

Japan Tax Bulletin

Tax audit and administrative appeal procedures in Japan

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In this issue of the tax newsletter, we discuss the following topics:

- Tax audits and assessments;
- Imposition of tax penalties;
- The Statute of Limitations; and
- The Japanese Administrative Appeals process.

1. Tax Administration

The National Taxation Agency (“NTA”) was organized in 1949 as an external function of the Ministry of Finance. The NTA supervises 12 Regional Taxation Bureaus (including the Okinawa Regional Taxation Office, and the same applies hereinafter) and 524 Tax Offices throughout Japan. Both Regional Taxation Bureaus and Tax offices conduct tax audits.

Usually a company with a stated capital of JPY 100M or more is audited by a Regional Taxation Bureau and a company with a stated capital amount of less than JPY 100M is audited by a Tax Office. Given that Regional Taxation Bureaus have more resources than Tax Offices, audits conducted by the Bureaus tend to be more extensive, conclusive and longer lasting than those performed by Tax Offices. Tax audits are never duplicated by Regional Taxation Bureaus and Tax Offices. In other words, a taxpayer can only be the subject of a tax audit by a Regional Taxation Bureau or a Tax Office. A taxpayer is never subject to a tax audit from both authorities.

2. Tax Audit and Assessment

In a tax audit where tax assessments are issued, tax auditors discuss their findings with the taxpayer in the closing state of the audit. Where required, the tax auditors will request the taxpayer to file an amended tax return voluntarily. The amended tax return will reflect the tax auditor's findings. In situations where the taxpayer has accepted the tax auditor's findings and has filed the amended tax return, the tax audit and the tax assessment process is complete. The taxpayer has essentially forfeited its right to go through the administrative appeal process.

Where the taxpayer disagrees with the tax auditor's findings and does not file an amended tax return, the tax authority has the power to correct the taxpayer's tax returns to reflect their findings. In this situation, the tax authority is required to provide the taxpayer with a letter of correction which states the reasons for the corrections, the amounts of corrected

income or tax losses and the additional tax amounts etc.

International tax auditors are assigned to tax audit teams in Regional Taxation Bureaus and Tax Offices. They are involved in tax audits of the corporate income tax returns of corporate taxpayers who have international transactions or operations. International tax auditors review international tax matters extensively and if they identify issues for further review, they will commence an audit. For example, if they identify issues regarding a taxpayer's transfer pricing, they will initiate a transfer pricing audit.

Generally, a transfer pricing audit is a much more time consuming process than an ordinary corporate income tax audit. However, if a taxpayer is the subject of both an ordinary corporate income tax audit and transfer pricing audit they are treated as being one audit and the closing procedures under the Act on General Rules for National Taxes are applied. This means that the tax auditors need to either delay the closing of the ordinary corporate income tax audit until the closing of the transfer pricing audit or close the transfer pricing audit earlier at the same time as the ordinary corporate income tax audit. As a transfer pricing audit usually takes 1 year or more and an ordinary income tax audit is normally completed in a couple of weeks to a couple of months, tax auditors generally request that taxpayers sign a consent letter which allows the tax auditors to conduct ordinary income tax audits and transfer pricing audits separately.

3. Tax penalty

3.1 Tax penalty for under declaration or no/late filing

A penalty tax for under declaring taxable income may be imposed and is assessed at the rate of 10% of the additional national corporate income tax due, and 15% of the total tax due in the event of a failure to file or late filing. If the tax amount paid by amended return or correction (additional tax due) exceeds the greater of: (i) the tax amount paid with the original tax return; or (ii) yen 500,000, an additional 5% penalty tax is imposed on the excess.

However, if an amended return is filed voluntarily before the tax auditor amends the taxable income through a tax audit, without expectation of such correction on discovery of an underassessment, penalty tax is not imposed if the underassessment is deemed to be an innocent error. Furthermore, if the tax amount is paid by amended return after the notification of an audit without expectations of correction by the tax auditor, then the rate is reduced to 5%.

3.2 Tax penalty where there is intentional misrepresentation or fraud

In the case of concealment or fraud, the rate is increased to 35% for underassessment and 40% for a failure to file or late filing.

3.3 Delinquency tax

A delinquency tax (entai zei) is assessed at the rate of 7.3% (or the average domestic bank loan interest rate called as the specified base rate plus 1%, if this is lower) per annum for an unauthorized failure to pay national corporate income tax when due. For the period from January 1, 2018 to December 31, 2018, the specified base rate +1% is 2.6%. The delinquency tax rate is increased to 14.6% (or the specified base rate plus 7.3%, if this is lower) per annum after two months from the due date of the tax payment. For the period from January 1, 2018 to December 31, 2018, the specified base rate +7.3% is 8.9%.

If the taxpayer filed by the due date and if one year passes without an assessment being made, the delinquency tax stops being imposed until the tax office issues a deficiency notice, at which point it resumes running at 7.3% (or the specified base rate plus 1%, if this is lower) and then doubles to 14.6% (or the specified base rate plus 7.3%, if this is lower) per annum if payment is not made within two months from the due date fixed for payment of the deficiency, which is normally one month after issuance of the deficiency notice.

4. *Statute of limitations*

The period within which the tax authorities may correct corporate returns and issue deficiency notices is generally five years from the due date for filing of the return concerned. The period is seven years from the due date in cases of fraud. Amendments to increase or decrease net operating losses (NOLs) can be made up to nine years (10 years for fiscal years starting on or after April 1, 2018) from the due date.

5. *Administrative Appeal*

Where a taxpayer has received the letter of correction, the taxpayer can rely on the administrative appeal procedures. The administrative appeal procedures are established in two tiers.

(1) Request for re-examination

A taxpayer who is dissatisfied with the decision made by a Regional Taxation Bureau or a Tax Office, such as a correction, determination, or seizure etc. can make a request for a re-examination.

A request for re-examination is selectively filed against either the Commissioner of the Regional Taxation Bureau or the District Director of the Tax Office. The purpose of this appeal process is to protect the rights and interests of citizens and to ensure the appropriate

operation of public administration with simplified, prompt and fair procedures. Thus, when a request for re-examination is filed, the authorities endeavour to listen intently to taxpayers' claims, conduct fair examinations and process requests appropriately and expeditiously. The request must be filed within 3 months from the day when the letter of correction was received.

(2) Request for re-consideration

A taxpayer who is dissatisfied with the decision made by the District Director of the Tax Office or the Commissioner of the Regional Taxation Bureau such as a correction, determination, or seizure etc. can request a re-consideration. The taxpayer does not need to submit a request for re-examination before proceeding with a request for re-consideration. Alternatively, if a taxpayer has requested a re-examination and is dissatisfied with the decision, the taxpayer can file a request for re-consideration.

The request must be filed within 3 months from the day when the letter of correction was received or within 1 month from the day when the letter of the re-examination decision was received.

According to the statistics published by the NTA and NTT, 12.3% of requests for re-examination and 8.2% of requests for reconsideration were wholly or partially approved in favour of taxpayers.

According to the same statistics published by NTA and NTT, 96.6% of request of re-examinations were re-examined and decisions were made within 3 months from the time when the requests were filed. 99.2% of request of re-examinations were re-examined and decisions were made within 1 year from the time when the requests were filed.

Contact us for any enquiry on our services;

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