

**Testimony of James W. Fatheree  
President, U.S.-Japan Business Council  
U.S.-Japan Tax Treaty  
February 25, 2004**

I am pleased to be here today to testify in support of the “Convention between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income,” hereafter referred to as the revised U.S.-Japan Tax Treaty.

The U.S.-Japan Business Council (USJBC) is comprised of many of the largest U.S. companies operating in Japan across a broad range of industries, including agribusiness, automotive, consumer products, financial services, information technology, and pharmaceuticals. The USJBC’s mission is to promote the business interests of its members on policy issues regarding Japan, as well as improved U.S. relations with Japan.

**U.S. and Japanese Business Support a New Treaty**

A revised US-Japan Tax Treaty is clearly in the interests of U.S. business and the two economies, and the U.S.-Japan Business Council and its members support this very strongly. The USJBC is working closely with the American Chamber of Commerce in Japan (ACCJ), National Foreign Trade Council (NFTC), and U.S. Chamber of Commerce to support ratification of the Treaty in the Senate and the Japanese Diet.

Unique among these organizations, the USJBC has a long-standing relationship with a Japanese counterpart organization, the Japan-US Business Council, comprised of Japan’s leading companies. For 40 years, senior corporate executives belonging to the two organizations have met to discuss economic and trade issues. In light of the strong relationship between our two governments and with U.S. companies making more headway in the Japanese market, these meetings are more amicable than ever.

For the past five years, we have worked together to help realize a new U.S.-Japan Tax Treaty. Our backing helped move things from informal discussions to formal negotiations. We continue to cooperate during the ratification process in the U.S. Senate and Japanese Diet, as the Treaty is a clear “win-win” for both economies. Our goal is not only for the Treaty to be ratified, but that it be ratified before the March 31, 2004 date specified for making the withholding rate reduction effective July 1, 2004.

The Chairman of the USJBC, Sir Deryck Maughan, Chairman and CEO of Citigroup International, and his counterpart, Toshiba Corporation Chairman Taizo Nishimuro, have written to Senator Lugar, the Chairmen of the Foreign Affairs committees in Japan’s Upper and Lower Houses of Parliament, and the Japanese Ministers of Finance and Foreign Affairs to express support for early ratification. To quote from the letter:

“The Treaty...is a major achievement benefiting U.S. and Japanese companies and the two economies. U.S. companies operating in Japan, and Japanese companies operating in the United States, will benefit significantly from the elimination of withholding taxes on all royalty income, certain interest income, and dividend income as stipulated in the

treaty, as well as other provisions. The revised treaty will provide incentives to further bilateral trade and investment by eliminating tax-related barriers.

The letter also states that an early effective date of July 1, 2004, for the withholding provisions would “provide immediate economic benefits to U.S. and Japanese companies at a time when more foreign investment is needed to supplement employment and provide needed economic impetus in both countries.”

On this point, I would like to note that the timing of Senate action is important. The Japanese Diet is poised to ratify the Treaty before March 31st if the Senate ratifies it without amendment or reservation. Japan’s process is more complicated in that there is a parallel budgetary action that must be taken, and the Emperor must also sign the Treaty. As a practical matter, Senate approval in early March would therefore be essential. The fact that the Diet is prepared to ratify a treaty early is unprecedented, so we encourage the Foreign Relations Committee, and the full Senate, to approve the Treaty as quickly as possible in order to leave sufficient time for the Diet to act before March 31.

### **Changes in U.S.-Japan Business Necessitate a New Treaty**

It is entirely appropriate that the treaty governing income tax treatment between the U.S. and Japan be adjusted to reflect the enormous growth and changes in our economic relationship over the past 30 years. The existing treaty reflects both the great disparities, as well as the much smaller trade and investment flows, between the two economies when the original Treaty was ratified in 1972. Although hard to imagine now, when the original treaty was negotiated, Japan was a “developing” economy, a bilateral trade deficit amounting to a few billion dollars was considered a major problem, and cross-border investment flows were a fraction of what they are today.

Since then, the bilateral economic relationship and our respective tax systems have grown tremendously in magnitude and complexity. Two-way trade now exceeds \$180 billion annually. More significant for purposes of the treaty is the sharp rise in direct investment by U.S. and Japan companies in each other’s economy. For years, the imbalanced nature of the economic relationship led to considerable friction.

Given much greater access to U.S. markets, Japanese companies exported to and invested in the U.S. to a much greater extent than U.S. companies did to/in Japan. Japanese foreign direct investment, or FDI, in the United States grew tremendously, and today is over \$150 billion on a stock basis. Japan’s global companies have established production, distribution, and R&D facilities throughout the U.S. from which they generate sizable revenues and earnings -- and provide over 800,000 domestic jobs.

Over the past five years, the Japanese market has become relatively more open to U.S. goods, services and investment. Financial hardship has helped bring about important changes in certain industries, particularly financial services. While U.S. exports to Japan have fallen due to weak Japanese demand, U.S. FDI in Japan has, despite many obstacles, doubled, from \$33 billion in 1997 to almost \$70 billion in 2002. U.S. companies have made inroads into sectors such as autos, health care, IT and, particularly, financial services that were unimaginable a few years ago. Some U.S. companies are generating

significantly more revenue and income in Japan, with a few deriving over 10% of total profits from their Japanese activities. U.S. companies are currently subject to double taxation on this income.

### **Benefits of the New Treaty**

Trade and investment between the two largest economies could and should be greater. The revised Treaty will help improve business conditions and provide incentives to more activity. Thus, while there are many important provisions in the new Treaty, from my perspective the primary benefit for U.S. -- and Japanese companies -- is the elimination or significant reduction of withholding rates on dividends, royalties, and interest:

- Royalties - Most significantly, the treaty would lower the withholding rate on royalties from 10% to 0% in most cases except those involving certain back-to-back payments. Japan previously has not agreed to a full exemption in other treaties. Given the extensive cross-border technology and intellectual property flows, media and technology companies will benefit most, but any U.S. or Japanese company licensing patents, trademarks, designs or formulas will benefit as well.
- Dividends – The full exemption on dividends in cases such as qualifying pension funds and those in which the beneficial owner has at least a 50% stake in the foreign subsidiary is a major improvement over the current 10% rate. Even in cases not qualifying for full exemption, the new 5% rate is a significant improvement.
- Interest – The full exemption provides significant benefits to specified companies such as banks, insurance companies, securities dealers and other financial institutions meeting a 50% test for liabilities or assets claimed; some pension funds; cases of government-insured or financed debt; and debt arising from specified credit and equipment sales.

While aggregate numbers are difficult to come by, I can provide some sense of the magnitude of benefit to U.S. companies and the U.S. Treasury. For some U.S. companies with the largest operations in Japan, the reduction in Japanese withholding taxes could amount to as much as \$100 – 200 million annually. Some portion of this amount may result from the reduction of the double taxation experienced under the current regime. These savings will produce greater cash flow that can be used for additional U.S. investment and job creation. In addition, the increased flow from these savings will directly benefit the U.S. Treasury in the form of greater U.S. tax receipts.

### **Conclusion**

The USJBC and the Japan-U.S. Business Council strongly support the revised U.S.-Japan Tax Treaty and would like to see the Senate and Japanese Diet ratify it before March 31, 2004, so that withholding rates are reduced starting July 1, 2004. This will provide immediate savings to U.S. and Japanese companies as well as long-term incentives for new investments that will boost economic activity and employment in both countries.

On behalf of the member companies of the U.S.-Japan Business Council, I thank you for the opportunity to express our support for expeditious ratification of the revised Treaty.