EXPLANATORY MEMORANDUM TO

THE DRAFT DOUBLE TAXATION RELIEF (TAXES ON INCOME) (JAPAN)

ORDER 2006

1. This explanatory memorandum has been prepared by HM Revenue & Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

This draft Order brings into effect those arrangements specified in the Convention set out in the attached Schedule.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 Type of resolution

This draft Order is subject to the affirmative resolution procedure.

3.2 Effect

This Order is made under section 788 of the Income and Corporation Taxes Act 1988 (c.1) but will have extended effect in relation to arrangements relating to exchange of information under a provision in the current Session's Finance Bill once that Bill receives Royal Assent.

3.3 Details of the Convention

Further details of the Double Taxation Convention scheduled to the draft Order are annexed to this memorandum.

3.4 Extended effect

Section 4 below explains the way in which a provision in the current Finance Bill will (if Parliament agrees) extend the scope of provisions on exchange of information having effect under Orders in Council made under section 788 and which are in force at the time that Bill receives Royal Assent.

4. Legislative Background

4.1 General

This Order is made under section 788 of the Income and Corporation Taxes Act 1988 (c.1) which has been amended by section 277 of the Taxation of Chargeable Gains Act 1992 (c.12) and section 198 (1) and (2) of the Finance Act 2003 (c.14).

Section 788 provides the mechanism by which arrangements made with overseas territories for the purpose of affording relief from double taxation in relation to income tax, corporation tax and capital gains tax and taxes of a similar character in the other territory, and the exchange of information in respect of those taxes between that territory and the United Kingdom, are given effect in the United Kingdom. The relevant Convention is scheduled to an Order under section 788 and thus given domestic legislative effect.

This Order gives effect to arrangements affording relief from double taxation in relation to income tax, corporation tax and capital gains tax and taxes of a similar character and provisions concerning the exchange of information between the territories in relation to those taxes and every other kind and description of tax imposed by the United Kingdom or Japan. As section 788 only permits the exchange of information in respect of income tax, corporation tax, capital gains tax and taxes of a similar character, the Order will initially have effect only in relation to those taxes. However a provision contained in the current Session's Finance Bill 2006, once that Bill receives Royal Assent, will permit arrangements in relation to the exchange of information between territories in respect of taxes of every kind and description.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Paymaster General (Dawn Primarolo) has made the following statement regarding Human Rights:

In my view the provisions of the draft Double Taxation Relief (Taxes on Income) (Japan) Order 2006 are compatible with the Convention rights.

7. Policy background

Double Taxation Conventions aim to eliminate the double taxation of income or gains arising in one State and paid to residents of another State. They do this by dividing the taxing rights that each treaty partner has under its domestic law over the same income and gains. They provide additional protection for taxpayers by specific measures combating discrimination in tax treatment. More generally, Conventions benefit the taxpayer by ensuring certainty of treatment and, as far as possible, by reducing compliance burdens. Double Taxation Conventions also serve an Exchequer protection role by including provisions to combat avoidance and evasion — not least by measures providing for the exchange of information between Revenue authorities. They also encourage and maintain international

consensus on the appropriate tax treatment of cross-border economic activity and thus promote international trade and investment.

It is not possible to delay the making of this Order until the Finance Bill receives Royal Assent because any delay in completing the parliamentary procedures might mean that the Order would not enter into force this year and would therefore not become effective until a whole year later. It is vitally important that individuals and companies in the UK and Japan receive the benefits of the proposed Order as soon as possible, and therefore that parliamentary procedures should be completed without delay.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies. However, taxpayers may in some cases have to make a claim to HM Revenue & Customs or the other country's fiscal authority in order to benefit from the Convention. However taxpayers will benefit from reduced compliance burdens and, in many cases, from having to deal with just one fiscal authority.

8.2 The impact on the public sector is that because of the nature of a Double Tax Convention, one or both of the Contracting States gives up all or part of their taxing rights so that a given source of income is taxed only once. Measured against a baseline of single taxation only, Conventions do not therefore generally have an exchequer cost; rather, by encouraging cross-border economic activity, they can lead to an increase in tax revenue. But where double taxation is unrelieved, the economic activity in question, and hence the higher tax revenue attributable to it, will often be only temporary.

9. Contact

Douglas Rankin at HM Revenue & Customs (Tel: 020 7147 2696 / Email: Douglas.Rankin@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.

ANNEXE

GENERAL

All the United Kingdom's recent Double Taxation Conventions largely follow the approach adopted in the OECD's *Model Tax Convention on Income and on Capital*. This Convention continues that approach. In addition, it reflects changes in policy and legislation in the United Kingdom and Japan since the entry into force of the existing 1969 Convention (as amended by a 1980 Protocol) between the two countries, which this new Convention replaces.

NOTES ON DETAILS

Treaties entered into by the Government of Japan, by convention, do not give titles to the articles. Titles are given below for ease of reference.

ARTICLE 1 – PERSONS COVERED

This Article sets out the general scope of the Convention.

It provides that the Convention is to apply to persons who are residents of one or both of the Contracting States (the United Kingdom and Japan).

ARTICLE 2 – TAXES COVERED

This Article gives a definition of the taxes to which the Convention is to apply.

Paragraph 1 provides that the Japanese taxes to which the Convention applies are the income tax, the corporation tax and the local inhabitant taxes. The United Kingdom taxes to which the Convention applies are the income tax, the corporation tax and the capital gains tax.

Paragraph 2 provides that the Convention is to apply also to any identical or substantially similar taxes subsequently imposed by either country in addition to or in place of the taxes mentioned above. The paragraph also imposes an obligation on the competent authorities to notify each other of changes in their laws that significantly affect the Contracting States' obligations under the Convention.

ARTICLE 3 – GENERAL DEFINITIONS

This Article contains definitions of words and phrases used in the Convention.

Paragraph 1 of this Article defines a number of terms used in the Convention.

Paragraph 2 provides a rule for determining the meaning of terms not defined in the Convention.

ARTICLE 4 - RESIDENT

This Article establishes the meaning of "resident of" the United Kingdom or Japan and lays down detailed rules for resolving cases where individuals or other persons may be considered residents of both countries for tax purposes. The Article also sets out rules relating to treaty benefits where an entity is fiscally transparent.

Paragraph 1 provides a general definition of "resident of a Contracting State"; any person who under the laws of a Contracting State is liable to tax in that State by reason of his domicile, residence, place of head or main office, place of management, place of incorporation or any other criterion of a similar nature is a resident of that State for the purposes of the Convention. The Government, political subdivisions or local authorities of a State are residents of that State and the paragraph also confirms that, subject to certain conditions, pension funds/schemes established under the laws of that State and charities established in a State are residents of that State. However a person who is liable to tax in a Contracting State in respect only of income from sources in that State, or of profits attributable to a permanent establishment in that State, is not a resident.

Paragraph 2 sets out a series of rules for resolving the case where, applying the definition in paragraph 1, an individual is a resident of both Contracting States.

Paragraph 3 provides that where, applying the definition in paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities shall attempt to resolve the matter by mutual agreement. The paragraph also provides that, if the competent authorities do not reach agreement, the dual resident person will not, with some exceptions, be able to claim the benefits of the Convention.

Paragraph 4 provides that a Contracting State may restrict any reduction of or exemption from taxation on income arising in that State where the income is subject to a reduction of or exemption from taxation in the State of residence of the recipient.

Paragraph 5 sets out rules relating to the application of treaty benefits when an entity is fiscally transparent. Benefits will be available if the beneficiaries, members or participants of the entity are residents for the purposes of the Convention and satisfy any other relevant condition.

ARTICLE 5 – PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment" for the purposes of the Convention. In general the definition follows Article 5 in the OECD Model Tax Convention. Taken together with Article 7, it prescribes in general terms the circumstances and manner in which enterprises of one country may be taxed on their business profits arising in the other.

Paragraph 1 provides a definition of the term “permanent establishment”; it is a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Paragraph 2 gives examples of permanent establishments.

Paragraph 3 provides that a building site or a construction or installation project constitutes a permanent establishment only when it lasts for more than 12 months.

Paragraph 4 identifies a number of activities that do not constitute a permanent establishment even though they are carried on through a fixed place of business.

Paragraph 5 provides that an enterprise has a permanent establishment in a Contracting State where a dependent agent acts on behalf of the enterprise in that State and has, and habitually exercises, an authority to conclude contracts that are binding on the enterprise.

Paragraph 6 provides that an enterprise will not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through an agent of independent status, provided that that agent is acting in the ordinary course of his business as an independent agent.

Paragraph 7 provides that the existence of a control relationship between two companies does not, of itself, mean that either company is a permanent establishment of the other.

ARTICLE 6 – INCOME FROM IMMOVABLE PROPERTY

This Article is concerned with the taxation of income from immovable property.

Paragraph 1 provides that income derived by a resident of one Contracting State from immovable property situated in the other Contracting State may be taxed by the State in which the property is situated.

Paragraph 2 defines immovable property.

Paragraph 3 clarifies the scope of paragraph 1 by referring to income derived from the direct use, letting or use in any other form of immovable property.

Paragraph 4 makes clear that the provisions of paragraphs 1 and 3 also apply to income from immovable property of industrial, commercial and other enterprises.

ARTICLE 7 – BUSINESS PROFITS

This Article sets out the rules for the taxation of business profits.

Paragraph 1 provides that the business profits of an enterprise of a Contracting State shall be taxed only in the Contracting State of which it is a resident unless the enterprise carries on business in the other Contracting State through a permanent establishment in that other State. Where the enterprise carries on business through such a permanent

establishment, the State in which the permanent establishment is situated may tax the profits attributable to the permanent establishment. The rules for determining when a permanent establishment exists are contained in Article 5 (Permanent Establishment).

Paragraphs 2 - 4 lay down rules for attributing profits to a permanent establishment.

Paragraph 2 sets out an "arm's length" rule for the attribution of profits: the profits to be attributed to the permanent establishment are those it would be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Paragraph 3 provides for deductions to be allowed in attributing profits in respect of expenses incurred for the purposes of the permanent establishment.

Paragraph 4 provides that profits may be attributed to a permanent establishment by apportionment, provided that the outcome is consistent with the arm's length principle.

Paragraph 5 states that no profits shall be attributed to a permanent establishment where the permanent establishment merely purchases goods or merchandise for the enterprise of which it is a part.

Paragraph 6 requires that the same method be used year on year to determine the profits of the permanent establishment unless there is good and sufficient reason to the contrary.

Paragraph 7 clarifies the interaction between Article 7 and other provisions of the Convention. Where business profits include items of income dealt with separately in other Articles, those Articles take precedence over Article 7.

ARTICLE 8 – SHIPPING AND AIR TRANSPORT

This article sets out the rules for the taxation of profits from the operation of ships and aircraft in international traffic.

Paragraph 1 provides that profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

Paragraph 2 provides that profits from the operation of ships or aircraft include profits from the rental of ships, aircraft or the use of containers. In each case the rental or use must be incidental to the operations in international traffic.

Paragraph 3 excludes enterprises operating ships or aircraft in international traffic from taxes similar to that of the Japanese enterprise tax.

Paragraph 4 extends the scope of paragraphs 1-3 to cover profits from participation in a pool, a joint business or an international operating agency.

ARTICLE 9 – ASSOCIATED ENTERPRISES

This Article governs the evaluation for tax purposes of transfers of goods, services, finance and intangible property between associated enterprises. It is based upon the "arm's length principle", which requires such transfers to be evaluated as if they had taken place between independent enterprises.

Paragraph 1 confirms that a Contracting State may adjust the profits of a resident enterprise where conditions made or imposed between it and an associated enterprise of the other Contracting State differ from those that would be made between independent enterprises. The first State may increase the profits of its enterprise to the level of profits which would have been earned by the enterprise if it had transacted the business in question at arm's length.

Paragraph 2 provides that, where the profits of an enterprise are adjusted in accordance with paragraph 1, and the other Contracting State agrees that the adjustment is justified, that other State shall make a corresponding adjustment to the tax charged on the profits of its enterprise.

Paragraph 3 provides that the profits of an enterprise of a Contracting State shall not be changed if an enquiry into these profits is not initiated within seven years from the end of the relevant accounting period. Paragraph 3 will not apply in the case of fraud or wilful default or the inability to initiate an enquiry is attributable to the actions or inaction of the enterprise.

ARTICLE 10 – DIVIDENDS

This Article contains the rules for the taxation of dividends paid by a company that is a resident of one Contracting State to a resident of the other Contracting State.

Paragraph 1 provides that dividends paid by a company resident in one Contracting State to a resident of the other Contracting State may be taxed in that other State.

Paragraph 2 provides that the Contracting State of which the company paying the dividends is a resident may also tax the dividends, but it places a limit on the amount of tax which may be charged by that State. The tax charged by that State may not exceed 5 per cent of the gross amount of the dividends when the beneficial owner is a company which owns shares representing, directly or indirectly, at least 10 per cent of the voting power in the company paying the dividends. In all other cases the tax is limited to 10 per cent of the gross amount of the dividends. This does not affect the taxation of the paying company in respect of the profits out of which the dividend is paid.

Paragraph 3 provides exceptions to the rule in paragraph 2. Dividends paid by a company resident in one Contracting State to a resident of the other Contracting State may not be taxed in the first State if the beneficial owner of the dividends is a company which meets the conditions set out in the paragraph. Those conditions are that the beneficial owner must have owned shares representing 50 per cent or more of the voting power of the paying company for a period of 6 months ending on the date the dividend is

declared. Similarly, if the beneficial owner of the dividends is a pension scheme, the dividends shall not be taxed in the source State, provided that the dividends are not derived from the carrying on of a business by the pension scheme.

Paragraph 4 provides that the provisions of paragraphs 2(a) and 3(a) will not apply in the case of dividends paid by a Japanese company which is entitled to a deduction in computing its taxable income in Japan for dividends paid to its beneficiaries.

Paragraph 5 defines the term "dividends".

Paragraph 6 provides that paragraphs 1 to 3 shall not apply where a resident of a Contracting State receives dividends from the other Contracting State and the dividends are attributable to a permanent establishment through which that resident carries on business in the Contracting State of which the payer is a resident. In such circumstances, the taxation of the dividends is governed by Article 7 (Business Profits).

Paragraph 7 prevents the extra-territorial taxation by one Contracting State of dividends paid by a company that is a resident of the other Contracting State. The first State may not tax the dividends unless they are attributable to a permanent establishment in that State or are paid to a resident of that State. There is a similar provision concerning undistributed profits.

Paragraphs 8 and 9 contain anti-abuse provisions.

Paragraph 8 provides that a resident of a Contracting State shall not be considered the beneficial owner of dividends in respect of preferred stock or similar shares held under "back-to-back" arrangements. The benefits of Article 10 are not available where dividends are paid in such circumstances.

Paragraph 9 ensures that the provision of the Article will not apply to any dividend paid under arrangements where the main purpose, or one of the main purposes, in assigning or creating the relevant shares, is to take advantage of the Article.

ARTICLE 11 – INTEREST

This Article contains the rules for the taxation of interest paid by a resident of one Contracting State to a resident of the other Contracting State.

Paragraph 1 provides that interest arising in one Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

Paragraph 2 provides that interest may also be taxed in the State in which the interest arises but at a rate not exceeding 10 per cent of the gross amount of the interest if the beneficial owner of the interest is a resident of the other Contracting State.

Paragraph 3 provides that interest arising in a Contracting State and beneficially owned by a resident of the other State shall, under certain conditions, be taxable only in that other State. This paragraph applies to interest beneficially owned by the Government of

a Contracting State, the central bank of a Contracting State or an institution owned by a Contracting State. Certain financial enterprises may also benefit from this paragraph.

Paragraph 4 defines terms used in paragraph 3.

Paragraph 5 defines "interest".

Paragraph 6 provides that paragraphs 1, 2 and 3 shall not apply where a resident of a Contracting State receives interest from the other Contracting State and the interest is attributable to a permanent establishment through which that resident carries on business in that other State. In such circumstances, the taxation of the interest is governed by Article 7 (Business Profits).

Paragraph 7 sets out rules for determining where interest arises.

Paragraph 8 provides that where, because of a special relationship between the payer and the recipient, the amount of interest paid exceeds the amount which would have been paid in the absence of that special relationship, the Article will apply only to the interest that would have been payable in the absence of the special relationship. The "excess" part of the payment shall remain taxable according to the laws of each State.

Paragraphs 9 and 10 contain anti-abuse provisions.

Paragraph 9 provides that a resident of a Contracting State shall not be considered the beneficial owner of interest where the interest is paid under certain "back-to-back" arrangements.

Paragraph 10 ensures that the benefits of the Article will not apply to interest paid under arrangements where the main purpose, or one of the main purposes, of the creation or assignment of the relevant debt claim is to take advantage of the Article.

ARTICLE 12 – ROYALTIES

This Article contains the rules for the taxation of royalties arising in one Contracting State and derived by a resident of the other State.

Paragraph 1 provides that royalties arising in one Contracting State and beneficially owned by a resident of the other shall be taxable only in that other State.

Paragraph 2 defines the term "royalties".

Paragraph 3 provides that paragraph 1 shall not apply where a resident of a Contracting State receives royalties from the other Contracting State and the royalties are attributable to a permanent establishment through which that resident carries on business in that other State. In such circumstances, the taxation of the royalties is governed by Article 7 (Business Profits).

Paragraph 4 provides that where, because of a special relationship between the payer and the recipient, the amount of royalties paid exceeds the amount which would have been paid in the absence of that special relationship, the Article will apply only to the amount that would have been agreed upon by the two parties in the absence of the special relationship. The "excess" part of the payment shall remain taxable according to the laws of each State.

Paragraphs 5 and 6 contain anti-abuse provisions.

Paragraph 5 provides that a resident of a Contracting State shall not be considered the beneficial owner of a royalty if that royalty is paid under certain "back-to-back" arrangements.

Paragraph 6 ensures that the benefits of the Article will not apply to royalties paid under arrangements where the main purpose, or one of the main purposes, of the creation or assignment of the relevant right or property is to take advantage of the Article.

ARTICLE 13 – CAPITAL GAINS

This Article contains the rules for the taxation of capital gains.

Paragraph 1 provides that gains derived by a resident of one Contracting State that are attributable to the alienation of immovable property situated in the other Contracting State may be taxed in the State in which the property is situated.

Paragraph 2 provides that, subject to certain conditions, gains derived from the sale of shares in a company or an interest in a partnership where the shares or interest derive their value from immovable property situated in a Contracting State, may be taxed in that Contracting State.

Paragraph 3 provides that, subject to certain conditions, gains derived from the sale of shares in a company which is resident in a Contracting State may be taxed in that Contracting State. Paragraph 3 does not apply where the gains are subject to tax in the State of the resident to whom the gain arises.

Paragraph 4 provides that gains derived by an enterprise of a Contracting State from the alienation of movable property forming part of the business property of a permanent establishment maintained by that enterprise in the other Contracting State may be taxed in that other State. The paragraph also applies to gains derived from the alienation (in whole or in part) of such a permanent establishment.

Paragraph 5 provides that gains derived by an enterprise of a Contracting State from the alienation of ships or aircraft operated in international traffic or of movable property pertaining to the operation or use of such ships or aircraft shall be taxable only in that State.

Paragraph 6 provides that gains from the alienation of any property, other than that detailed in paragraphs 1 to 5, shall be taxable only in the Contracting State of which the alienator is a resident.

ARTICLE 14 – INCOME FROM EMPLOYMENT

This Article contains the rules for the taxation of employment income.

Paragraph 1 provides that employment income of a resident of a Contracting State may be taxed only in that State unless the employment is exercised in the other Contracting State. In the latter case the income may be taxed in the other State, subject to certain conditions.

Paragraph 2 sets out those conditions. They are

(a) the employee is in that State for more than 183 days in any 12 months period or

(b) the remuneration is paid by or on behalf of an employer who is a resident of that State or
(c) the remuneration is borne by a permanent establishment which the employer has in that State.

Paragraph 3 provides that remuneration derived by a resident of a Contracting State from an employment as a member of the regular complement of a ship or aircraft operated in international traffic may be taxed in that State.

ARTICLE 15 – DIRECTORS' FEES

This Article contains the rule for the taxation of directors' fees.

It provides that directors' fees etc. may be taxed in the Contracting State of which the company paying them is a resident.

ARTICLE 16 – ARTISTES AND SPORTSMEN

This Article contains the rules for the taxation of income derived from personal activities as an entertainer or sportsman.

Paragraph 1 provides that income of a resident of a Contracting State from his activities as an entertainer or sportsman in the other Contracting State may be taxed in that other State.

Paragraph 2 provides that income may be taxed in the Contracting State in which those activities are exercised irrespective of whether the income accrues to the entertainer or sportsman himself or to some other person.

ARTICLE 17 – PENSIONS

This Article provides that pensions and other similar remuneration beneficially owned by a resident of a Contracting State shall be taxable only in that Contracting State.

ARTICLE 18 – GOVERNMENT SERVICE

This Article contains rules for the taxation of remuneration and pensions paid in respect of Government Service.

Paragraph 1 provides that remuneration paid from the public funds of a Contracting State, or of one of its political sub-divisions or local authorities, to an individual for services rendered will be taxable only in that State. However such remuneration will be taxable only in the other Contracting State if the services are rendered in that other State by a national of that other State who is resident there or by a resident of that State who, although not one of its nationals, did not become a resident solely to render the services.

Paragraph 2 provides that a pension paid out of the public funds of a Contracting State, or of one of its political sub-divisions or local authorities be taxable only in that State. Such pensions may, however, be taxed in the other Contracting State if the recipient is a resident and a national of that other State.

Paragraph 3 provides that paragraphs 1 and 2 shall not apply to remuneration or pensions for services rendered in connection with a business carried on by a Contracting State, or by one of its political sub-divisions or local authorities. Such income is dealt with under Article 14, 15, 16 or 17 as appropriate.

ARTICLE 19 – STUDENTS

This Article contains the rules for the taxation of maintenance, education and training payments received by students and business apprentices.

It provides that payments for the maintenance, education or training of a student or business apprentice who is present in a Contracting State for his full-time education or training and who, immediately before visiting that State, was a resident of the other Contracting State, will not be taxed in the first-mentioned State, provided the payments are made from sources outside that State. In the case of business apprentices, the relief afforded by the Article is available for a maximum of one year from the date of the apprentice's arrival in the host State.

ARTICLE 20 – TOKUMEI KUMIAI

Article 20 provides that income, profits or gains derived by a sleeping partner in respect of a sleeping partnership (Tokumei Kumiai) contract may be taxed in the Contracting State in which the income, profits or gains arise.

ARTICLE 21 – OTHER INCOME

This Article contains the rules for the taxation of income not dealt with elsewhere in the Convention.

Paragraph 1 provides that income not covered elsewhere in the Convention will be taxed only by the State of which the recipient is a resident. There is an exception to this rule in the case of income paid out of trusts or the estates of deceased persons in the course of administration.

Paragraph 2 provides that paragraph 1 shall not apply, except in the case of income from immovable property, where the beneficial owner of the income is a resident of a Contracting State and carries on business in the other Contracting State through a permanent establishment and the income is attributable to the permanent establishment. In such circumstances, the taxation of the income is governed by Article 7 (Business Profits).

Paragraph 3 provides that where, because of a special relationship between the payer and the recipient, the amount of the income referred to in paragraph 1 exceeds the amount which the two parties would have agreed upon in the absence of that special relationship, the Article will apply only to the amount that would have been agreed upon by them in the absence of the special relationship. The "excess" part of the income shall remain taxable according to the laws of each country.

Paragraphs 4 and 5 contain anti-abuse provisions.

Paragraph 4 provides that a resident of a Contracting State shall not be considered the beneficial owner of other income when the other income is paid under certain "back-to-back" arrangements.

Paragraph 5 provides that the benefits of this Article will not apply to income paid under arrangements where the main purpose, or one of the main purposes, in assigning or creating the rights relating to that income is to take advantage of this Article.

ARTICLE 22 – LIMITATION ON BENEFITS

This Article is designed to counter abusive arrangements intended to enable persons who would not otherwise be entitled to certain benefits of the Convention to obtain such benefits.

Paragraph 1 provides that a resident of one Contracting State who derives income, profits or gains from the other Contracting State will be entitled to certain benefits of the Convention only if he is a "qualified person" (as defined in paragraph 2) and satisfies any other specified conditions for the obtaining of benefits.

Paragraph 2 lists categories of resident who will be "qualified persons". To be a qualified person, a resident must fall within one of these categories in the taxable or chargeable period in which the relevant income, profits or gains arise.

Under sub-paragraph (a), all individual residents of the Contracting States are qualified persons.

Under sub-paragraph (b), "qualified governmental entities" (as defined in Article 22(7)(a)) are qualified persons.

Under sub-paragraph (c), a company will be a qualified person if the "principal class" of its shares (as defined in paragraph 7(b)(i)) is listed or admitted to dealings on a "recognised stock exchange" (as defined in paragraph 7 (c)) and is regularly traded on one or more recognised stock exchanges.

Under sub-paragraph (d), a person other than an individual or a company will be a qualified person if the "principal class" of units (as defined in paragraph 7 (d)) in the person is listed or admitted to dealings on a "recognised stock exchange" (as defined in paragraph 7(c)) and is regularly traded on one or more recognised stock exchanges.

Under sub-paragraph (e), pension funds or pension schemes (as defined in Article 3(1)(m)), and charities (as described in Article 4(1)(c)) will be qualified persons, provided, in the case of a pension fund or pension scheme, that more than 50 per cent of the beneficiaries, members or participants are individuals who are residents of one or other of the Contracting States.

Under sub-paragraph (f), a person other than an individual will be a qualified person if it meets the "ownership" test set out in the subparagraph.

Under sub-paragraph (g), a trust, or the trustee of a trust acting in their capacity as such, will be a qualified person if at least 50 per cent of the beneficial interest in the trust is held either by persons who are qualified persons by virtue of sub-paragraph (a), (b), (c), (d) or (e) or by "equivalent beneficiaries" (as defined in paragraph 7(e)).

Paragraph 3 sets out a "derivative benefits" test. It provides that a company which is not a qualified person may qualify for the benefits of the Convention with respect to an item of income, profit or gain if it satisfies any other specified conditions for the obtaining of the benefits in question and shares representing at least 75 per cent of its voting power are owned, directly or indirectly, by seven or fewer persons who are "equivalent beneficiaries" (as defined in paragraph 7(e)).

Paragraph 4 sets out time requirements relating to ownership conditions in order that benefits may apply.

Under sub-paragraph (a), which applies to payments subject to a withholding tax, conditions are satisfied in a taxable year or chargeable period if those conditions are met during a 12 month period preceding the date of payment.

Under sub-paragraph (b) which applies to other payments, the conditions described in sub-paragraphs (f) and (g) of paragraph 2 and in paragraph 3 of this Article are satisfied for a taxable year or chargeable period if they are met on at least half the days of that taxable year or chargeable period.

Paragraph 5 sets out a "carrying on a business" test.

Sub-paragraph (a) provides that a resident of a Contracting State which is not a qualified person shall nonetheless be entitled to benefits granted by certain articles with respect to an item of income, profit or gain derived from the other Contracting State if it satisfies any other specified conditions for the obtaining of such benefits and it carries on a business in the State of which it is a resident and the income, profit or gain in question is derived in connection with, or is incidental to, that business. The "carrying on of a business" does not include the business of making or managing investments for the resident's own account, unless the resident is a bank, an insurance company or a registered securities dealer.

Sub-paragraph (b) provides that sub-paragraph (a) shall apply to an item of income, profit or gain only if the business activity in the Contracting State of which the person deriving the item is a resident is substantial in relation to the trade or business activity in the other Contracting State. This is to be determined on the basis of all the facts and circumstances.

Sub-paragraph (c) provides that, for the purpose of determining whether a person is engaged in the carrying on of a business, activities conducted by a partnership of which that person is a member shall be deemed to be conducted by that person. Similarly activities conducted by persons connected to that person shall be deemed to be conducted by that person. For this purpose, a person is connected to another if one of them possesses at least 50 per cent of the beneficial interest in the other, or, in the case of a company, shares representing at least 50 per cent of the voting power of the company or if another person possesses at least 50 per cent of the beneficial interest, shares or beneficial equity interest in each of them. Finally, the sub-paragraph provides that in any case a person shall be considered to be connected to another if, having regard to all the facts and circumstances, one has control of the other or both are under the control of the same person or persons.

Paragraph 6 gives to the competent authority of the Contracting State from which benefits granted by certain articles of the Convention are claimed discretion to grant such benefits to a resident of the other Contracting State who would not otherwise be entitled to them under the Article. The competent authority shall grant such benefits if it considers that the establishment, acquisition or maintenance of that resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Convention.

Paragraph 7 is an interpretative provision which sets out a number of definitions and rules which apply for the purposes of the Article.

Sub-paragraph (a) defines the term "qualified governmental entity".

Sub-paragraph (b) defines the term "principal class of shares".

Sub-paragraph (c) defines the terms "recognised stock exchange".

Sub-paragraph (d) defines the terms “units” and “principal class of units”.

Sub-paragraph (e) defines the term “equivalent beneficiary”.

ARTICLE 23 –ELIMINATION OF DOUBLE TAXATION

This Article sets out the methods by which the Contracting States will relieve double taxation.

Paragraph 1 sets out how Japanese tax is to be allowed as a credit against UK tax.

Sub-paragraph (a) provides that Japanese tax on profits, income or chargeable gains from sources within Japan is to be allowed as a credit against any UK tax computed by reference to the same income, profits or chargeable gains.

Sub-paragraph (b) provides that, in the case of a dividend paid by a company resident in Japan to a company resident in the UK which controls at least 10 per cent of the voting power in the paying company, the credit will take into account Japanese tax payable by the company in respect of the profits out of which the dividend is paid. .

Paragraph 2 sets out how UK tax is to be allowed as a credit against Japanese tax.

Sub-paragraph (a) provides that UK tax on profits, income or chargeable gains from sources within the United Kingdom is to be allowed as a credit against any Japanese tax computed by reference to the same profits, income or chargeable gains.

Sub-paragraph (b) provides that, in the case of a dividend paid by a company resident in the United Kingdom to a company resident in Japan which controls at least 25 per cent of the voting power in the paying company, the credit will take into account United Kingdom tax payable by the company in respect of the profits out of which the dividend is paid.

Paragraph 3 sets out a source rule for the purposes of paragraphs 1 and 2.

ARTICLE 24 – NON-DISCRIMINATION

Subject to certain provisos this Article provides that neither State shall impose discriminatory taxes (or requirements) on nationals, permanent establishments or enterprises of the other State.

Paragraph 1 sets out the basic principle: nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation, or any requirement connected with taxation, which is more burdensome than those imposed on nationals of the other State who are in the same circumstances, particularly with respect to residence.

Paragraph 2 is concerned with the taxation of permanent establishments; it provides that a permanent establishment maintained by an enterprise of a Contracting State in the other Contracting State may not be exposed in that other State to taxation which is less favourably levied than the taxation levied on enterprises of that other State carrying on the same activities. The Article does not oblige a Contracting State to grant to individuals not resident in that State any of the personal allowances, reliefs and reductions for tax purposes which are granted to residents of that State.

Paragraph 3 provides that interest, royalties and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall be deductible in computing the payer's taxable profits in the same way as if they had been paid to a resident of the first State. This rule does not apply, however, where certain other specified provisions of the Convention apply; these are the "special relationship" and anti-abuse" provisions in Articles 10, 11 and 12, and paragraph 1 of Article 9.

Paragraph 4 provides that enterprises of a Contracting State which are wholly or partly owned or controlled, directly or indirectly, by residents of the other Contracting State shall not be subjected to any taxation, or any requirement connected with taxation, which is more burdensome than the taxation or requirements to which other similar enterprises of the first State are subjected.

ARTICLE 25 – MUTUAL AGREEMENT PROCEDURE

This Article authorises the competent authorities of the two Contracting States to endeavour, by mutual agreement, to resolve cases of taxation not in accordance with the Convention and to settle points of doubt or difficulty in the application or interpretation of the Convention.

Paragraph 1 provides that, where a person considers that the actions of one or both Contracting States will result in taxation not in accordance with the Convention, he may present his case to the competent authority of the Contracting State of which he is a resident or national. This right applies irrespective of any remedies provided by domestic law. The paragraph also sets out time limits for the presentation of a case: a case must be presented within three years of the first notification of the action resulting in taxation not in accordance with the Convention or, if later, within six years from the end of the taxable or chargeable period in respect of which that taxation is imposed or proposed.

Paragraph 2 requires the competent authority to which the case is presented to endeavour, if it considers the objection justified and if it is unable to deal with the matter unilaterally, to resolve the case by mutual agreement with the competent authority of the other Contracting State. The paragraph also provides that any agreement reached between the competent authorities shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States, except such limitations as apply for the purposes of giving effect to such an agreement.

Paragraph 3 provides that the competent authorities shall endeavour to resolve by mutual agreement any difficulties or doubts arising over the interpretation or application of the Convention.

Paragraph 4 permits the competent authorities to communicate directly with one another (i.e. not through diplomatic channels) for the purposes of reaching agreement under the Article.

ARTICLE 26 – EXCHANGE OF INFORMATION

This Article contains rules governing the exchange of information between the Contracting States.

Paragraph 1 requires the competent authorities to exchange such information as is foreseeably relevant for carrying out the provisions of the Convention or of their domestic laws. This requirement extends to all taxes imposed by the Contracting States and not just to those taxes otherwise covered by the Convention. The exchange of information is not restricted by Article 1; this means that information relating to persons who are not residents of either Contracting State may be exchanged.

Paragraph 2 provides that information exchanged in accordance with paragraph 1 shall be treated as secret, although it may be disclosed to certain specified persons or authorities. Such information may be disclosed in public court proceedings or in judicial decisions.

Paragraph 3 imposes certain limitations on the exchange of information. Paragraphs 1 and 2 cannot impose an obligation on a Contracting State to carry out administrative measures at variance with the laws and administrative practices of either Contracting State or to supply information which is not obtainable under the laws or in the normal course of the administration of either Contracting State or to supply information that would disclose any trade, business, industrial, commercial or professional secret or trade process, or information whose disclosure would be contrary to public policy.

Paragraph 4 provides that the Contracting State from which information is requested shall use its information gathering powers to obtain the requested information even though that State may have no domestic tax interest in that information. The obligation is subject to the limitations of paragraph 3 but a Contracting State cannot decline to supply information solely because it has no domestic tax interest in that information.

Paragraph 5 makes clear that paragraph 3 cannot be applied to permit a Contracting State to decline to supply requested information solely because the information is held by certain entities such as banks. However a State may decline to supply information which is covered by professional privilege provisions in domestic law.

ARTICLE 27 – MEMBERS OF DIPLOMATIC OR PERMANENT MISSIONS AND CONSULAR POSTS

This Article contains rules for the taxation of diplomatic agents and consular officers.

It ensures that diplomatic or consular officials shall not receive less favourable treatment under the Convention than they are entitled to under international law or under the provisions of special agreements.

ARTICLE 28 – ENTRY INTO FORCE

This Article contains the provisions governing how and when the Convention will enter into force and take effect.

Paragraph 1 provides that the Convention will enter into force on the thirtieth day after the exchange of diplomatic notes indicating approval of the Convention in accordance with domestic legal procedures.

Paragraph 2 provides that in the United Kingdom, in respect of withholding taxes, the Convention will apply on or after 1st January in the calendar year next following the year in which the Convention enters into force. For income tax and capital gains tax the Convention applies for any year of assessment beginning on or after 6th April in the calendar year next following the year in which the Convention enters into force. Similarly, for corporation tax, the relevant date is 1st April in the calendar year next following the year in which the Convention enters into force.

In the case of Japan the relevant dates are 1st January in the calendar year next following that in which the Convention enters into force.

Paragraph 3 explains when the existing Convention will cease to have effect.

Paragraph 4 explains when the existing Convention will cease to have effect in respect of development land tax and petroleum revenue tax.

Paragraph 5 states that the existing Convention shall terminate on the last date on which it has effect in accordance with this Article.

Paragraph 6 ensures that an individual receiving the benefits of Article 22 (Teachers Article) in the existing Convention will continue to receive that benefit in accordance with the time limits in that Article.

ARTICLE 29 – TERMINATION

This Article contains provisions for the termination of the Convention.

This Article provides that the Convention may be terminated by either country giving notice of termination through diplomatic channels.

In the event of termination, the Convention shall, in the case of the United Kingdom, cease to have effect in respect of withholding taxes on or after 1st January in the calendar year next following that in which the notice is given. For income tax and capital gains the relevant date is 6th April and for corporation tax 1st April; in each case the date is that of the calendar year next following that in which the notice is given.

In the case of Japan the relevant date is 1st January in the calendar year next following that in which notice is given.

PROTOCOL AND EXCHANGE OF NOTES

The Protocol and Exchange of Notes contain clarificatory material relating to the Articles above. The usual practice of the UK is to place this material in an Exchange of Notes. The split between a Protocol and an Exchange of Notes is at the request of Japan.

Paragraph 1 clarifies the circumstances under which a Japanese pension fund will be regarded as exempt from tax.

Paragraph 2 clarifies that a resident of the United Kingdom who is a member of a partnership established in Japan will be taxed in the United Kingdom on his share of income, profits or gains arising to that partnership.

Paragraph 3 clarifies that paragraph 6 of Article 13 of the Convention shall not affect the right of the United Kingdom to levy according to its law a tax chargeable in respect of gains from the alienation of any property on a person who is a resident of the United Kingdom at any time during the fiscal year in which the property is alienated, or has been a resident of the United Kingdom during the six fiscal years immediately preceding that year.

Paragraph 4 clarifies how Article 14 will apply to share options.

Paragraph 5 clarifies how the ownership condition in paragraph 3 of Article 10 will apply to equivalent beneficiaries.

Paragraph 6 provides a source rule where gains are taxable by the United Kingdom under circumstances described in paragraph 3 of this Protocol.

EXCHANGE OF NOTES

Paragraph 1 describes, for the purposes of subparagraph (m) of paragraph 1 of Article 3, the domestic legislation which relates to pension funds and pension schemes.

Paragraph 2 clarifies, for the purposes of paragraphs 2 and 3 of Article 10, the date of entitlement to dividends paid by Japanese companies.

Paragraph 3 clarifies that trustees or managers of investment funds may submit claims on behalf of those funds where benefits are sought under Articles 10,11, or 12.

Paragraph 4 states that paragraph 8 of Article 11 and paragraph 4 of Article 12 do not, of themselves, permit Contracting States to recharacterise interest or royalties as a different type of income.

Paragraph 5 clarifies the meaning of “subject to tax” for the purposes of paragraph 3 of Article 13.

Paragraph 6 clarifies the meaning of “sources outside a Contracting State” for the purposes of Article 19.