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Transfer Pricing Chat: Harumi Yamada of Grant Thornton Taiyo Tax

By Kazuhiko Shimizu2022-08-03T04:55:42000-04:00

Japanese companies and their overseas subsidiaries have reaped a surprising bounty over the course of the pandemic, as sales and profits boomed. That has raised concerns companies could face heightened scrutiny from the Japan National Tax Agency.

Bloomberg Tax spoke with Harumi Yamada, transfer pricing team leader at Grant Thornton Taiyo Tax Corp. in Tokyo, about current issues in Japanese transfer pricing and intragroup services. Yamada previously spent 27 years working for the Tokyo Regional Tax Bureau.

Bloomberg Tax: What are the biggest transfer pricing issues to watch for in Japan, and how have COVID and remote work affected the field?

Yamada: One major transfer pricing issue is that companies' overseas subsidiaries have been hugely profitable under Covid. Many were concerned that profits might decline or even turn to losses, because some factories and operations faced shutdowns at the beginning of the pandemic in 2020. So it came as a big surprise when they closed their books and found that many of their overseas subsidiaries had logged big operating profits.

The tax agency had been doing fewer investigations over the past two years, and it almost stopped on-site investigations during the pandemic. But this year, with Covid more under control, it has been ramping up investigations to make up for lost tax revenue.

Many Japanese companies had much-higher-than-expected overseas operating profit because of extraordinary demand for Covid-related products. For example, companies making face masks and producing disinfectant experienced huge booms, and bigger overseas sales. Some even posted record revenue and profit.

The NTA might suspect they are transferring profit to their overseas subsidiaries. The headache for Japanese companies with such huge profits is to explain to the agency why those subsidiaries have

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such big earnings. Many Japanese companies are like this, including some auto parts makers, which made big profits in Southeast Asia, and Japanese printer makers, which had huge sales because the growing number of people working from home boosted demand.

For example, Japanese companies whose operating margins were up to 10%, compared with about 2% in the past, will have to explain and prove to the agency why their operating profit ratios rose so sharply. Otherwise, it may say the companies are transferring their profits to their overseas subsidiaries. When the agency comes to investigate, companies need to explain how Covid demand caused profit ratios to increase sharply, something they can do by using third-party market statistics on the unusual Covid demand and sales.

Bloomberg Tax: If Japanese companies are doing so well overseas, won't the tax authorities in those markets investigate?

Yamada: I don't think they need to come up with explanations to those tax authorities, because they will be happy that the Japanese companies are paying more tax thanks to their bigger revenue and profit. The transfer pricing risk is only in Japan, and I don't think there is much risk of investigations or any need for special measures. Tax authorities overseas are very unlikely to investigate when Japanese companies are paying bigger taxes because of bigger profits.

Bloomberg Tax: What are some other issues for Japanese companies?

Yamada: Another big issue is that of intragroup service fees, or IGS. Many Japanese companies are being taxed for their IGS, because they are providing services to overseas subsidiaries for free, without charging the fees. Japanese companies have had a tendency not to charge their overseas subsidiaries such fees for technical assistance or education of local staff by sending their staff to those overseas units. Since they are doing it for free, this service is regarded as a donation to the subsidiary and should be taxed as part of the parent's income. The NTA has told Japanese companies that they should charge for services such as the salaries of headquarters staff sent to the subsidiaries, business trip costs and so on.

There are no official statistics on IGS taxation. I think that many companies—I would say about 70% of our clients—are taxed for IGS. This fee amounts to over a few tens of millions of yen a year on average for one company [10 million yen is equivalent to around $75,000]. We have given seminars on IGS and are telling Japanese companies to collect IGS fees from their overseas subsidiaries.

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Bloomberg Tax: How do the pandemic and remote work affect the IGS issue?

Yamada: In fact, Japanese companies haven't been able to send their staff to their overseas subsidiaries, instead they have to do this online. Since they haven't been able to make business trips to overseas subsidiaries, they thought there would be no IGS fee.

The tax agency has investigated some companies even if they did not make business trips to their overseas subsidiaries. Since I was an agency investigator, I knew this would happen and did some seminars on this. Even if companies didn't send their staff to their subsidiaries in some other countries, they still provided technical assistance and educational training online, using Zoom, for example, and sometimes even more than before. The agency found that some companies have neglected to charge IGS fees. Online technical assistance and educational training is also regarded as IGS.

Bloomberg Tax: I was looking at recent statistics on the mutual agreement procedures **for Advance Pricing Agreements and Transfer Pricing, which show that the Asia-Oceania region had 572 carry-over cases, the most in the world for the business year that ended June 30, 2021. The US had the most, but China and India were close behind. Why are there so many carry-over cases in the Asia-Oceania region?**

Yamada: Southeast Asia, China and India account for a big portion of the Asia-Oceania region, because it takes so much time to finish mutual agreement procedures there. The U.S. used to account for about 33% of the total, and while it's still the biggest, it has declined to 19% now. The number of carry-over cases with the U.S. remains the same, but cases with India, China and Southeast Asian countries have increased. It takes so much time to reach agreement with their tax authorities, because they lack experience with MAP, unlike the US. It seems they did not understand transfer pricing well, and they started MAPs because they realized that they could get more tax revenue from transfer pricing than from other taxes. MAP meetings only happen twice or so a year, so carryover cases are increasing a great deal.

The increase of MAP cases with India, China, Thailand, Indonesia and Vietnam started a few years ago. Only OECD member countries were able to join the BEPS project until only a few years ago.

Interview has been edited for length and clarity.

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