

Japan's DTA Strategy and its Implications to Developing Countries

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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》

Europe (36)

<u>Austria</u>	<u>France</u>	<u>Netherlands</u>	<u>Spain</u>	<u>Guernsey (*)</u>
<u>Belgium</u>	<u>Germany</u>	<u>Norway</u>	<u>Sweden</u>	<u>Isle of Man (*)</u>
<u>Bulgaria</u>	<u>Hungary</u>	<u>Poland</u>	<u>Switzerland</u>	<u>Jersey (*)</u>
<u>Czech</u>	<u>Ireland</u>	<u>Portugal</u>	<u>U.K.</u>	<u>Liechtenstein (*)</u>
<u>Denmark</u>	<u>Italy</u>	<u>Romania</u>		
<u>Finland</u>	<u>Luxemburg</u>	<u>Slovakia</u>		

(No bilateral treaty with Japan)

<u>Albania</u>	<u>Cyprus</u>	<u>Greece</u>	<u>Latvia</u>	<u>Malta</u>
<u>Croatia</u>	<u>Estonia</u>	<u>Iceland</u>	<u>Lithuania</u>	<u>Slovenia</u>

Russia and New Independent States (12)

<u>Armenia</u>	<u>Georgia</u>	<u>Moldova</u>	<u>Turkmenistan</u>
<u>Azerbaijan</u>	<u>Kazakhstan</u>	<u>Russia</u>	<u>Ukraine</u>
<u>Belarus</u>	<u>Kyrgyz</u>	<u>Tajikistan</u>	<u>Uzbekistan</u>

Middle East (6)

<u>U.A.E.</u>	<u>Oman</u>
<u>Israel</u>	<u>Saudi Arabia</u>
<u>Kuwait</u>	<u>Turkey</u>

North America (2)

<u>Canada</u>
<u>U.S.</u>

East and Southeast Asia (11)

<u>Brunei</u>	<u>South Korea</u>
<u>China</u>	<u>Singapore</u>
<u>Hong Kong</u>	<u>Thailand</u>
<u>Indonesia</u>	<u>Vietnam</u>
<u>Malaysia</u>	<u>Macao (*)</u>
<u>Philippines</u>	

Central and South America (10)

<u>Brazil</u>	<u>Bermuda (*)</u>
<u>Mexico</u>	<u>B.V.I. (*)</u>
<u>Bahamas (*)</u>	<u>Cayman Islands (*)</u>

(No bilateral treaty with Japan)

<u>Argentina</u>	<u>Colombia</u>
<u>Belize</u>	<u>Costa Rica</u>

Africa (5)

<u>Egypt</u>	<u>Zambia</u>
<u>South Africa</u>	

(No bilateral treaty with Japan)

<u>Ghana</u>	<u>Tunisia</u>
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South Asia (4)

<u>Bangladesh</u>
<u>India</u>
<u>Pakistan</u>
<u>Sri Lanka</u>

Pacific (4)

<u>Australia</u>
<u>Fiji</u>
<u>New Zealand</u>
<u>Samoa (*)</u>

(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 Argentina Barbados Belgium Bermuda British Virgin Islands Bulgaria Cayman Islands Chile Colombia Croatia Curaçao Cyprus Czech Republic Denmark Dominica Estonia Faroe Islands Finland France Germany Gibraltar Greece Greenland Guernsey Hungary Iceland India Ireland Isle of Man	Italy Jersey Korea Latvia Liechtenstein Lithuania Luxembourg Malta Mauritius Mexico Montserrat Netherlands Niue Norway Poland Portugal Romania San Marino Seychelles Slovak Republic Slovenia South Africa Spain Sweden Trinidad and Tobago Turks and Caicos Islands United Kingdom Uruguay [58 jurisdictions]	Albania Andorra Antigua and Barbuda Aruba Australia Austria The Bahamas Belize Brazil Brunei Darussalam Canada China Costa Rica Grenada Hong Kong (China) Indonesia Israel Japan Marshall Islands Macao (China) Malaysia Monaco New Zealand Qatar Russia Saint Kitts and Nevis Samoa Saint Lucia Saint Vincent and the Grenadines Saudi Arabia	Singapore Sint Maarten Switzerland Turkey United Arab Emirates	Bahrain Cook Islands Nauru Panama Vanuatu
			[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

Criteria of LOB

Qualified Person Test (para.1&2)

- (a) Individual
- (b) Government and central bank
- (c) Publicly-traded company
- (d) Pension fund
- (e) Tax exempt organisation
- (f) Other entity satisfying ownership requirement (at least 50%)

No

Carrying on Business Test (para.4)

- (a) Requirement
 - Carrying on business
 - Income must be connected or incidental to the business
- (b) Additional Requirement
 - Business must be substantial
- (c) Special Treatment of business of related person

No

Determination by the Competent Authority (para.5)

No

Qualification for benefits provided in Articles 10(1), 11(1) or 12(1)

A Person
(year by year basis)

Yes

*Other conditions specified in each related Article should be satisfied.

An Item of Income

Yes

*Other conditions specified in each related Article should be satisfied.

A person
(year by year basis) or
An Item of Income

Yes

*Other conditions specified in each related Article should be satisfied.

No benefits provided in Articles 10(1), 11(1) or 12(1) are granted

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