

Tax Controversy

In 20 jurisdictions worldwide

Contributing editor
Jean A Pawlow



2015

GETTING THE
DEAL THROUGH 

GETTING THE
DEAL THROUGH 

Tax Controversy 2015

Contributing editor

Jean A Pawlow

McDermott Will & Emery LLP

Publisher
Gideon Robertson
gideon.roberton@lbresearch.com

Subscriptions
Sophie Pallier
subscriptions@gettingthedealthrough.com

Business development managers
George Ingledeu
george.ingledew@lbresearch.com

Alan Lee
alan.lee@lbresearch.com

Dan White
dan.white@lbresearch.com



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87 Lancaster Road
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Japan

Eiichiro Nakatani and Kai Isoyama

Anderson Mōri & Tomotsune

Overview

1 What is the relevant legislation and who enforces it?

Articles 30 and 84 of the Japanese Constitution require that all taxes be imposed by acts of the Diet. The legislation that is relevant to the procedural aspects of taxes in Japan includes:

- the National Tax General Rule Act (Act No. 66 of 1962), which deals mainly with matters generally related to national taxes, such as due dates for filing of tax returns, time limits for the tax authority to issue tax assessments, penalties for failure to file tax returns and rules on tax audits;
- the National Tax Collection Act (Act No. 147 of 1959), which stipulates the procedures for collection of national taxes; and
- the National Tax Violation Control Act (Act No. 67 of 1900), which sets out the criminal procedures related to evasion of national taxes.

Some pieces of legislation that mainly deal with substantive aspects of national taxes also provide procedural rules related to national taxes, such as the Income Tax Act (Act No. 33 of 1965), the Corporation Tax Act (Act No. 34 of 1965), the Inheritance Tax Act (Act No. 73 of 1950), the Consumption Tax Act (Act No. 108 of 1988) and the Act on Special Measures Concerning Taxation (Act No. 26 of 1957).

Tax legislation is administered by the national tax administration (see question 3).

2 Other than legislation, are there other binding rules for taxpayers and the tax authority?

Tax treaties

Tax treaties that have been concluded by the cabinet and approved by the Diet are given full force in Japan. As a member of the OECD, Japan adopts provisions that are in line with the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention when concluding treaties with other countries. As of 1 July 2014, Japan has concluded 61 tax treaties that are applicable to 84 jurisdictions and designed to avoid double taxation, prevent tax evasion and foster the exchange of information and assistance in collection of taxes.

Cabinet orders, ministerial ordinances and administrative circulars

The cabinet can, within the powers granted to it under the relevant acts, enact cabinet orders to implement the acts. Similarly, ministers can, within the powers granted to them under the acts or cabinet orders, enact ministerial ordinances to implement acts and cabinet orders.

The Commissioner of the National Tax Agency (NTA) issues circulars, which are directives to officials of the NTA and its subordinate bureaus to provide a uniform interpretation and application of tax laws. However, circulars are merely interpretations by the tax authority and are not binding as a source of law.

Court precedents

The courts' interpretations of tax laws are not binding as a source of law. The interpretations of the courts, especially those of the Supreme Court, are generally respected in practice as an authority to support one's position.

3 How is the tax authority organised?

The NTA, which is an extra-ministerial bureau of the Ministry of Finance, is the primary governmental agency with respect to national taxes. The NTA has a three-tiered organisational structure: the head office, 11 regional taxation bureaus, Okinawa Regional Taxation Office and over 500 tax offices. Local governments, their subordinate prefectural tax offices, city offices and town and village offices handle matters regarding local taxes.

Enforcement

4 How does the tax authority verify compliance with the tax laws? What is the typical procedure for the tax authority to review a tax return and how long does the review last?

The tax authority verifies compliance by reviewing filed tax returns and conducting field examinations, which are audits conducted at the site of the taxpayers. While reviews are generally handled by tax offices, corporations with over ¥100 million in capital and foreign corporations are subject to review by regional taxation bureaus.

If a review reveals failure to file tax returns or underreporting of tax amount, the taxpayer is usually contacted by a tax officer and instructed to file a return stating the correct tax amount and paying the unpaid tax (with a penalty, if applicable). In other cases, taxpayers are subject to field examinations that are conducted at their site. The 2011 amendment to the National Tax General Rule Act requires the tax authority to give the taxpayer notification before the tax officer's visit to the taxpayer's site. A field examination can last from a few days to more than a year depending on various factors, such as the scale of the business operated by the examined taxpayer. A field examination generally involves studying the books and accounting records and inventories, and interviewing the employees of the taxpayer. These interviews are conducted under the power to access the relevant book-records and other materials and to ask questions (see question 6). In field examinations of business entities or individuals operating businesses, the examiners investigate all income tax concurrently, including tax that should have been withheld, corporation tax and consumption tax. At the end of a field examination the tax authority issues a disposition to impose the tax that the taxpayer should have reported in the returns for the previous years, or a document that no disposition is imposed on the taxpayer.

5 Are different types of taxpayers subjected to different reporting requirements? Can they be subjected to different types of review?

The reporting requirements for all taxpayers are generally the same. However, upon approval of the head of the relevant tax office, taxpayers can file 'blue returns' for income tax and corporation tax. A taxpayer who has received approval to file a blue return is granted certain privileges, such as a deduction of ¥100,000 or ¥650,000 from the amount of income. At the same time, individual taxpayers who file blue returns are obliged to attach their balance sheet, income statement and other documents containing sufficient details to calculate their income to the returns. In contrast, individual taxpayers who file white returns (ie, tax returns that are not blue returns) are only required to submit documents explaining their gross income and deductible expenses.

There is no substantial difference between reviews of blue returns and white returns. Note that approval to file a blue return places an obligation on the taxpayer to keep book-records of its transactions in the manner

specified by the relevant ministerial ordinances. The tax authority can request the records from the blue-return taxpayers in tax audits. In this sense, taxpayers filing blue returns have more obligations at a review than those filing white returns.

6 What types of information may the tax authority request from taxpayers? Can the tax authority interview the taxpayer or the taxpayer's employees? If so, are there any restrictions?

The National Tax General Rule Act provides that the tax authority may ask the taxpayer and certain persons specified by the Act (eg, persons to whom the taxpayer is or was obligated to pay money) to submit or present the relevant book-records and other materials, which generally include business books and records, financial information and copies of transaction documents. The tax authority is likely to interpret the phrase 'book-records and other materials' as authorising the auditors to access a wide range of information. However, the power to request information from taxpayers is restricted by the requirement of necessity (see question 8).

The Act empowers the tax authority to ask questions to the taxpayer and the persons specified by the Act. Under this rule, the tax authority can interview the taxpayer and its employees. As with the power to access book-records and other materials, the power to ask questions is also subject to the requirement of necessity.

7 What actions may the agencies take if the taxpayer does not provide the required information?

The agencies are prohibited from intruding on any private premises or auditing any materials without the consent of the taxpayer. However, a taxpayer is punishable by imprisonment of up to one year or a fine of up to ¥500,000 if the taxpayer fails to provide an answer, provides a false answer or obstructs an audit. If the matter concerns tax evasion, which is subject to criminal punishments, the agencies can obtain a court approval to access private premises or materials without the taxpayer's consent.

8 How may taxpayers protect commercial information, including business secrets, from disclosure?

Japanese law does not explicitly protect commercial information against tax audits. But the tax agencies are subject to two requirements under the National Tax General Rule Act in their conduct of tax audits: the agencies are allowed to ask taxpayers questions or audit materials only if it is objectively necessary; and taxpayers are criminally punishable only if there are no reasonable grounds to refuse the agencies' request for materials or copies of the materials. These two requirements of necessity and lack of reasonable grounds function, to a certain extent, as protection of commercial information. It is an open question as to whether a duty of confidentiality provides professionals, such as accountants or attorneys, with reasonable grounds to refuse the agencies' requests, although a few judicial decisions seem to deny the existence of reasonable grounds.

9 What limitation period applies to the review of tax returns?

The National Tax General Rule Act provides that the statute of limitation on assessment is five years from the statutory due date of tax return. This general rule does not apply to certain cases, such as cases of tax evasion (seven years) and situations to increase or decrease the amount of net loss (nine years). The Act further exempts cases where certain events occur after the statutes of limitation under the general rule have expired. For example, if a tax had been reported based on a transaction that brought about an income, and the income was later returned due to invalidity of the transaction, the limitation is three years from the day that the income was returned.

10 Describe any alternative dispute resolution (ADR) or settlement options available.

There are three methods for a taxpayer to seek resolution of a tax dispute with the government: filing an objection, requesting administrative review and filing a lawsuit. The first two are systems of administrative appeal and the last is a judicial appeal system. Besides these options, there are no other systems to resolve tax disputes with the government. Japanese tax laws do not allow the government to settle with taxpayers. However, there are some cases of de facto settlement, in which the government cancels a disposition in exchange for the taxpayer's concession of a related claim.

An objection is generally filed with the administrative agency that has made the disputed disposition. For example, an objection to a disposition

of the head of a tax office is filed with him or her. It must be filed within two months from the date of receipt of the notice of disposition. The period will be extended to three months by the 2014 amendment to the National Tax General Rule Act, which will take effect within two years from 13 June 2014. Execution of a disposition is not suspended by the filing of an objection. If the objection is upheld, the disposition is cancelled; otherwise it will continue to be valid.

Generally, a request for administrative review can be filed with the President of the National Tax Tribunal by a taxpayer who is not satisfied with the decision received concerning an objection within one month after the decision issuance date, or who has not received any decision concerning an objection within three months from the filing of the objection. There are also specific cases in which a taxpayer may file a request for administrative review without having filed an objection, such as where the concerned disposition is issued by the head of a regional taxation bureau. The 2014 amendment to the National Tax General Rule Act will expand these specific cases to grant taxpayers the option to choose between filing an objection first or filing a request for administrative review without having filed an objection.

See question 26 for details on the judicial appeal system.

11 How may the tax authority collect overdue tax payments following a tax review?

The general process to collect defaulted tax involves the tax authority first sending a collection letter to the taxpayer within 50 days from the original due date. If a payment is not made despite the demand letter, a disposition for non-payment will be instituted. The tax authority will then initiate a procedure to collect the defaulted tax if full payment of the tax due is not made within 10 days after the notice. Without the need for a court permit, the tax authority is allowed to seize the defaulting taxpayer's assets (including claims to a third party, such as a claim for funds in a bank account), convert the assets into money and seize the proceeds derived from the sales of assets. Such money raised is then used to pay the defaulted tax and any remaining amount is returned to the taxpayer or distributed to other creditors of the taxpayer.

12 In what circumstances may the tax authority impose penalties?

If a taxpayer underreports its payable tax amount, fails to file a tax return by the due date or fails to pay withholding tax by the due date, the tax authority will impose additional tax on the taxpayer as a penalty. In the case of tax evasion, additional aggravated tax will be imposed instead of the general additional taxes. Furthermore, a taxpayer who has violated tax laws may be subject to imprisonment of not more than 10 years, a fine of not more than ¥10million, or both.

13 How are penalties calculated?

The additional tax for underreporting is 10 per cent of the difference between the unreported and reported taxes (the 'Difference') plus 5 per cent of the difference between the Difference and the larger of ¥500,000 or the reported tax.

In the case of a failure to file a tax return, the additional tax is 15 per cent of the unreported tax plus 5 per cent of the difference between the unreported tax and ¥500,000. The additional tax for a failure to pay withholding tax is 10 per cent of the unpaid amount (see question 21 for the case where a taxpayer files a tax return with the correct tax amount after filing an earlier erroneous tax return without having predicted a disposition by the tax authority prior to the first filing.) For tax evasion, the rate of additional tax as a penalty is increased to 35 per cent (in the case of underreporting tax or not paying withholding tax), or 40 per cent (in the case of non-filing).

14 What defences are available if penalties are imposed?

Penalties are not imposed if there are reasonable grounds for the taxpayer's non-compliance with the laws. For example, if a certain interpretation of the laws has been customarily established in practice and the interpretation is later found by the court to be a misinterpretation, a taxpayer may be regarded as having reasonable grounds for underreporting the tax amount due to the misinterpretation. However, mere misunderstanding of the laws or reliance on professional advice (eg, legal or accounting advice) does not constitute reasonable grounds.

15 In what circumstances may the tax authority collect interest and how is it calculated?

Additional tax is payable on unpaid taxes as interest. The rate of additional tax on unpaid taxes is: 7.3 per cent per annum for the period up to the due date or the period up to the day on which two months have elapsed from the day following the due date, and 14.6 per cent thereafter until the date payment is completed.

Under the current rule, the 7.3 per cent and 14.6 per cent are reduced respectively to: 1 per cent plus a certain rate calculated based on the average rate of banks' new short-term loans; and 7.3 per cent.

Interest tax is also payable on postponement of tax payment, tax payment in kind (to be made after the initial due date), or postponement of due date of tax return. In principle, the amount of interest tax shall be calculated by using rates similar to those used for the calculation of additional tax.

16 Are there criminal consequences that can arise as a result of a tax review?

Two types of criminal consequences can arise from a tax review. The first is criminal punishment for obstructing a tax audit. As mentioned in question 7, a taxpayer who has failed to provide an answer, provided a false answer or obstructed an audit is punishable by imprisonment of up to one year or a fine of up to ¥500,000.

The second is criminal punishment for tax evasion. If a tax review reveals potential tax evasion, the NTA is authorised to carry out coercive investigation that is similar to the criminal investigation process. The NTA will report tax evasion that it discovers from such an investigation to the public prosecutors for criminal prosecution. As mentioned in question 12, a person who is prosecuted and convicted for tax evasion is punishable by imprisonment of not more than 10 years, a fine of not more than ¥10 million, or both.

17 What is the recent enforcement record of the authorities?

The NTA announced that, in operation year 2012, the number of field examinations that it conducted at the sites of individual and corporate taxpayers are, respectively, approximately 69,974 (among 21.52 million individual tax returns filed) and 93,000 (among 2,761,003 corporate tax returns filed). These field examinations revealed unreported income of ¥450 billion in individual income tax and ¥999.2 billion in corporation tax. These figures do not include examinations that involved simply contacting and giving instructions to taxpayers. In addition, the tax authorities conduct examinations of other taxes, such as consumption tax, inheritance tax, gift tax and withholding income tax.

Third parties and other authorities

18 Are third parties involved in the authority's review of tax returns and what rights do taxpayers have with respect to their involvement?

As mentioned in question 6, the tax authority may ask not only the taxpayer but also certain persons specified by the Act (eg, persons to whom the taxpayer is or was obligated to pay money) for relevant materials and ask them questions. Even though taxpayers do not have any specific rights with respect to involvement of third parties, the two requirements of tax audits as mentioned in question 8 (ie, necessity and lack of reasonable grounds) apply to tax audits involving third parties.

19 Does the tax authority cooperate with other authorities within the country? Does the tax authority cooperate with the tax authorities in other countries?

There is no law generally authorising the tax authority to cooperate, or share information that it obtained through its operations, with other authorities in Japan. However, there are some acts that explicitly empower the tax authority to do so in specific cases (eg, the Public Assistance Act). At the same time, it has been strongly argued that the tax authority should not share such information with other authorities due to the duty of confidentiality of all national public officers. The Supreme Court has not issued a clear position on this matter and therefore, Japanese law on this issue remains unclear.

On the other hand, there are relatively clear rules on the cooperation of the Japanese tax authority with authorities of other countries. Under tax treaties as mentioned in question 2, the NTA exchanges information with

foreign tax authorities and collects data and information relating to taxpayers, including foreign corporations. In addition, the NTA cooperates with foreign authorities to resolve international double taxation issues.

Special procedures

20 Do any special procedures apply in cases of financial or other hardship, for example when a taxpayer is bankrupt?

There is no single general rule aimed at dealing with taxpayers' hardship. However, some legislation provides rules that are applicable to specific cases of hardship. For example, there is legislation that provides for postponement of the due dates of taxes if certain conditions are satisfied.

Furthermore, the tax authority may suspend collection of taxes from taxpayers in certain kinds of hardship, such as a disaster, an illness or the closing of the taxpayer's business.

In addition to the postponement of due dates and suspension of collection, certain properties are prohibited from being seized to ensure that taxpayers have a minimum standard of living. Therefore, necessities such as clothes, bedding, furniture and also a portion of taxpayers' salaries cannot be seized for national taxes.

21 Are there any voluntary disclosure or amnesty programmes?

Additional tax as a penalty is not imposed on a taxpayer who files a tax return to amend a previously filed tax return in which the tax amount was underreported, as long as the taxpayer did not predict a disposition by the tax authority prior to the first erroneous filing. The rate of the additional tax is reduced to 5 per cent per annum if a tax return is overdue but it was not predicted that the tax authority would issue a disposition. Similarly, the rate of the additional tax on withholding income tax is reduced to 5 per cent per annum if the taxpayer pays the unpaid withholding tax amount without such a prediction.

Rights of taxpayers

22 What rules are in place to protect taxpayers?

As mentioned in question 1, the Japanese Constitution requires that all taxes be imposed by acts of the Diet. The 2011 amendment to the National Tax General Rule Act requires the tax authority to give the taxpayer advance notification of the time, place, and purpose of the audit, relevant taxes, relevant years, books and materials to be investigated, and other items specified by the relevant cabinet order, such as the names of the officers.

23 How can taxpayers obtain information from the tax authority? What information can taxpayers request?

Taxpayers can obtain information from the tax authority under the Act on Access to Information Held by Administrative Organs (Act No. 42 of 1999). It sets out the right of taxpayers to access information held by the government by filing a claim to the head of the relevant administrative organisation, unless the requested information falls under any of the exempted categories specified by the Act, such as information which, if disclosed, will endanger the government's accurate understanding of the facts pertaining to tax collection.

24 Is the tax authority subject to non-judicial oversight?

Tax authorities are supervised by their superior agencies. For example, a tax office is supervised by the regional taxation bureau that has jurisdiction over the relevant region. However, there is no procedure for a taxpayer to request oversight by a superior agency. Dispositions of tax authorities can be subject to administrative appeal if requested by taxpayers, as summarised in question 10.

Court actions

25 Which courts have jurisdiction to hear tax disputes?

There are no specialised courts for tax-related matters in Japan. Cases relating to tax matters are decided by ordinary courts. The rules under the Administrative Case Litigation Act stipulate that more than one court can be specified as the forum of jurisdiction in many cases, and they are designed to include the Tokyo District Court as a forum in all cases in which the national government is the defendant. Therefore, taxpayers can select the Tokyo District Court as the first instance forum for all cases involving national taxes.

26 How can tax disputes be brought before the courts?

The grounds to bring a dispute before the courts vary depending on the type of the claim that the taxpayer or plaintiff intends to bring. The most common is a request to cancel the disposition imposed on the taxpayer, as follows.

The grounds to bring such a claim are the illegality of the disposition (see question 34 for details on burden of proof).

Prior to filing a claim with the court to cancel the disposition, the taxpayer is required to have undergone the administrative procedures, which are filing an objection or requesting an administrative review. In particular, a taxpayer may file a lawsuit only if: (i) it files a complaint with the court within six months from the date of notice of the National Tax Tribunal's dismissal of the request for administrative review; or (ii) the agency with which the taxpayer has filed an objection or the Tribunal fails to give a decision within three months of the taxpayer filing a request for administrative review (see question 10 regarding the necessary administrative procedures).

In general, a person with a legal interest in the cancellation of the disposition has standing to bring the claim. In most cases, the taxpayer, including a successor of the taxpayer, to whom the disposition was issued, has standing.

There is no minimum threshold amount to bring a claim to the courts.

A disposition will be cancelled if the taxpayer or plaintiff's request for cancellation is upheld in a final and binding court decision. In such a case, the government or defendant will usually refund any tax that the taxpayer has paid based on the cancelled disposition after the decision of the court becomes final. However, if the government does not do so voluntarily, the taxpayer has to file a separate claim for a refund.

27 Must the taxpayer pay the amounts in dispute into court before bringing a claim? Can the costs of a dispute be recovered?

A disposition is valid until it is cancelled by an authority, including a court. This means that the taxpayer must pay the amount imposed by the disposition even while it is being disputed in court. If the taxpayer does not pay the imposed amount, the tax authority may collect the amount through the measures described in question 11.

The court usually awards to the losing party the costs that arose from the administrative matters of the case, including the court fees to file the claim. Administrative costs can therefore be recovered if the taxpayer or plaintiff is successful. Not all actual costs borne by the taxpayer are recoverable, which means a successful taxpayer cannot recover from the government or defendant any attorneys' fees.

28 Who is the decision maker in the court? Is a jury trial available to hear tax disputes?

Tax litigation is heard and decided by a judge or panel of judges in ordinary courts. With regard to criminal cases, while there is a judicial system known as *Saiban-in Seido*, under which citizens and judges form a panel that decides a case, this system is not applicable to tax litigation.

Update and trends

One of the main concerns of the tax authorities is accurate and prompt tracking of information of taxpayers. For this reason, a discussion group established within the government has discussed establishing a system to assign an identification number to each person, which is called 'my number' for individuals and 'corporation number' for corporations. The system is planned to be implemented from January 2016.

29 What are the usual time frames for tax trials?

The Supreme Court published that, for administrative cases (including tax cases), the average period in 2012 for: (i) a first-instance decision was 13.9 months; (ii) an appeal court decision was 6.1 months; and (iii) a Supreme Court decision was 6.5 months. The time frame for tax trials varies from case to case depending on various factors. However, it tends to take longer if the issues in the case are complicated and the disputed amount is large. For example, two recent cases that involved corporate restructuring, in which approximately ¥30 billion was disputed, took around three years between filings and the Tokyo District Court issuing first instance decisions.

30 Describe the discovery process for a tax trial.

A discovery system is not available in Japan. However, the Civil Procedure Code imposes broad obligations on possessors of documents to submit documents to the court if the court issues a document production order upon a request from another party. Under this obligation, a party (in tax litigation, the taxpayer or plaintiff and the government or defendant) that possesses the relevant documents must submit the documents to the court unless the documents fall under one of the exceptions under the Code. Exceptions include documents concerning a secret related to a public officer's duties, which, if submitted, is likely to harm public interest or substantially hinder the person's performance of public duties.

31 What testimony is permitted in a tax trial?

Tax litigation generally adopts a cross-examination system. Under the system, a person examined before the court is asked questions by the party who has requested the examination, the other party and the judge (in this order). Any person, including the taxpayer or plaintiff or experts, can be examined if the court finds, upon application by either the plaintiff or the defendant, that the person's statement is relevant to the case. There are only clerical differences between examination of a party to the case and examination of a third party.

32 Who can represent taxpayers in a tax trial? Who represents the tax authority?

As in all litigation on civil and administrative matters, taxpayers can represent themselves in tax litigation. Taxpayers can also be represented by qualified attorneys. A certified public tax accountant can attend hearings and make allegations to the court as an assistant of the taxpayer and the attorney. The Japan Legal Support Center provides legal aid to those who

ANDERSON MŌRI & TOMOTSUNE

Eiichiro Nakatani
Kai Isoyama

eiichiro.nakatani@amt-law.com
kai.iso-yama@amt-law.com

Akasaka K-Tower, 2-7
Motoakasaka 1-chome
Minato-ku, Tokyo 107-0051
Japan

Tel: +81 3 6888 1039 / 5871
Fax: +81 3 6888 3039 / 6871
www.amt-law.com/en/

have financial difficulties in hiring an attorney. However, legal aid is not frequently used in tax litigation. The tax authority is represented by government officers.

33 Are tax trial proceedings public?

Court proceedings in tax cases are generally held at hearings, which are open to the public. However, the court can choose to adopt non-public procedures such as preparatory proceedings. Although case records are generally available to the public, only parties to a case and third parties with legal interests in the case can obtain copies of the records. Further, the court can restrict the disclosure of the records if the records contain a party's material private life secret or a trade secret.

34 Who has the burden of proof in a tax trial?

In general, the government or defendant has the burden of proof of legality of the disposition at issue. In theory, this requires the government to prove the existence of the facts that form the basis of the tax and the tax amount. In practice, however, a taxpayer or plaintiff cannot be successful in cancelling a disposition unless it presents detailed facts and evidence to support the allegation that the disposition is illegal.

Further, there are exceptions to the general rule that the government or defendant bears the burden of proof. For example, the defence of reasonable grounds (mentioned in question 14), which relieves a taxpayer or plaintiff from the additional penalty tax, is available only to taxpayers who successfully prove the existence of such reasonable grounds. Further, in certain statutorily provided situations, the government is allowed to estimate the taxpayer's income based on general information of the taxpayer, such as changes in the amount of the taxpayer's assets or debts.

35 Describe the briefing process for a tax trial.

The process varies on a case-by-case basis, but the usual process is as follows:

- the taxpayer or plaintiff files a complaint to the court with jurisdiction;
- the first hearing date is scheduled to be held one and a half months or more from the filing date;
- several hearings are held before examination and issuance of the court's decision;
- testimony is heard from testifiers or the taxpayer, or both (if necessary);
- during the intervals between the hearings and the decision day, the parties submit briefs and evidence to the court;
- the court decides on the case; and
- the losing party may file an appeal.

36 Can a court decision be appealed?

As in other cases, a three-tiered judicial system is applicable to tax cases. Under the system, if a taxpayer is dissatisfied with the judgment of the first instance court, the taxpayer may appeal to one of the High Courts of Japan within two weeks from the date the judgment is delivered to the losing party. If the decision of the High Court is unsatisfactory, subject to certain requirements, an appeal may be made to the Supreme Court of Japan within two weeks from the delivery of the judgment.

Getting the Deal Through

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