

## Client Alert

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[www.bakermckenzie.com](http://www.bakermckenzie.com)

For further information please  
contact

Edwin T. Whatley  
+813 5157 2801  
[edwin.t.whatley@bakernet.com](mailto:edwin.t.whatley@bakernet.com)

Hideyuki Yamamoto  
+813 5157 2806  
[hideyuki.yamamoto@bakernet.com](mailto:hideyuki.yamamoto@bakernet.com)

Toshio Ishikawa  
+813 5157 2808  
[toshio.ishikawa@bakernet.com](mailto:toshio.ishikawa@bakernet.com)

Baker & McKenzie GJB  
Tokyo Aoyama Aoki Koma Law  
Office  
(Gaikokuho Joint Enterprise)

The Prudential Tower  
2-13-10, Nagatacho  
Chiyoda-ku, Tokyo 100-0014 Japan  
Tel + 81 3 5157 2700  
Fax + 81 3 5157 2900  
[www.taalo-bakernet.com](http://www.taalo-bakernet.com)

## Japan's National Tax Tribunal Reverses ¥14.1 Billion Transfer Pricing Assessment Against TDK Corporation

Japan's National Tax Tribunal ("NTT"), in a February 1, 2010 decision, reversed ¥ 14.1 billion (US\$ 156 million) of a ¥ 21.3 billion (US\$ 236 million) revenue reassessment against TDK Corporation ("TDK"). This represents the highest tax refund made in a transfer pricing matter in Japan to date. This Client Alert provides an overview of the background details resulting in the NTT's reversal, and highlights the significance of the NTT's reversal for future transfer pricing controversies.

### 1. Background

The Regional Commissioner of the Tokyo Regional Taxation Bureau ("Commissioner") made transfer pricing assessments pertaining to deemed profits on transactions between TDK and its overseas subsidiaries between March 1998 and March 2003, ultimately issuing a tax reassessment on June 29, 2005 against TDK claiming that TDK had underreported its income during the relevant period by approximately ¥ 21.3 billion.

The facts surrounding the reassessment involved TDK shipping parts and materials for personal computers and other electronic products from its Tokyo headquarters to subsidiaries in Hong Kong and the Philippines, among other incidental activities. In making its initial finding in 2005, the Tokyo Regional Tax Bureau claimed that profits that should have been logged by TDK's Tokyo headquarters were instead transferred to the overseas subsidiaries.

In its defense, TDK argued that transaction prices with its overseas subsidiaries were appropriate because they were based on prices it routinely charged third party companies, and were therefore at arm's length. TDK filed a formal objection to the Commissioner's calculation of its income, lodging a request for reinvestigation on August 26, 2005. On June 29, 2007, the Commissioner responded to the reinvestigation request by revoking approximately ¥ 3 billion of the original ¥ 21.3 billion deemed income, with TDK being reimbursed ¥ 1.6 billion in tax it had overpaid on that assessment. Nevertheless, TDK maintained its objection to the entire ¥ 21.3 billion reassessment, filing a request for reconsideration on July 26, 2007 with the Director of the NTT, seeking revocation of the remaining ¥ 18.3 billion of the original reassessment.

After a two and a half year investigation, the Director of the NTT gave its decision to TDK on February 1, 2010 to revoke approximately ¥ 14.1 billion of the remaining ¥ 18.3 billion of deemed income on which tax was assessed.

As a result of the decision, TDK expects to receive a tax refund of approximately ¥ 9.4 billion.

## 2. Comments

There are many areas in the Japanese transfer pricing regime for which no clear standard has been established, with the result that situations frequently arise where the tax authorities' opinion differs greatly from that of taxpayers. Accordingly, many transfer pricing reassessments are disputed through reinvestigation, reconsideration, and—in an increasing number of cases—litigation. Among these taxpayer objections, only one matter has been successfully litigated by a taxpayer (also represented by Baker & McKenzie's Hideyuki Yamamoto and Toshio Ishikawa),<sup>1</sup> although there are several cases in which a portion of the reassessment has been revoked by the authorities during the reconsideration process. This is one of those cases. However, this case is unique given the high amount of tax liability revoked in the reconsideration process.

We consider that the outcome in this case will influence NTT objection investigations that are currently pending, as well as future reinvestigation requests. Significantly, the outcome for TDK in this matter adds encouraging anecdotal evidence to the increasing number of successful taxpayer outcomes in the Japanese tax reinvestigation and litigation processes.

<sup>1</sup> On October 30, 2008, the Tokyo High Court upheld an appeal brought by Adobe Systems Co., Ltd., in the first ever successful transfer pricing case brought by a taxpayer in Japan.