Who, me? Tax Planning and Japanese Multinational Enterprises, 1887–2019*

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Summary

This study explores a history of Japan's international tax system and tax planning of Japanese overseas business over one century. Whereas Japan is one of the most powerful capital exporters in the world, the Japanese multinational enterprises (MNEs) have not engaged in, or regarded themselves as not implementing, aggressive tax planning. The hypotheses through the historical analysis that Japanese MNEs regarded themselves as not engaging in aggressive tax planning are as follows: (a) lack of experience; (b) Japanese government's coordinated tax regime learned from foreign precedents; and (c) preference for nationality. Meanwhile, it should be paid more attention that some leading Japanese MNEs have always endeavoured to avoid the international tax burden.

Key words: International Taxation, Japanese Multinational Enterprises, Tax History, Nationality of the company

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Introduction

In 1927, a high-ranking officer of the Ministry of Finance Japan, who participated in the Committee of Technical Experts on Double Taxation and Tax Evasion in the League of Nations, stated: 'the seriousness of European nations and taxpayers to the problems on double taxation and tax evasion was beyond our imagination' (Okura-sho, 1928, pp. 86-91). Such recognition by Japanese that the issues of the international taxation problems are not ours has continued till date. While the project of Basic Erosion and Profit Shifting (BEPS) in OECD became a worldwide issue in 2015, a report of the Japan Business Federation (JBF, or Keidanren), the Japan's most powerful business interest group, claimed, 'Japanese firms initially regarded the questions on BEPS as somebody else's problem. Even now, the shared understanding remains' (21 Seiki Kenkyujo and Keidanren Keizai Kiban Hombu, 2016, p. 22).

However, it does not signify that no Japanese investors and multinational enterprises (MNEs) engage in tax planning. The statistics of outward foreign direct investment of Japan, in which reputed tax-privileged areas, such as Hong Kong, Singapore, Luxembourg, the Netherlands and the Cayman Islands, are popular with Japanese MNEs, imply the prevalence of tax avoidance (Table 1). In fact, Jones and Temouri (2016) found that MNEs in liberal market economies (e.g., United States and United Kingdom) were more likely to invest in tax haven FDIs compared with those from coordinated market economies (e.g., Germany and Japan), but revealed that the investment in tax havens by Japanese MNEs was in the top league among coordinated market economies (Jones and Temouri, 2016, p. 242). Moreover, a flag of convenience (FOC) has been widely used since the 1960s and the transfer pricing of Japanese multinationals in the United States became an American political agenda in the 1980s (Imayuki 1983; Fujie, 1993). Referring to the tax planning by Japanese-owned or foreign-owned MNEs and international tax systems across the world, the Japanese government has introduced various tax rules. In the present day, Japan adopts a unilateral foreign tax relief system (e.g., foreign tax credit from 1953 and foreign dividend exclusion from 2009) and concludes bilateral tax treaties with 71 countries. The government also issued controlled foreign corporation rules (CFC rules or the so-called anti-tax haven rules) in 1978, transfer placing rule in 1986, thin capitalisation rule in 1992 and corporate inversion rules in 2007.

This study outlines the history of Japan's international taxation system on corporate income, and then explores how the systems of Japan and other countries have influenced Japanese MNEs. With regard to world history on international taxation, some representative works such as Picciotto (1992) and Picciotto (1992) and Palan, Murphy and Chavagneux (2013) provide short summaries. In addition, a group of tax historians has started the tax history conferences since 2002, thus deepening the national-level analysis (*Studies in the History of Tax Law*, vol. 1-8). Nevertheless, historical studies on international tax system of Japan are limited even if we grope for the articles or books written in Japanese; for example, Yanai (2018) is the first book-volume study on Japan's international tax history. Furthermore, these extant works exclusively focus on the post–World War II history. Therefore, the study follows how the Japanese government has developed the international tax codes over 140 years.

Following the review on the tax history, this article subsequently explores corporate behaviours under institutional pressure. Given that there were a limited number of Japanese MNEs facing international taxation problem in the pre–World War II period and the difficulty of access to the corporate archival materials on the post–World War II period, a research based only on corporate archival materials is difficult. Nevertheless, newspaper archives, articles on company histories, or histories of business interest group could help understanding the characteristics of Japanese MNEs' tax planning. This study summarizes a history on Japanese overseas business confronting international taxation.

In addition, this study highlights the 'tax strategy in corporate-level strategy.' Strategic decisions are usually determined by several factors including taxation (Glaister & Hughes, 2008; Sholes et al., 2015, p. 2). Then, the analysis on tax strategy must be integrated into corporate-level strategy where multiple interests are clashed and coordinated. This article particularly focuses on the relationship between tax avoidance and the choice of nationality. One of the key elements of international tax planning is shopping nationalities (Ogle, 2017; Gehlen, Marx and Reckendress, 2018). Most extremely, a corporation changes its head office to a low-tax or no-tax jurisdiction; this tax scheme was named as corporate inversion. On the other hand, these tax strategies might lead to the corporations to relinquish the advantage of having a nationality and/or damage of the reputation from stakeholders. Through a case analysis of big trading companies and/or Sogo Shosha (hereinafter, referred to trading companies), the nationality of firms and tax planning are considered.

International tax system of Japan, 1887–2019

A biography of the delegates of the Committee of Technical Experts on Double Taxation and Tax Evasion evaluated that the 'Japan was little interest in the tax committee in the League of Nations, but expertise of the Japanese delegate on international taxation was impressed by other delegates' (Ishiwata Sotaro Denki Hensankai, 1954, pp. 132-134). Such knowledge was derived from the studies on foreign tax systems in the Research Division of the Tax Bureau in the Ministry of Finance (Hirata ed., 1979, pp. 331-333).

Following the experiences in leading countries, the Japanese government established its international tax system in pre–as well as the post–World War II period.

(1). 1887–1945

It was not until 1899 that Japan imposed taxes on profits of corporate income, 12 years after the introduction of the income tax law. The revised law levied 2.5% of income tax on worldwide profits of corporations registering their headquarters in the territory of Japan (Figure 1). The international double taxation between Japan and other nations had emerged already at this stage. While the personal income tax earned outside Japan was exempted, the same treatment did not apply to corporate income. After colonisation of Taiwan in 1895, the government decided to extend some parts of Japanese income tax law to this area. Thus, the rate of income tax on profits of colonial firms was tantamount to Japanese taxes (Okura-Sho, 1940a, pp. 977-1079; 1940c, pp. 288-332).

The Japanese government reformed the tax system after World War I, which had produced complicated tax rules, as many developed countries experienced. In short, the income tax law of 1920 built a basic structure of Japan’s pre-WWII international tax regime. Under this system, foreign tax deduction, which is known to be flawed in preventing international double taxation compared with foreign tax credit, was introduced as a form of relief for international double taxation. Yet the rule was imposed only for investment outside the Empire of Japan. Japanese businesses operating within the Empire did not face international double taxation in spite of the fact that the colonial governments were formally allowed to provide their income tax rules. For example, the Korean authority enacted its Income Tax Decree on the same day as the Japanese government legislated its Income Tax Act of 1920. The tax rate and rules specified in Korea’s decree were identical to the Japanese Act (5–20% in Japan and Korea in 1920). Consequently, business income was taxed uniformly within the Empire. A company registered in a jurisdiction within the Empire paid tax to that jurisdiction; other jurisdictions within the Empire were unable to impose the taxes on the company if the profits were generated beyond the registered country/area (Okura-sho, 1940a, pp. 1080-1190; 1940b, pp. 359-380).[1] A Director-General of the Tax Bureau self-evaluated Japan’s system stated that, ‘Whereas the tax rights were divided between Japan and colonised countries, the well-coordinated system made the Empire’s companies be under the one tax order’ (Okura-sho, 1924).

Meanwhile, Japanese government in the pre-WWII period did not enter into comprehensive tax treaties with other countries, unlike the continental Europe and the United States (Picciotto, 1992, Chapter 1). Similar to the United Kingdom, Japan only concluded agreements for the reciprocal exemption from income tax on shipping (e.g., UK–Japan tax agreement in 1924 and the US–Japan agreement in 1926). One exceptional case was the relationship with Manchukuo, which was founded as a puppet state in 1931. The status of the ‘independent’ state led to the international double taxation problem between Japan and Manchukuo (Shibata, 2007, pp. 31-54). Finally, a royal decree was issued in 1942 to prevent international double taxation between Japan and Manchukuo (Hirata, 1942).

(2). 1945–2019

The 1945 defeat forced Japan’s international tax policy to change directions. The loss of her colonies inevitably terminated the differential international tax system between inside and outside the Empire. Importantly, the government had to accept the American hegemony, which espoused an open trading system based on free trade. The US–Japan tax treaty, a main purpose of which was to promote to US investment, was concluded in 1954. Japan also changed the domestic tax rules to prepare for the first comprehensive tax treaty and adopted the foreign tax credit system in 1953 for a relief to prevent international double taxation.[2]

Nevertheless, the volume of Japan’s foreign investment until the early 1970s was so miniscule that there was no urgency in the debate on international taxation in the political agenda: Sweden (1957), Denmark (1959), Pakistan (1959), Norway (1959), India (1960), Singapore (1961), Austria (1963), New Zealand (1963), UK (1963), Thailand (1963), Malaysia (1963), Canada (1965), France (1965), Germany (1967), Brazil (1967), Sri Lanka (1968), Belgium (1970), South Korea (1970), the Netherland (1970), Switzerland (1971), Finland (1972), Italy (1973), Spain (1974), Ireland (1974). During the period, the government steadily extended the network of bilateral tax treaties. In 1962, the rule of foreign tax credit system was eased ‘in response to the present needs for promotion of foreign investment by Japanese firms’.

The government revised the international tax system in the late 1970s as Japan’s foreign investments revived. Above all, the government introduced controlled foreign corporation rules in 1978 to limit artificial deferral of tax using low-taxed entities in the so-called tax haven countries or areas. The main legislative interest was to prevent the tax deferral of the companies or owners possessing FOC ships. In this backdrop, 27 countries or areas (such as Panama and Liberia) were designated as the ‘low-tax countries’, the profits of which became taxable even when the profits were reserved in the designated countries.

While transfer pricing problem also emerged as a political agenda in the late 1970s, it was triggered by the conflict with US government. The US Inland Revenue Service investigated the case of transfer pricing with regard to the subsidiaries of Toyota, Nissan and Honda in the United States and asked them to pay tax amounting to almost 0.5 billion dollars (10 billion yen). The incident named 'auto cases' profoundly shocked not only the Japanese automobile industry but also Japanese government, who were concerned about the US–Japan trade friction. The government, therefore, decided to introduce its own transfer pricing rules in 1986 'to curb the excessive taxation imposed by the US and negotiate with the counterpart (Komamiya, 2010)'.[3]

After the 1980s reviewed the international tax system regarded as more generous than in other countries. The government revised the foreign tax credit system in 1988 on the ground that it eroded the tax base. Thin capitalisation rule was also promulgated in 1992, although the policy maker reflected that 'there was a dispute even in the Ministry of Finance because of few cases to be applied' (Zaimu-sho, 2014, p. 334). In the 2000s, Japan re-concluded the tax treaties with the article of 'Limitation on Benefits', which aims at eliminating treaty shopping. Moreover, in 2007, the government established the rule on corporate inversion. This legislation was meant to prevent a type of triangular merger, which enables a Japanese company to become a subsidiary of a foreign company located in a low-tax jurisdiction and to reduce the global effective tax rate of the group.

Meanwhile, 'the race to the bottom' strengthened the pressure on the Japanese government to reduce corporate income tax rate. For example, the rate of corporation tax decreased from 43.3% in 1984 to 23.2% in 2019. In parallel, the effective statutory corporate income tax rate dropped from 52.92% in 1984 to 30.62% in 2019. Moreover, the rates were assumed to be high, therefore the Keidanren and *The Nikkei*, the largest financial newspaper in Japan, repeatedly urged the government to lower the rates. In addition, Japanese government in 2009 enacted the foreign dividend exclusion rule. The rule permits that 95% of dividends from a foreign subsidiary to be exempted from corporate income tax controlled by the Japanese parent company. Moreover, foreign withholding taxes on dividends from foreign subsidiaries are not be taxed. The introduction of a territorial tax system aimed at repatriating the income gained overseas and promoting reinvestment in Japan.

As a matter of course, these problems on erosion and securing of tax revenue are universal. As a country, which produced the Chair for the OECD Committee on Fiscal Affairs from 2011 to 2016 and hosted the OECD meeting on the BEPS project in 2016, Japan is implementing the action plans.

International taxation and Japanese overseas business

Japan emerged as a powerful capital exporter in the world economy since the 1970s (Jones, 2005, p. 22). Yet there was a strong presence of foreign investment in the domestic economy even in the pre-WWII period. For example, the ratio of stock of foreign investment to the GNP was almost 44% in 1930 (Izawa, 2016, p. 22). Given that the ratio of stock of outward FDI to the GDP was about 33% in 2018, the magnitude of foreign investment of pre-war Japan was not at all inferior to the present. Nevertheless, the investment in pre-war Japan exclusively directed to its colonies and mainland China could prevent most Japanese overseas business from suffering international taxation. After the revival of foreign investment from the 1970s, Japanese MNEs have taken up the issue of international tax as a managerial agenda.

(1). 1887–1945

The most important feature of foreign investment in pre-WWII Japan was that the investment to colonies and the mainland China accounted for 96.5% (Izawa, 2016). As already noted, a united tax order within the Empire of Japan prevented double taxation on corporate income inside the area. With regard to the mainland China, the Japanese overseas firms could exploit the extraterritorial rights of foreigners based on the Sino-Japanese Treaty of Commerce and Navigation in 1896, and then pay few taxes (Gao, 2004). Regarding Japanese-owned cotton firms in China (Zaikabo), the tax rate in Shanghai was estimated to be 3.4–6% and in Qingdao 1.7–2% (Okabe, 1937, pp. 53-61). Thus, reliance on the zone where Japan could wield an unequal power meant that most Japanese firms did not face serious problems on international taxation. With regard to the UK, the investment towards the Empire accounted for almost 50% in 1930 (Royal Institute of International Affairs, 1937, p.142).

Nevertheless, no Japanese overseas business did not face the problem of international taxation. Some trading companies were concerned with international double taxation, discussed later. Besides, shipping companies such as Nippon Yusen, Osaka Shosen and Toyo Kisen suffered heavier taxation between 1916 and 1924 when the British government introduced taxation on foreign shipping using British ports and the United States promulgated a similar provision (Masui, 2010). Tax query and a petition from the Japanese Shipowners' Association drove the government to revise its tax policy on shipping profits; the Japanese government changed the domestic law in 1924 and successively concluded the reciprocal exemption agreements on shipping income. On the other hand, although the petition in 1926 from the Federation of Japanese Industries (formerly JBF) requested tax exemption of foreign-sourced income, the government rejected the postulation owing to revenue deficit (Okura-sho, c.a.1926). During the interwar period, requests made to the government for providing a general foreign tax relief for investment outside the Empire were always rejected (e.g. Keidanren, 1962, Chapter 2-4).

Some examples of Japanese overseas business show that these firms operating within the Japanese Empire or Japanese sphere of influence could exploit the benefits of tax avoidance. For example, Nihon Chisso (Japan Nitrogenous Fertilizer Company) Group, a ‘New Zaibatsu’, could use the tax break of Korea and squeeze the accounting profits on Korean business. The foreign subsidiary, Chosen Chisso, founded in 1927, was established as a separate legal entity to use the special tax reduction for promoting investment in Korea. After Nihon Chisso exploited the four-year special tax provision, the Korean subsidiary ceased to pay dividends to the head office and instead paid huge patent royalties and sales commissions. Thereby Chosen Chisso could treat these royalties and commissions as deductible expenses and reduce taxable profits. Finally, the tax scheme worked till 1941 when the Ministry of Finance Japan discovered the manipulation and forced the Korean company to be merged into the parent company (Oshio, 1989, Chapter 4 & 6).

Taking up an example of Manchukuo, Nihon Sangyo Group, a New Zaibatsu, moved its headquarters to Manchukuo to avail a tax privilege. The industrial conglomerate, which agonised over the tax burden in Japan and was on the verge of dissolution in 1936, was seen as the best partner to construct a new ‘ideal country’ by the Japanese and Manchukuo governments. Nihon Sangyo and both the governments consented to a plan in which Manchukuo imposed 6% income tax and Japan waived the tax right on the company’s business in Japan. Under the condition, Nihon Sangyo relocated the headquarters and changed its name to Manchurian Heavy Industrial Development Corporation (Hara, 1973, pp. 239-248). This case could be regarded as an early example of corporate inversion.

(2). 1945–2019

The stock of Japan’s foreign direct investment, which turned into nil through the WWII, gradually increased due to the rebirth of Japanese economy. While the Japanese government applied a case-by-case screening on outward-FDI by 1969, the capital liberalisation programs from 1969 to 1971 abolished the restriction, thus providing a legislative stimulus to foreign investment (Fujiwara, 1987). Japanese MNEs with international competitive advantage in various sectors aggressively invested into foreign countries and faced the issue on international taxation.

While trading companies and cotton spinning firms were the key industrial drivers engaging in FDI until the late 1960s, the shipping industry was most remarkable in terms of the international tax issues (Kojima, 1985). Some shipping companies started to use FOC ships registered in Liberia or Panama from the early 1960s. The shipping association brochures claimed that it was defensive reaction to counter the Greek and American ship owners who had exploited the tax privilege from the 1950s (Matsuo, 1959, pp. 150-159; *Nikkei Kinyu Shimbun*, 17 Oct, 1988). Anyhow, the tax avoidance by shipping companies led the government to introduce the controlled foreign corporation rules in 1978. Nevertheless, the number of FOC ships did not reduce; one reason was that the shipping companies could switch to the countries out of scope of CFC rules, for example, Singapore (Aida, 2011).

As Japan's automobile and electronics industries had international competitive edge, the American fear of loss of the extant markets ignited the US–Japan trade friction. Under these circumstances of the late 1970s, the US Inland Revenue Service imposed additional taxes on Japanese automobile makers because they squeezed the US profits through transfer pricing manipulation (Fujie, 1993). A Japanese tax policy maker recalled that, 'there was little incentive for Japanese firms to implement transfer pricing manipulation on the grounds that the effective corporate tax rate of the US at that time was higher than Japan' (Komamiya, 2010). It is not known whether the corporations actually intended to evade taxation, but the political risks appalled many Japanese MNEs.[4] In 1984, the JBF established a new division on international taxation in the Taxation Committee, launching a survey on the corporate reaction to the issues of international taxation. The 1984 survey report disclosed that 20 out of 285 companies faced the tax problem on transfer pricing and 35 firms were concerned with the future possibilities of transfer pricing taxation by foreign governments (Keidanren, 1984).[5] It appeared for the first time that that many Japanese MNEs became aware of worth of tax transparency.[6]

Japanese society also evinced more interested in the topic of MNEs' tax planning. The symbolic event was that the Japan's biggest newspaper, *Yomiuri Shimbun*, devoted the front page on 1 January 1984 to the tax planning of general trading companies; the article shed light on the fact that the companies paid no corporation tax (*Yomiuri Shimbun*, 1 January, 1984, p. 1). Although it was true that the general trading companies only utilised the foreign tax credit system, the system deemed a generous rule was reconsidered in 1988. Moreover, the newspaper reported the tax scheme by Oriental Leasing that exploited a loophole of the CFC rule and tax privileges of the Netherland and the Dutch Antilles, on the same day as last year (*Yomiuri Shimbun*, 1 January, 1985, p. 1). The tax avoidance also led to the revision of CFC rules.

During the late 1980s and early 1990s, the boom of setting up regional headquarters occurred in Japanese business world. Many Japanese MNEs planned to establish a tri-polar management composed by North America, Europe and Asia. In the international management, each regional headquarters with local managers was intended to control the regional business. From an international taxation perspective, it was an intriguing phenomenon that the global headquarters in Japan established the European regional headquarters mostly in the Netherland or the UK, and Asian headquarters in Singapore or Hong Kong. The parent companies set up the intermediate holding companies in these countries to accumulate and reinvest the regional profits. From the managerial perspective, regionalisation made little progress against the original intention of the head offices. Nevertheless, the holding companies and some human resources still remain in these countries (Takahashi, 1998; Mori, 2003; Mori, 2014; Shimizu, 2018).

In the twenty-first century, the tax authority and media looked at tax planning of Japanese MNEs with more stern eyes. Although the transfer pricing taxation introduced in 1986 initially applied to the Japan's subsidiaries of foreign companies (e.g., Coca cola, Roche, and Hoechst), the 2000s saw the imposition of transfer pricing taxation on the head offices of Japanese MNEs (e.g., Honda, Sony, and Takeda). Besides, the case of Takefuji, a consumer finance company, the founder's son of which moved to reside in Hong Kong for Japan's inheritance tax evasion of almost 2 billion dollars (20 billion yen), became a sensational news for Japanese society. Meanwhile, although the tax loophole was plugged, the media recently reported that the founding families of some Japanese big businesses emigrated to the foreign countries such as Singapore, New Zealand, and Switzerland. In the case of Sunstar Inc. that founded an oral care company in 1932, the company decided to engage in corporate inversion and relocated its headquarters to Switzerland in 2009. Otherwise, some companies recently spun off the departments or functions into separate corporations and the departmental or functional headquarters shifted to low-tax countries. For example, HOYA has financial function's global headquarters in the Netherland, glass department headquarter in Thailand, and surgical optics headquarters in Singapore (Mizuho, 2012; Fukami, 2015, Chapter 1; Yanai, 2018).

Nonetheless, Japanese MNEs appear to avoid aggressive tax planning as a whole. The small gap between statutory and effective tax rate implies that the Japanese MNEs pay the imposed taxation (Table 2). According to surveys of KPMG and Deloitte Tohmatsu, Japanese firms—even those with over 10,000 employees—rarely establish an independent tax department and only set 10–20 employees in charge of tax issues (KPMG, 2014, Chapter 1; Deloitte Tohmatsu, 2014). It is common knowledge among business people and tax experts in Japan that the 'tax strategy of Japanese MNEs has lagged far behind European and American ones'.

Trading companies and international taxation: nationality of firms and tax planning

When the characteristics of Japanese trading companies are considered, the historical background of the growth has to be referred because the industrial policy introduced by the national government to nurture Japanese traders was arguably essential. After opening the country in 1858, the export and import trade was monopolised by foreign trading companies or traders. Then, the new Meiji government regarded the reliance on foreigners with excessive profits as a serious problem and decided to promote direct export by Japanese traders. Under the economic and political situations, Japanese trading companies grew up by harnessing governmental supports; therefore, the companies were privately owned firms but national-interest-minded ones (Omori, Oshima & Kiyama, 2011).

The imprinting characteristics sometimes influenced tax strategies of Japanese trading companies. In the examples of the pre-WWII period, Morimura-gumi in 1918 planned to convert the branch office in New York into American corporation to reduce the tax burden. However, the head office abandoned the conversion scheme. According to a book on the company's history, the reason was that corporate law in the United States did not permit to establish and manage the American cooperation by only Japanese (Morimura Shoji, 1986, pp. 121, 133). In other words, the non-change decision signified that the company preferred paying international double taxation to losing control by Japanese. In another case, local managers in US branch offices of Mitsui Bussan, the biggest general trading company in the pre-WWII period, requested the head office to convert the US branches into subsidiaries during the interwar period (Mitsui Bussan, 1928). Yet the headquarters did not yield. Perhaps the president's policy affected the (non-)decision: 'I have patronised Japanese workers since 1879, and we persist in the policy until today. If foreign workers follow the Mitsui way, it is OK. However, if we recruit some foreign workers following the foreign way, our policy will be broken' (Mitsui Bussan, 1906).

As expected, not all Japanese trading companies chose to bear international double taxation even in the pre-WWII period. Some cotton trading companies such as Nihon Menka and Gosho established the US subsidiaries in Texas (Nichimen, 1962, pp. 149-154; Gosho, 1967, pp. 236-246). Whereas Mitsui Bussan continued to have branch offices in the United States and the United Kingdom, the French and German branch offices were converted in 1920s (Hara, 2000). In addition, a study on the history of Mitsui Bussan revealed the use of secret reserve to manipulate accountable profits in the California branch (Ueyama, 2005, pp. 167-171). Nevertheless, the most popular corporate form adopted by Japanese trading companies was a branch office. In the United States, 27 out of 31 companies chose branch offices. Similarly, 10 out of 13 firms in Australia chose the corporate entity (see, Okura-sho, 1948; Kawabe, 1982, pp. 1-51). There were perhaps no subsidiaries in the UK. Besides, regardless of branch offices or subsidiaries, top management positions were virtually monopolised by Japanese.[7]

The World War II, as ever, steered tax management of Japanese trading companies towards a new course. Owing to sharp increase in taxes on corporate income by the total war, the international double taxation has a destructive effect on foreign-sourced profits. Then, companies that fortunately retuned to foreign markets could not bear the shortage of international double taxation relief and await new international tax policies. A newspaper reported that, by 1952, 11 out of 33 branch offices in the United States had converted into subsidiaries to avoid double taxation between the United States and Japan (Asahi Shimbun, 5 April, 1952, p. 3). These corporate reactions must have contributed to the introduction of foreign tax credit in 1953 and the US–Japan tax treaty in 1954. Moving forward, the trading companies as a front runner of foreign direct investment of Japan became the leading companies to develop tax strategies. In 1977, the Japanese Communist Party introduced the National Diet the tax planning of trading companies' LNG business that utilised transfer pricing and paper companies in Bermuda (Fuji, et al. 1979, pp. 66-72). The maximum use of foreign tax credit system, as mentioned earlier, galvanised public opinion in 1984, pushing the government to promulgate a new relief provision: the ratio of foreign source income to total taxable income was limited to a maximum of 90%.

Meanwhile, although a giant trading company, Itochu Shoji, announced a plan in 1988 that 'the head office would relocate from Japan to a foreign country in 10 years' (*The Nikkei*, 20 March, 1986, p.10), Japanese trading companies have persisted in management by Japanese in Japan. Yoshihara and Hoshino (2003) revealed that only two non-Japanese were presidents of foreign subsidiaries in important overseas branch offices and subsidiaries of nine general trading companies. Their research added that the two managers spoke Japanese fluently. As of 2019, the big seven general trading companies has no non-Japanese in the board of executive directors. There are only two non-executive directors in a company and three executive officers in two companies. The most rational explanation of the preference for Japanese is that the clients of Japanese trading companies are mainly Japanese firms. Even so, the historical persistence of Japan appears to be undeniable, thereby the relocation from Japan for tax planning seems to be regarded as a prohibited strategy.

However, an incident that might show symptoms of change in Japanese trading companies occurred in 2012. Mitsubishi Shoji, the biggest general trading company in the post-WWII period, moved the global headquarters of the mineral resources and metals trading business to Singapore; the head office in Singapore controls the Japanese branch. The news shocked many business analysts because the division of the mineral resources and metals trading business accounted for 40% of the company's profits (Nakamura, 2012). Having said so that, it was the relocation of divisional headquarters.

Conclusion

This study explored a history of Japan's international tax system and tax planning of Japanese overseas business over a century. Based on this study, the working hypothesis that Japanese MNEs regarded themselves as not engaging in aggressive tax planning are as follows: (a) lack of experience; (b) Japanese government's coordinated tax regime learned from foreign precedents; and (c) preference for nationality. With regard to (a), most Japanese MNEs seriously faced international tax issues at least from the 1970s. While Japan's foreign investment itself was not a post-WWII phenomenon, investment into the zone where Japan could wield its power prevented the problem on international taxation. Furthermore, the Japanese government has studied the foreign tax laws and international tax system well over 140 years. Owing to (b), Japanese MNEs could not see a big opportunity to avoid international taxation. The examples of Japanese trading companies might show the possibilities of (c). As in cases of the trading companies', Japanese MNEs perhaps preferred management by Japanese to tax-minimisation strategy. In fact, the persistence of control by headquarters in Japan was repeatedly substantiated by previous studies (Bartlett & Ghoshal, 1989; Harzing, 2000). Sometimes, Japanese MNEs preferred being Japanese firms to tax-minimisation.

On the other hand, as Japanese MNEs accumulate experiences on foreign investment and Japan's economic and political presence is eclipsed, the Japanese MNEs must reconsider the tax strategy. However, the underdeveloped tax management might bear some risk when Japanese MNEs take over companies that are engaged in more complicated tax schemes (e.g., Softbank) or received some advice from international tax consultants or 'experienced' top management (e.g., Nissan). Otherwise, to respond a social request, the company ought to not only pay the taxation but also fulfil accountability on tax transparency. Training in-house tax experts and establishing corporate ethics beyond national logic are needed.

Figures and Tables

Table 1. Japan's Outward FDI by Country/Region (Balance of Payments Basis, Net and Flow)

(Unit: US$ million)

	1987	1997	2007	2017
Asia	n.a.	13,114	19,388	38,266
China	177	1,862	6,218	9,679
Asia NIES	1,671	5,228	6,039	14,983
Hong Kong	n.a.	1,755	1,131	2,121
Singapore	n.a.	2,559	2,233	9,677
ASEAN4	n.a.	4,954	5,007	10,052
India	n.a.	485	1,506	1,060
North America	9,903	7,765	17,385	52,879
U.S.A.	9,641	7,430	15,672	51,981
Central and South America	n.a.	2,364	9,482	10,950
Cayman Islands	n.a.	1,082	5,838	4,664
Oceania	n.a.	284	4,204	3,185
Europe	n.a.	2,607	20,965	59,536
Western Europe	n.a.	2,502	20,456	58,948
Germany	188	277	880	4,670
U.K.	1,038	1,608	3,026	21,628
France	190	−27	479	1,903
Netherlands	n.a.	1,283	12,440	18,552
Luxembourg	n.a.	−670	2,291	4,779
Switzerland	n.a.	15	61	2,441
Eastern Europe, Russia, etc.	n.a.	104	509	589
Middle East	n.a.	205	958	2,044
Africa	n.a.	136	1,101	1,726
World	19,519	26,057	73,483	168,587

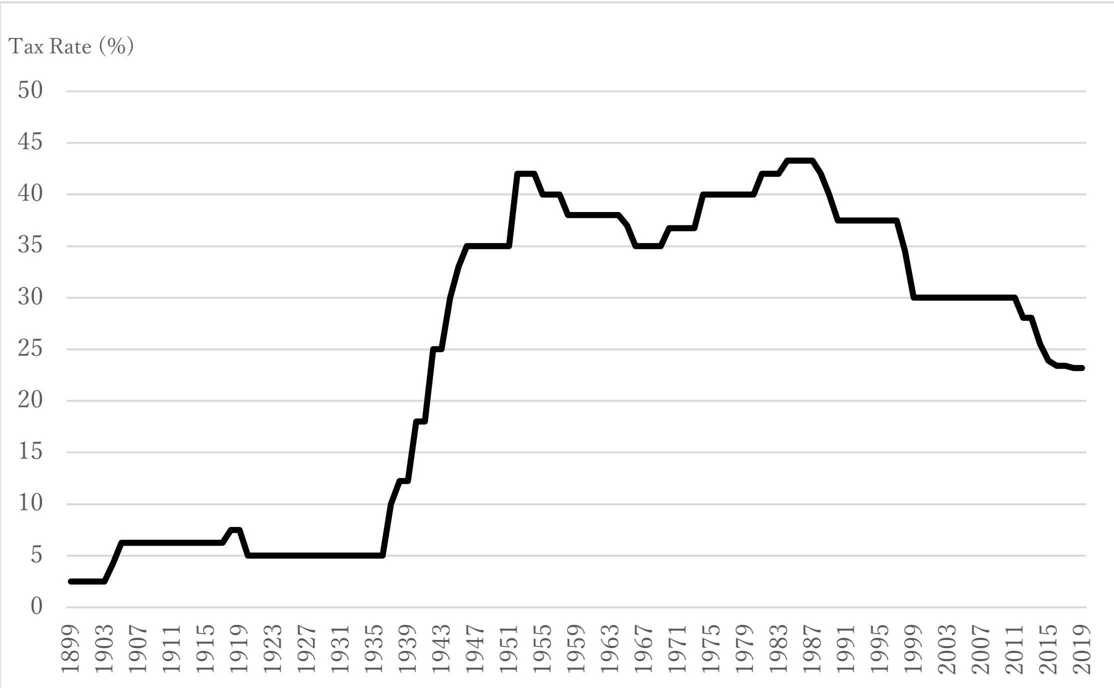
JETRO: https://www.jetro.go.jp/en/reports/statistics.html
(retrieved from 10 August 2019)

Table 2. Comparison between Statutory Tax Rate and Effective Tax Rate

	Statutory tax rate	Effective tax rate	Diffrence
Japan	39.54	38.8	-0.74
US	39.1	27.7	-11.4
UK	28	23.6	-4.4
Mexico	28	27.2	-0.8
Greece	25	25.2	0.2
S. Korea	24.2	24.3	0.1
Poland	19	19.4	0.4

(Source) PwC (2011), p.102

Figure 1. Corporation Tax Rates in Japan (minimum), 1899-2019



(Sources) Okura-sho (1940), Zaimu-sho (2019)

Footnotes

1. Unlike the British Empire, where the suzerain relatively granted client states or territories latitude with regard to taxation, client states or territories of the Japanese Empire had no such rights. Therefore, jurisdictions within the Japanese Empire could not alter their tax systems without the consent of Japan.
2. This sub-section is based on the studies of Akamatsu (2010), Masui (2010) and Yanai (2018).
3. The transfer pricing legislation in 1986 introduced 'Advance Price Agreement', which is an agreement between a tax payer and tax authority determining the transfer pricing methodology for pricing the tax payer's international transactions for future years. The world's first ever agreement was adopted, in turn, by the US in 1991 (Komamiya, 2010).
4. In 1990, the IRS imposed an additional tax for transfer pricing to electronics firms (e.g. Matsushita, Hitachi, Toshiba and Fujitsu). See, Yanai (2018).
5. The questionnaire survey of 1991 revealed that 47 out of 269 companies experienced disputes on transfer pricing taxation and 107 firms feared the future possibilities on the issue. Most companies were anxious about the disputes with US tax authority (Keidanren, 1991).
6. Regarding another case of US-Japan tax confliction, Japanese MNEs strongly resisted the unitary tax in California that allowed the state to tax a company's worldwide operations. Under a leadership of Sony's chairperson, Akio Morita, the scrum of Japanese MNEs powerfully lobbied the state and federal governments against the tax legislation. Eventually, the unitary tax was stopped in the early 1990s (Sony, 1996, pp.311-314).
7. A remarkable exceptional case is Kanematsu, a wool trading company in Australia. The Sydney branch was converted into F. Kanematsu(Australia) Ltd. in 1922. Further, the company appointed two Australian members as managerial directors (Fujimura, 2010, pp. 183-187).

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