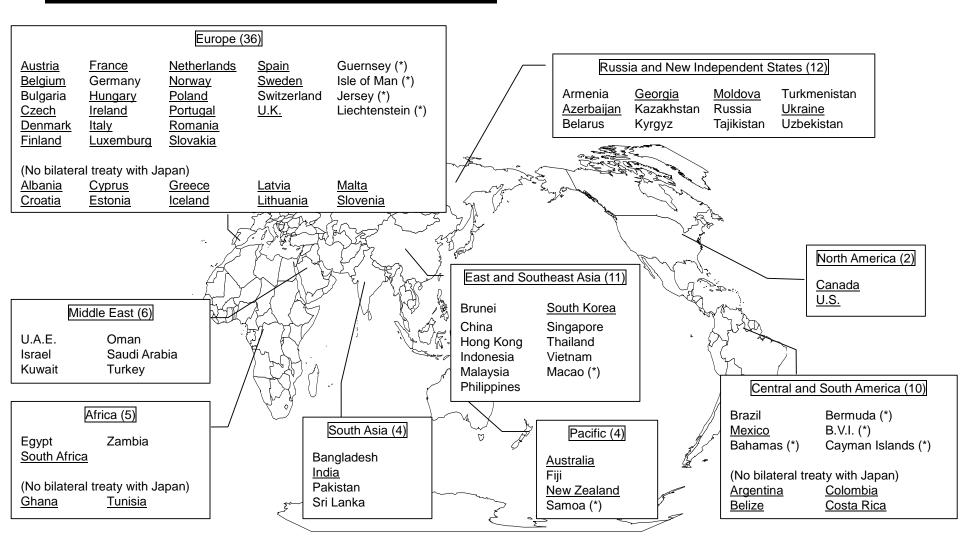
Countries likely to benefit from DTA

- Countries with strong economic ties between them
 - Large FDI flows require DTA; opposite some doubts
- Countries seeking appropriate taxation of investment in natural resources
- Countries in need to win trust from foreign investors
 - DTA may help, but it alone cannot address the issue

Countries wanting to invite investment?

Japan's Tax Convention Network

《64 conventions, applicable to 90 jurisdictions; as of April 1, 2015》



- (Note 1) Since the Convention on Mutual Administrative Assistance in Tax Matters is a multilateral treaty, and the tax conventions with the former Soviet Union and with the former state of Czechoslovakia were succeeded by more than one jurisdiction, the numbers of jurisdictions do not correspond to those of tax conventions.

 (Note 2) The breakdown of the numbers of conventions and jurisdictions is as follows:
- Tax conventions for the avoidance of double taxation and the prevention of fiscal evasion; 53 conventions and 64 jurisdictions Tax information exchange agreements; 10 conventions and 10 jurisdictions (These jurisdictions are marked with (*) above) Convention on Mutual Administrative Assistance in Tax Matters; 47 jurisdictions (These jurisdictions are underlined above).

JP DTA Strategy: Recent developments

- Growing focus on global approach
 - Effective EOI network
 - EOI under DTA
 - TIEA
 - Multilateral convention
 - CRS
 - BEPS
 - Increasing importance of MAP/APA/Arbitration
- Promotion of investment flows even without the need for double taxation relief
 - Middle East
- Potential investment partners?

Status of Commitments to AEOI New Standard

As at 6 March 2015

FIRST EXCHANGE BY 2017		FIRST EXCHANGE BY 2018		NOT INDICATED A TIMELINE NOT YET COMMITTED
Anguilla	Italy	Albania	Singapore	Bahrain
Argentina	Jersey	Andorra	Sint Maarten	Cook Islands
Barbados	Korea	Antigua and Barbuda	Switzerland	Nauru
Belgium	Latvia	Aruba	Turkey	Panama
Bermuda	Liechtenstein	Australia	United Arab Emirates	Vanuatu
British Virgin Islands	Lithuania	Austria		
Bulgaria	Luxembourg	The Bahamas		
Cayman Islands	Malta	Belize		
Chile	Mauritius	Brazil		
Colombia	Mexico	Brunei Darussalam		
Croatia	Montserrat	Canada		
Curaçao	Netherlands	China		
Cyprus	Niue	Costa Rica		
Czech Republic	Norway	Grenada		
Denmark	Poland	Hong Kong (China)		
Dominica	Portugal	Indonesia		
Estonia	Romania	Israel		
Faroe Islands	San Marino	Japan		
Finland	Seychelles	Marshall Islands		
France	Slovak Republic	Macao (China)		
Germany	Slovenia	Malaysia		
Gibraltar	South Africa	Monaco		
Greece	Spain	New Zealand		
Greenland	Sweden	Qatar		
Guernsey	Trinidad and Tobago	Russia		
Hungary	Turks and Caicos Islands	Saint Kitts and Nevis		
Iceland	United Kingdom	Samoa		
India	Uruguay	Saint Lucia		
Ireland		Saint Vincent and the Grenadines		
Isle of Man	[58 jurisdictions]	Saudi Arabia	[35 jurisdictions]	[5 jurisdictions]

^{*} The United States has indicated that it will be undertaking automatic information exchanges pursuant to FATCA from 2015.

Increasing importance of MAP

- DTA itself does not resolve double taxation
- However, some MAP cases left unresolved
 - Difficult balancing of taxing right and elimination of double taxation
 - Challenges for CAs to concede
 - Costly for CA and taxpayers

- APA to avoid future disputes
- Arbitration to ensure no unresolved MAP case

Evolution of MAP Arbitration

- Jan. 2007: "Improving the Resolution of Tax Treaty Disputes" (OECD/CFA)
- Jul. 2008: Amendment of OECD Model
 - Art.25 (5)
 - Sample Mutual Agreement on Arbitration
- Nov. 2011: Amendment of UN Model

2015: BEPS Action 14?

MAP Arbitration

- Supplement to MAP under Art.25
 - Not an independent judicial dispute resolution
- Facilitate MAP settlement
 - Mandatory arbitration may provide CAs with more incentive to arrive at negotiated settlements
 - Closing older MAP cases to avoid arbitration
 - "No actual arbitration" is the best case scenario

Preventing treaty abuse (LOB/PPT)

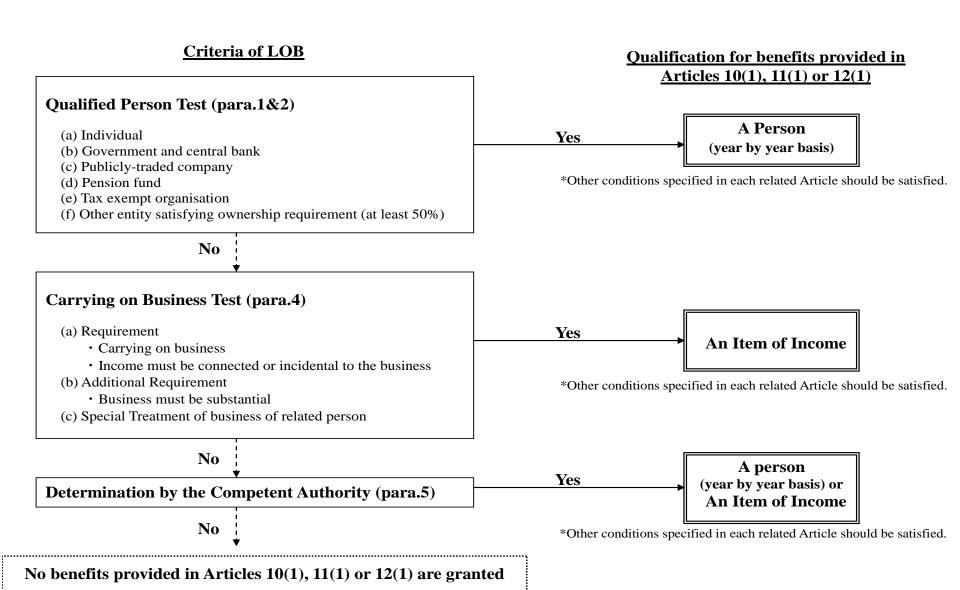
LOB

- Balancing risk of abuse and cost of anti-avoidance
- LOB only when exemption (current JP approach)

Do all DC need LOB?

- LOB/PPT require implementation capacity
- LOB arguably easier to administer than PPT
- Should be able to punish most abusive case to make an example for others
- Better to avoid potential loopholes in DTA

JP LOB structure



Expanding DTA network: "Potential" investment partners

- DTA as part of basic economic infrastructure
 - Other non-DTA factors are being in place, incl.:
 - Macroeconomic stability
 - Effective legal system (rule of law, courts, etc.)
 - Structural reforms to promote market economy
 - Admin. capacity to implement DTA procedures
- Strong political will to invite investment
- Diplomatic relationship

DTA as an economic infrastructure

- Legal stability and predictability
- Credible evidence of strong political will to maintain pro-investment policy
- Admin. procedures (MAP) to ensure elimination of double taxation
 - "Actual" elimination of double taxation requires MAP, which requires DTA
- Admin procedures to avoid being (perceived as) a center of international tax evasion/avoidance
 - Effective EOI
 - Assistance in collection
 - Measures to avoid treaty-shopping (LOB/PPT)

What about revenue?: Balancing revenue and FDI promotion

- Source taxation conundrum
 - Revenue mobilization: the more, the better?
 - FDI promotion: the less, the better?
- Consistency and predictability
 - Signaling (will to abide by international norm)
 - Lessor gap to be exploited
 - Tax planning is costly for business and government
- BEPS added complexity, but cannot ignore
 - Distinguish anti-abuse from more source taxation

New international taxation norm?

- Source taxation on active business, residence based worldwide taxation on passive income
 - Definition of active business (PE, CFC, etc.)
- CEN, CIN, CON: limited use as actual guidance
- Case for moderate source taxation on investment income
 - Withholding tax is very strong/effective compliance tool

Thank you