

Japan tax alert

Ernst & Young Tax Co.

A court in Japan and BEPS guideline reconsider taxation of online-business warehouses

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On 28 May 2015, the Tokyo District Court rendered its decision in a dispute over the existence of a permanent establishment of a US resident person conducting an online retail business of selling auto parts and accessories to Japanese customers. The taxpayer used an apartment and warehouse located in Japan for storage and delivery and for the receipt of returned products. Part-time Japanese employees packed orders, included appropriate product instructions, arranged for delivery, and handled product returns.

In analyzing the existence of a PE, the court held that the activities mentioned in Article 5 (4) of the Japan-US Double Tax Treaty (equivalent to Article 5(4) of the OECD Model Convention) are not automatically deemed to be "preparatory or auxiliary." It held that such activities should only be treated as exceptions to the general definition of PE if they are preparatory or auxiliary in character. The court noted in particular that a warehouse located in Japan for quick delivery to customers and the ability to handle returned products were important elements of the online retail business. Because these activities and other activities performed in Japan were in fact "significant" for an online retail business, the court upheld the existence of a PE in Japan. Furthermore, the court held that substantially all of the sales income from the business activity should be attributed to the PE, without any deductions, due to (i) the functional significance of the activities in Japan and (ii) the fact that the taxpayer did not cooperate in the tax audits process and did not disclose its accounting books which creates a rebuttable presumption for income calculation under the Japan-US Double Tax Treaty.

The OECD BEPS final report singles out warehouses as an example, describing how the maintenance of a very large local warehouse, in which a significant number of employees work for purposes of storing and delivering goods sold online to customers by an online retailer of physical products (whose business model relies on the proximity to customers and the need for quick delivery to clients), should constitute a PE for that seller. Some countries, however, believe that there is no need to modify Article 5(4) and that the

list of exceptions in subparagraphs a) to d) of Article 5(4) should not be subject to the condition that the activities referred to in those subparagraphs be of a preparatory or auxiliary character. Those countries may adopt a different version of Article 5(4) as long as they include the new anti-fragmentation rule. The extent to which the revised Article 5(4) would be implemented in each tax treaties will also depend on the outcome of Action 15's multilateral instrument negotiation.



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