

November 6, 2003

Excellency:

I have the honor to acknowledge receipt of Your Excellency's note of today's date which reads as follows:

“Excellency:

I have the honor to refer to the Convention between the Government of Japan and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income which was signed today (hereinafter referred to as “the Convention”) and to the Protocol also signed today which forms an integral part of the Convention, and to confirm, on behalf of the Government of Japan, the following understanding reached between the Government of Japan and the Government of the United States of America:

His Excellency

Ryozo Kato,

Ambassador of Japan.

1. In order to avoid application of the local inhabitant taxes or the enterprise tax as provided for in paragraph 3 of Article 8 of the Convention, if a political subdivision or local authority of the United States seeks to levy a tax similar to the local inhabitant taxes or the enterprise tax in Japan on the profits of any enterprise of Japan from the operation of ships or aircraft in international traffic in circumstances where the Convention would preclude the imposition of a Federal income tax on those profits, the Government of the United States will use its best endeavors to persuade that political subdivision or local authority to refrain from imposing such tax.

2. It is understood that the principle as set out in paragraph 1 of Article 9 of the Convention may apply for the purposes of determining the profits to be attributed to a permanent establishment. It is understood that the provisions of Article 7 of the Convention shall not prevent the Contracting States from treating the permanent establishment as having the same amount of capital that it would need to support its activities if it were a distinct and separate enterprise engaged in the same or similar activities. With respect to financial institutions other than insurance companies, a Contracting State may determine the amount of capital to be attributed to a permanent establishment by allocating the institution's total equity between its various offices on the basis of the proportion of the financial institution's risk-weighted assets attributable to each of them.

3. With reference to Article 9 of the Convention, it is understood that double taxation can be avoided only if tax authorities share a common understanding of the principles to be applied in resolving transfer pricing cases. Therefore, the Contracting States shall undertake to conduct transfer pricing examinations of enterprises and evaluate applications for advance pricing arrangements in accordance with the Transfer Pricing Guidelines for Multinational Enterprises

and Tax Administrations of the Organisation for Economic Cooperation and Development (hereinafter referred to as “the OECD Transfer Pricing Guidelines”), which reflect the international consensus with respect to these issues. The domestic transfer pricing rules, including the transfer pricing methods, of each Contracting State may be applied in resolving transfer pricing cases under the Convention only to the extent that they are consistent with the OECD Transfer Pricing Guidelines.

4. With reference to paragraphs 2 and 3 of Article 10 of the Convention, it is understood that, in the case of Japan, the date on which entitlement to the dividends is determined is the end of the accounting period for which the distribution of profits takes place.

5. With reference to subparagraph (c) of paragraph 3 of Article 11 of the Convention:

(a) it is understood that the term “bonds” includes bonds, commercial paper, and medium-term notes, whether collateralized or not; and

(b) it is understood that bonds that are subject to transfer restrictions applicable to private placements shall not be considered to have been issued in the financial markets.

The preceding sentence shall not apply to offerings qualifying for exemption from securities registration requirements pursuant to Rule 144A promulgated under the Securities Act of 1933 of the United States or any similar provisions under the domestic law of Japan.

6. It is understood that the term “authorities (including courts and administrative bodies) involved in the administration of the taxes” as referred to in paragraph 2 of Article 26 of the Convention includes such authorities as provide legal advice to those governmental entities that are directly involved in the assessment or collection, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes, but are not themselves a part of such

entities, and includes, in the case of the United States, the Office of Chief Counsel for the Internal Revenue Service.

7. It is understood that the term “supervisory bodies” as referred to in paragraph 2 of Article 26 of the Convention includes authorities that supervise the general administration of the government of a Contracting State.

8. It is understood that the powers of the competent authority of each Contracting State to obtain information include powers to obtain information held by financial institutions, nominees, or persons acting in an agency or fiduciary capacity (not including information relating to communications between a legal representative in its role as such and its client to the extent that the communications are protected under domestic law), and information relating to the ownership of legal persons, and that the competent authority of each Contracting State is able to exchange such information in accordance with Article 26 of the Convention.

If the foregoing understanding is acceptable to the Government of the United States of America, I have the honor to suggest that the present note and Your Excellency’s reply to that effect should be regarded as constituting an agreement between the two Governments in this matter, which shall enter into force at the same time as the Convention.

I avail myself of this opportunity to extend to Your Excellency the assurance of my highest consideration.”

I have further the honor to confirm on behalf of the Government of the United States of America that the foregoing understanding is acceptable and to agree that Your Excellency’s note

and this note shall be regarded as constituting an agreement between the two Governments which shall enter into force at the same time as the Convention.

I avail myself of this opportunity to renew to Your Excellency the assurance of my highest consideration.

For the Secretary of State: