Doing Business in Japan

PKF

Contents

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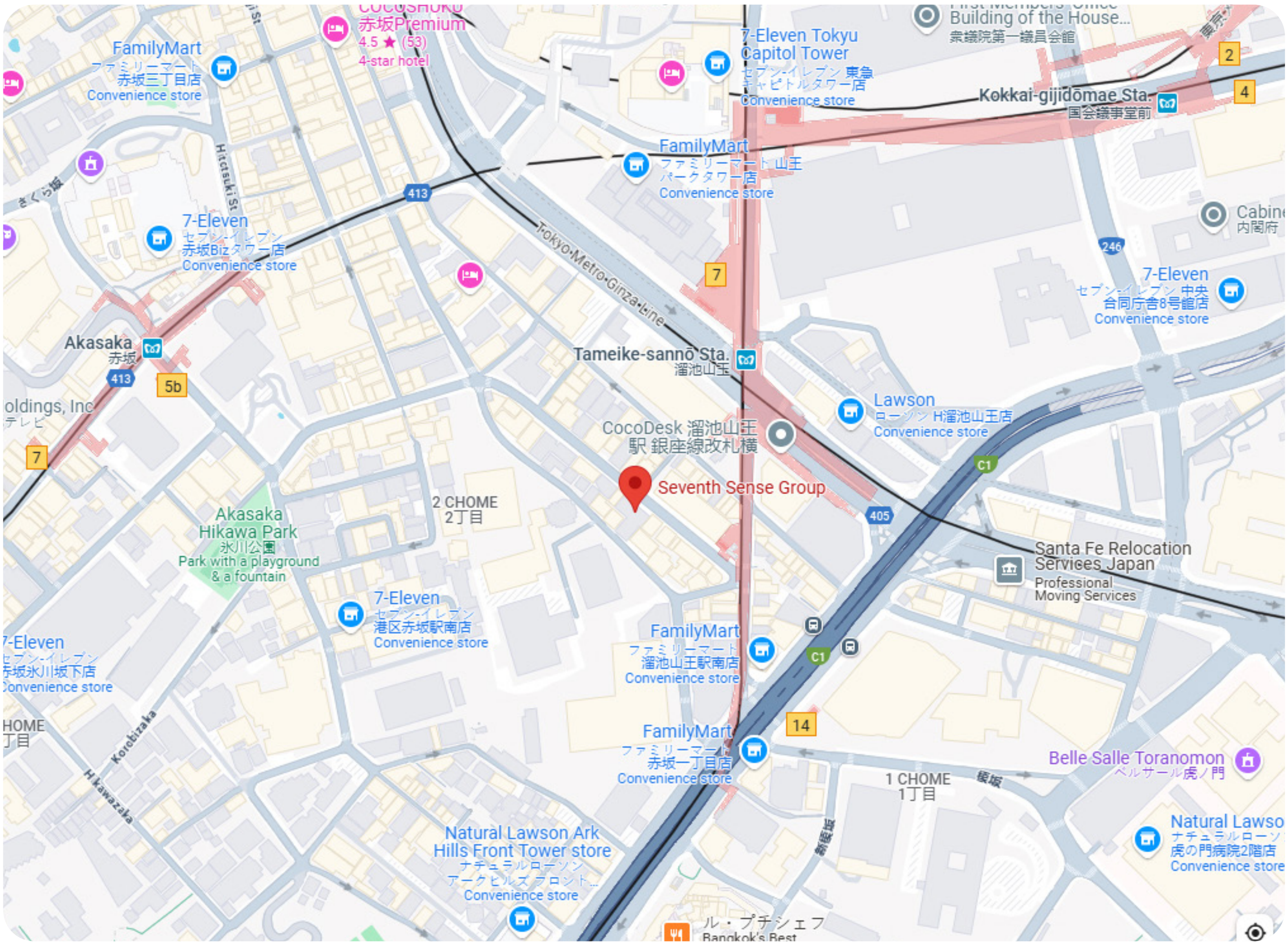


Foreword

This guide is produced for use by clients of PKF Global member firms around the world, and serves as an introduction to the fiscal and commercial environment of Japan for those who are considering doing business within its jurisdiction. The contents provide a guide for understanding the business processes, rather than a complete description of everything a business or entity needs to know. This guide should not be used as the basis for laws of Japan which are constantly being modified, both legislatively and judicially; clients are advised to seek specific professional advice from one of the PKF Japan network member firms before proceeding with any business activities in Japan.

The PKF Seventh Sense Tax Services team provides other booklets (in Japanese) regarding taxation, including the Worldwide Tax Guide and International Tax Alert. Please contact us if you're interested in accessing these publications.

Introduction to Japan

Geography and Population

Japan is situated in north-eastern Asia between the North Pacific and the Sea of Japan. The area of Japan is 377,873 square kilometres, nearly equivalent to Germany and Switzerland combined or slightly smaller than California. Japan consists of four major islands, surrounded by more than 10,000 smaller islands.

Japan's population is over 120 million. Most Japanese people reside in densely populated urban areas like Tokyo, the capital city of Japan. The population of the Tokyo Metropolitan Area including the city, some of its suburbs and the surrounding area is approximately 12 million.

Constitution

Japan is a constitutional monarchy where the power of the emperor is very limited. As a ceremonial figurehead, he is defined by the constitution as 'the symbol of the state and of the unity of the people'. Power is held chiefly by the prime minister of Japan and other elected members of the Diet, while sovereignty is vested in the Japanese people.

Legal System

Japan's legal system is conducted in a framework of a parliamentary representative democratic monarchy, where the prime minister of Japan is the head of government and the head of a multi-party system. Executive power is exercised by the government. Legislative power is vested in both the government and the two chambers of parliament, the Diet with the House of Representatives and the House of Councillors. The judiciary is independent of the executive and the legislature. In academic studies, Japan is generally considered a constitutional monarchy.

Communication and Transportation

Telecommunication, internet and transportation in Japan are highly developed. The telephone direct dialling system gives instantaneous international communication from both fixed and mobile units.

Language and Currency

Japanese is the official language used in Japan. However, many Japanese people can understand English since it is a compulsory subject under Japan's education system.

The currency used is Japanese yen (JPY).

Major Exports and Imports

Major trading partners of Japan for exports are China and the United States of America, and other countries in Asia, such as South Korea, Taiwan, Hong Kong, Singapore and Thailand. Cars, electric devices and machinery are the primary exports to other countries.

As for imports, China, the United States of America, Australia, Saudi Arabia, South Korea, UAE and Taiwan are the country's major trading partners. Imported items mainly include natural resources, such as oil, iron ore and food items.

Advantages of Investing in Japan

Japan is a centre of new trends and creativity and is a coveted testing ground for new products. Today, increasing numbers of companies around the world are partnering with Japanese companies to develop products and services, create innovative technologies and conduct research and development (R&D) projects.

Japan has an enormous market, one of the world's largest in terms of economic scale. The scale of the economy of Japan's individual regions rivals that of some countries.

Japan's industries are globally competitive and, as can be seen in the automotive sector, the nation's industrial structure is broad-based, with a large number of smaller companies functioning to support the world heavyweights. For foreign companies, Japan is not just an attractive sales market but also a country that offers foreign companies several opportunities in all its sectors.

As the East Asian market grows rapidly, the economic integration between countries in the region continues to strengthen. Japan is becoming ever more important for companies around the world as a location for regional headquarters and R&D bases to support their expansion into Asia.

Programmes and Support to Promote Investment in Japan

Foreign-capitalised firms operating in Japan are eligible to take out loans from government-affiliated financial institutions for the purposes of acquiring land, buildings, machinery and equipment and for R&D.

To improve the administration procedure for investment, each ministry or institution related to investment has established a single contact point, which can indicate the division in charge of a particular procedure.

Furthermore, many local governments provide local tax abatements or exemptions, subsidies and other incentives to firms that set up operations in their regions.

Import Control

The government levies customs duties on some goods entering Japan. In order to import goods, customs clearance must be obtained. This procedure includes import and quarantine controls on certain goods.

Exchange Control

The vast majority of industries in Japan have been liberalised from trade barriers and are welcoming foreign direct investment. Such investment is treated as 'foreign direct investment in Japan' under the Foreign Exchange and Foreign Trade Act and is distinguished from financial and portfolio investment. In principle, submitting an ex post facto notification to the Minister of Finance and the minister(s) with authority over a particular industry should be sufficient to ensure a foreign investor meets their reporting requirements when investing in Japan.

Source of Finance

Japan is a major international financial centre with a deregulated environment attracting the cream of the world's financial institutions and offering a full range of competitive financial services. Japan is a member of the World Bank and Asian Development Bank, both of which are among the financial institutions that provide loans and grants to national governments for the purposes of pursuing capital projects.

Business Structures

Types of Business Structures

The main business structures generally used by foreign companies to establish a business presence in Japan are:

- representative office
- branch office
- subsidiary company
- limited liability partnership.

Representative Office

Representative offices are established as locations for carrying out preparatory and supplemental tasks aimed at enabling foreign companies to engage in full-scale business operations in Japan.

These offices may conduct market surveys, collect information, purchase goods and implement publicity or advertising efforts, but they are not permitted to engage in any sales activities. The establishment of a representative office does not require registration. A representative office cannot ordinarily open bank accounts or lease real estate in its own name, thus, agreements for such purposes must instead be signed by the head office of the foreign company or by the representative at the representative office in their individual capacity.

Branch Office

A branch office can begin its business operations as soon as the office location is secured, the branch office representative is determined and the necessary information is registered. A Japanese branch office is a business location that provides services in Japan. Such services are decided upon by an organisation authorised by the foreign company, and the branch office is usually not expected to engage in independent decision-making. The branch office does not have its own legal corporate status, but instead is deemed to be encompassed within the corporate status of the foreign company. Therefore, in general, the foreign company is ultimately responsible for all debts and credits generated by the activities of its Japanese branch office. The branch office, however, may open bank accounts and lease real estate in its own name.

Subsidiary Company

A foreign company establishing a subsidiary company in Japan must choose to establish the subsidiary company as a joint stock corporation (**kabushiki kaisha** or KK), limited liability company (**godo kaisha** or LLC) or a similar entity recognised under Japanese corporate law.

All types of subsidiary companies can be established by completing the required procedures stipulated by law and then registering the corporation. A subsidiary is a separate corporation from the foreign parent company. Thus, the subsidiary will bear the liability of an equity participant stipulated by law for all debts and credits generated by its activities.

There are other methods by which a foreign company may invest in Japan using a Japanese corporation without establishing a subsidiary. One method is a joint venture with a Japanese enterprise or investment company and another method is by equity participation in a Japanese enterprise.

Limited Liability Partnership

It is also possible to do business in Japan by using a **yugen sekinin jigyo kumiai**. This type of entity, considered as the Japanese version of a limited liability partnership (LLP), is not a corporation, but a partnership formed only by the equity participants having limited liability. LLPs are also distinguished by the fact that internal rules can be freely determined by agreement between the equity participants, and that taxes are levied on profits allocated to equity participants without LLPs themselves being liable for taxation.

Comparison of Types of Business Operation

The legal differences between each of the different business structures described above are summarised in the following table.

	Representative office	Branch office (office of foreign company)	Subsidiary company (joint stock corporation)	LLP
Business activity	N/A	Available	Available	Available
Registration	N/A	Necessary	Necessary	Necessary
Capital	N/A	N/A	No minimum capitalisation requirements	
Representative director	N/A	Branch representative required	At least one	No legally stipulated minimum
Director	N/A	N/A	At least one	
Corporate auditor	N/A	N/A	One or more may be appointed	
Accounting	N/A	Aggregation with income in home country required	Responsible for preparing and filing entity accounts	

Joint Ventures

A joint venture (often abbreviated to 'JV') is an entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity by both contributing equity, and sharing the revenue, expenses and control of the enterprise. In Japan, joint ventures are mainly organised for one specific purpose like construction projects in the construction industry. There are no special regulations governing the establishment of joint ventures.

Accounting

Disclosure System

The principal objective of the disclosure requirement of a joint stock corporation (**kabushiki kaisha**) under the Corporation Law is to protect the interests of both creditors and shareholders.

A joint stock corporation is required to hold a general meeting of the shareholders within three months of each fiscal year end to deliberate on certain corporate matters, including the approval of its financial statements. Typically, the notification of a general meeting of the shareholders must be accompanied by a business report and financial documents attested by the corporate statutory auditor or the audit committee (being an internal committee responsible for the oversight of the financial reporting process, with no requirement for its members to be certified public accountants (CPAs)). The financial statements are required to be submitted to and approved by the shareholders at the general meeting.

These documents are subsequently mailed to the shareholders in the form of an annual report. In addition, the Corporation Law stipulates that these documents should be maintained at all times at the head office and at branches of the joint stock corporation for inspection by creditors and shareholders.

Reporting Standards

The underlying objective of financial documents prepared in accordance with the Corporation Law is to protect creditors' and shareholders' interests. Accordingly, disclosures relating to the availability of retained earnings for the distribution of dividends and to the creditworthiness and earning power of the reporting entity are of prime importance.

The following financial documents must be prepared and submitted by a corporation to its annual general meeting of the shareholders:

- balance sheet
- income statement
- statement of changes in net assets
- notes to financial statements.

In addition, the Corporation Law requires corporations to prepare certain supporting schedules to supplement the financial documents and business report.

Accounting Standards – Japanese GAAP and IFRS

Following the reorganisation of government ministries and agencies, the process of setting accounting standards has been gradually changing. This was previously overseen by the Ministry of Finance and the Financial Services Agency.

The Financial Accounting Standards Foundation (FASF) was established in 2001, and the Accounting Standards Board of Japan (ASBJ) was organised under the auspices of the FASF as an independent, private-sector entity to develop accounting standards in Japan. Since its inception, the ASBJ has issued many accounting standards, guidance and other documents that address practical issues. In addition, in January 2005, it announced the launch of a joint project with the International Accounting Standards Board (IASB), aimed at achieving convergence between Japanese GAAP and International Financial Reporting Standards (IFRS).

In October 2006, the ASBJ decided to formulate and release the 'ASBJ Project Plan' focusing on accounting standards development projects related to convergence, in an attempt to indicate the status of initiatives of the ASBJ to various constituencies in Japan and abroad.

In the report entitled 'Towards the International Convergence of Accounting Standards' issued by the Planning and Coordination Committee of the Business Accounting Council in July 2006, primary emphasis was placed on mapping out the work to be carried out up to the end of 2007. The report also noted the importance of bringing the convergence of Japanese GAAP and IFRS in line with the timetable for EU convergence. In practice, this meant focusing on the 26 issues highlighted by the Committee of European Securities Regulators (CESR) during the EU equivalence assessment process and addressing these issues by early 2008.

On 8 August 2007, the ASBJ and the IASB jointly announced an agreement (known as the Tokyo Agreement) to accelerate the convergence of Japanese GAAP and IFRS. This process was initiated in March 2005. As part of the agreement, the Boards aimed to eliminate the major differences between Japanese GAAP and IFRS by 2008 and the remaining differences by 30 June 2011. In the ministerial statement issued by the Minister of State for Financial Services in 2011 entitled 'Consideration of the Application of IFRS', it was announced that the mandatory application of IFRS would be temporarily delayed. In 2013, the Business Accounting Council's 'Tentative Policy on the Adoption of International Financial Reporting Standards' stated that mandatory adoption of IFRS was still not appropriate and that it was important for companies that voluntarily adopt IFRS to accumulate experience. In addition, Japan's Modified International Standards (JMIS) were introduced. Since 2014, the cabinet decision on the 'Revitalisation Strategy for Japan' has continued to promote the expansion of voluntary IFRS adoption. As a result, as at March 2024, the number of companies that have adopted IFRS is 270.

The following table shows the differences between Japanese GAAP and IFRS.

	Japanese GAAP	IFRS
Revenue recognition standards (sales recognition standards)	Realisation basis where revenue is recorded when realised	Revenue is recognised when the performance obligation is satisfied
Unlisted equity securities carried on the balance sheet	Acquisition cost in principle	Fair value
Valuation of intangible assets accepted at the time of M&A (acquired side)	Legal rights such as patents and trademarks recorded at fair value	Including licence agreements, franchise agreements, customer lists, etc., recorded at fair value
Goodwill	Straight-line amortisation over 20 years or less	Not amortised
Useful life of fixed assets	Useful life under corporate tax law	Period during which the entity expects to use the fixed asset
Research and development expenses	All expensed as incurred	Research costs are expensed as incurred and development costs are capitalised only if they meet requirements

Regarding revenue recognition standards, it was compulsory to apply Corporate Accounting Standard No. 29 'Accounting Standard for Revenue Recognition' (the so-called 'new revenue recognition standard') from the beginning of fiscal years starting on or after 1 April 2021. Since revenue is recognised when the performance obligation is satisfied, Japanese GAAP is basically aligned with IFRS.

Auditing System

There are two types of audits, the main difference being who performs the audit: internal audits are conducted by personnel in the organisation, and external audits are conducted by outside parties who are independent from the organisation (for example, audits by a CPA). The purpose of an external audit is to provide reasonable assurance to various stakeholders as to whether the financial statements prepared by companies are fairly presented, based on their audit as an independent third party. CPA audits are required under many laws, including the Companies Act and the Financial Instruments and Exchange Law, and contribute to ensuring the credibility of the financial information that entities provide.

A major Internal audit is one conducted by 'company auditors'. Under the Companies Act, large entities are required to appoint company auditors to oversee the activities of their directors. Recently, more companies have tended to employ internal auditors to audit internal control, under management supervision, in order to establish a more rigorous structure for external audits. In such cases, the work of CPAs, company auditors and internal auditors is closely interrelated to enable each party to conduct their audits more effectively.

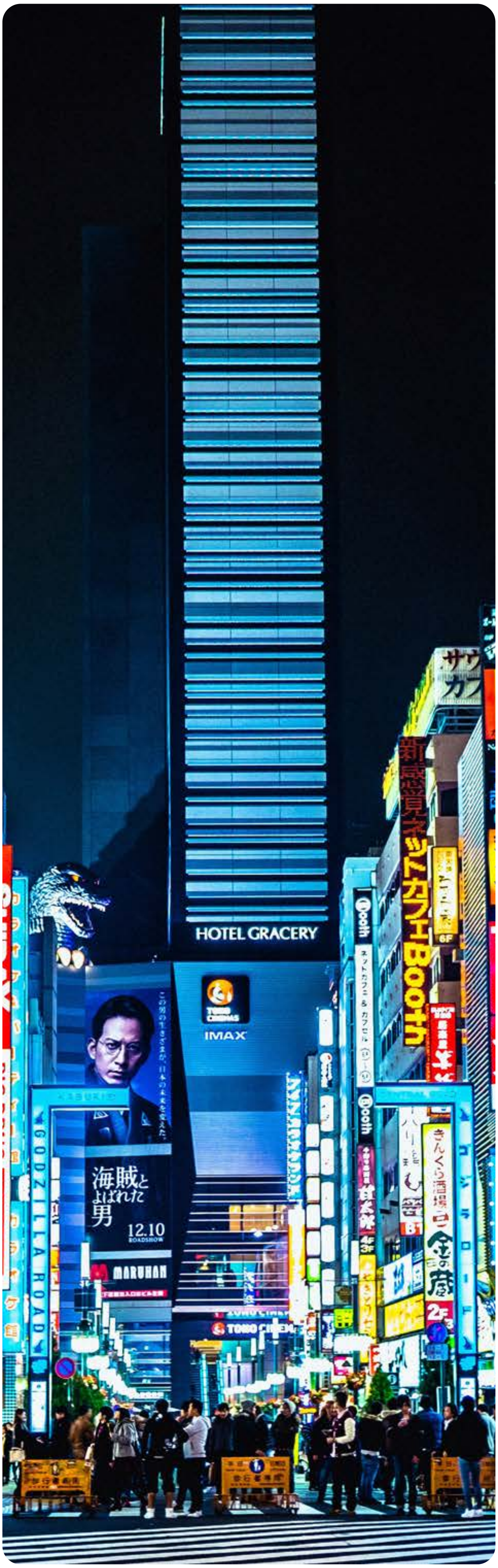
CPA external audits must be conducted in accordance with the Auditing Standards codified by the Business Accounting Council and with the implementation guidance (Auditing Standards Committee Statements) issued by the Japanese Institute of Certified Public Accountants (JICPA). The Auditing Standards codified by the Business Accounting Council together with the implementation guidance issued by JICPA are deemed to be the generally accepted auditing standards (GAAS) in Japan.

Statutory audits are required mainly under the Financial Instruments and Exchange Law and the Corporation Law. Financial statements of public corporations must be audited by independent CPAs under the Financial Instruments and Exchange Law. Furthermore, the Corporation Law requires certain corporations (for example, large corporations capitalised at JPY 500 million or more or corporations whose liabilities are JPY 20 billion or more at the fiscal year end) to have their financial documents audited by independent CPAs prior to being sent out with the invitation letter to the annual general meeting of the shareholders.

The Corporation Law also provides that the corporate statutory auditor or the audit committee has a duty to examine the financial documents prior to the annual general shareholders' meeting. The corporate statutory auditor or equivalent is also responsible for monitoring the activities of the directors as part of corporate governance. Some corporations request voluntary audits in order to obtain independent assurance regarding the accuracy and reliability of their financial statements in order to strengthen management's accountability or to facilitate activities.

In addition, in recent years, the number of companies with audit and supervisory committees has increased, and the number of companies that require their corporate auditors to actively provide management opinions is also increasing.

Taxation



Introduction

Japanese taxes comprise national and local taxes.

National Taxes

- Tax on income and profits
  - Individual income tax
  - Corporate tax
- Tax on consumption
  - Consumption tax
  - Other taxes (liquor tax, gasoline tax, local road tax, etc.)
- Tax on inheritance and gifts
  - Inheritance tax
  - Gift tax
- Taxes on property
  - Motor vehicle tonnage tax
- Tax on transactions
  - Stamp tax, registration and licence tax, customs duty, etc.

Local Taxes

- Tax on income and profits
  - Prefectural inhabitant tax
  - Enterprise tax
  - Municipal inhabitant tax
- Tax on consumption
  - Special local consumption tax
  - Other taxes (tobacco tax, golf course tax, bathing tax, etc.)
- Taxes on property
  - Fixed assets tax
  - Business office tax
  - Other taxes (automobile tax, special land holding tax, etc.)
- Other
  - Real property acquisition tax, automobile acquisition tax, etc.

Tax Administration System

National taxes are levied and collected by the National Tax Agency (NTA), which is a semi-independent organisation under the Ministry of Finance. The NTA consists of the headquarters office, 11 regional taxation bureaus and 524 tax offices.

Local governments have their own tax offices, separate from national tax offices, to levy and collect local taxes.

Scope of Taxable Income for Corporations

Japanese Company (Subsidiary)

A Japanese company is a corporation having its head office in Japan, such as a Japanese subsidiary of a foreign company. While worldwide income (domestic and foreign source income) is subject to Japanese corporate tax, a foreign tax credit is granted to Japanese companies.

Foreign Company (Branch Office)

Only domestic source income of a foreign company is subject to Japanese corporate tax. No foreign tax credit is granted to a foreign company.

Foreign companies, i.e. companies whose head office is not located in Japan, are classified into the following four types for tax purposes:

- Foreign company carrying on business through a branch office, factory or other fixed place of business (permanent establishment) situated in Japan
  - Subject to tax on all domestic source income and must file a tax return.
- Foreign company carrying on business not through a permanent establishment but through undertaking construction, installation or assembly activities in Japan for longer than one year or supervising such activities undertaken in Japan for longer than one year or an agent in Japan who habitually exercises the authority to conclude contracts for or on behalf of a foreign company
  - Subject to tax on income derived from such business in Japan and on certain other domestic source income and must file a tax return.
- Foreign company having no permanent establishment and not carrying on business as stated above but having certain domestic source income such as income from providing personal services in Japan, income from rent for the use of real estate and similar property in Japan, income from the sale of real property in Japan, income from the sale of stock of a Japanese company, etc.
  - Subject to tax levied on such income and must file a tax return. However, this may be subject to the application of a tax treaty.
- For a foreign company other than those described above
  - Certain income such as dividends and royalties are subject to Japanese withholding tax. However, this may be subject to the application of a tax treaty.

Representative Office

A representative office of a foreign company engaged in advertising, providing information, conducting market surveys and performing other supplementary activities in Japan for its head office is not subject to Japanese corporate tax.

Taxation of Corporations

Tax on corporate income consists of corporate tax (national tax), corporate inhabitant tax and corporate enterprise tax (local tax).

Corporate Tax

The tax on ordinary income is the tax levied on net income accruing to a company in a business year. The business year for tax purposes usually means the accounting period of a corporation.

The tax base for ordinary income tax is the corporation's net income for each business year. Net income is the excess of 'gross income' over 'total costs' for each business year. Gross income and total expenses are calculated according to Japanese GAAP, including using an accruals basis of accounting. There are some items which are not deductible for Japanese tax purposes (depreciation costs, provisions for certain allowances and reserves, etc.) and other items for which a deduction is limited or restricted (entertainment expenses, donations, certain taxes, etc.).

Gross Income

- Dividends received

  Substantial corporate shareholders
  Dividends (reduced by interest expenses) derived from shares of other companies are exempt, provided that the recipient company owns at least 25% of the shares in the distributing corporation.

  Following the 2010 tax reform, a dividend received from a 100% group company is fully excluded from taxable income without any reduction of the interest expenses.

  Portfolio corporate shareholders
  If the recipient company owns less than 25% of the shares in the distributing corporation, or shareholdings of at least 25% but held for less than six months, 50% of the dividends (reduced by holding expenses) are exempt from corporate income tax for the recipient.

- Ordinary sales

  Revenue from ordinary sales of merchandise is included in the amount of gross income of the business year in which delivery was made.

- Long-term contracts

  Net profit accruing from a contract is, in principle, reported in the business year in which the contract is completed, despite the fact that it may cover more than one business year. This rule may be referred to as the completed contract rule. However, in the case of a large-scale construction with a contract amount of JPY 1 billion or more, the percentage of completion rule must be applied if the term of construction is one year or more and certain conditions are met.

Total Costs

As a general principle, cost of sales, cost of completed construction, selling expenses, general and administrative expenses and other expenses and losses are deductible from gross income of the business year.

- Taxes paid

  Taxes such as enterprise tax, taxes on property or transactions, etc. are deductible for the purposes of the corporate tax calculation. Other taxes such as corporate tax, inhabitant tax, delinquency tax or penalties, etc. are not deductible.

- Salaries, wages and bonuses

  In principle, salaries, wages and bonuses paid to employees of a corporation are deductible expenses. However, unreasonably high salaries paid to directors and bonuses paid to directors and similar highly ranked persons are not deductible.

- Entertainment expenses

  In principle, entertainment expenses are not deductible for tax purposes, even though such expenses are necessary for carrying out a business activity. However, small and medium-sized enterprises (SMEs) whose paid-in capital is JPY 100 million or less are allowed to deduct entertainment expenses up to JPY 8 million or 50% of their eating and drinking expenses for tax purposes, except for SMEs which are wholly owned by a company that has paid-in capital of JPY 500 million or more after the group taxation regime is effective.

  For fiscal years beginning on or after 1 April 2020, no tax deduction is allowed for entertainment expenses of corporations whose amount of capital or investments exceeds JPY 10 billion at the end of the fiscal year.

- Donations

  Contributions to the national and local government and other contributions designated for public purposes are fully deductible. Other contributions to designated organisations are deductible up to a certain amount, subject to limitations.

- Bad debt losses

  Receivables to be written off which are determined as part of a restructuring plan or composition admissible under legal procedures or as agreed upon in a creditors' meeting and receivables which are ultimately uncollectible due to the financial position of the debtor are deductible as a bad debt loss.

- Depreciation costs

  Corporate tax law permits the deduction of a reasonable allowance for the exhaustion or wear and tear of depreciable assets, tangible or intangible, within the limits allowed, as expenses for accounting purposes.

  A corporation may choose one depreciation method for each group of its depreciable assets or for each office, shop, factory, etc. from among the depreciation methods such as the reducing balance method, straight-line method, unit of production method, etc. Also, in Japan, new and used assets differ with respect to useful life.

  The applicable depreciation method when a corporation has not notified a tax office of its choice is as follows:

Asset classification	Depreciation method
Tangible assets (excluding buildings)	Declining balance method
Buildings	Straight-line method
Intangible assets	Straight-line method

Minor assets whose acquisition cost per unit is less than JPY 100,000 can be immediately deducted as expenses in the business year of acquisition.

Credit for Foreign Tax

In order to eliminate international double taxation on income, foreign tax levied on a Japanese domestic corporation in the ordinary course of its business may be credited against Japanese corporation tax, subject to certain limitations. This is referred to as a foreign tax credit. Furthermore, in order to treat overseas investment through a foreign subsidiary in the same manner as overseas investment through a branch, foreign taxes levied on a foreign subsidiary of a Japanese domestic corporation may be credited against Japanese corporation tax levied on the Japanese parent company. This is called an indirect foreign tax credit. The credit for foreign taxes is granted unilaterally.

Place of Tax Payment

A corporation is required to file returns, pay taxes and supply details of the computation of taxable income to the tax office having jurisdiction over the place where the corporation is required to pay tax.

The place of tax payment of a domestic company (subsidiary of a foreign company) is the place where its head office is located. In the case of a foreign corporation (branch office of a foreign company), the place of tax payment is the location of the corporation's main permanent establishment.

Blue Returns

A corporation may file a blue tax return with the approval of the tax office. A corporation filing a blue return must keep a journal, a general ledger and other required books, and record all transactions affecting assets, liabilities and capital in the books clearly and in good order according to the principles of double entry bookkeeping in order to be able to calculate its taxable income accurately. Furthermore, the corporation must settle accounts based on its records, prepare balance sheets, profit and loss statements and other statements, and maintain its financial statements, accounting books and related documents for at least seven years (10 years for fiscal years in which tax losses are incurred). However, from 2023, the Electronic Books Preservation Act shortened or partially eliminated the retention period for financial documents.

The main privileges granted to corporations filing a blue return in the calculation of income include: 10 year carry forward of net loss for future deduction and allowance of reserves, special depreciation and tax credits stipulated in the Special Taxation Measures Law.

A corporation is required to apply for approval to file a blue return at the latest by the day prior to the first day of commencement of the business year.

With respect to the first business year of a new corporation, the application for approval must be made within three months from the date of incorporation or by the last day of the first business year, whichever comes earlier.

Return and Payment of Corporate Tax

- Interim return and tax prepayment

  Unless certain conditions are met, a corporation whose business year is longer than six months should file an interim return covering the first six months of its business year. The return should be filed and the tax amount should be paid to the tax office within two months of the end of the first six months.

- Final return and final payment or refund

  A corporation is required to file a final tax return within two months of the end of its business year, whether or not it has a positive income for that business year. Corporate tax on ordinary income for a business year, minus the amount of prepayment, must be paid to the tax office within two months of the end of the business year. A refund from overpaying the prepayment, tax credits, etc. will be made on request after a final return has been filed.

Corporate Inhabitant Tax

Corporate inhabitant tax is a local tax levied on a Japanese company and a foreign company with a permanent establishment in Japan. Corporate inhabitant tax includes a per capita levy, the amounts of which are fixed based on the capital amount and the number of employees, and a corporate tax levy imposed on a corporation's income allocated to each prefecture and city (or municipal borough).

Corporate Enterprise Tax

Corporate enterprise tax is a local tax levied on a Japanese company and a foreign company with a permanent establishment in Japan which conducts business activities continuously in Japan. Corporate enterprise tax is basically levied on the taxable income in each business year as per Corporation Tax Law, subject to certain exceptions. However, the size-based taxation is applied to large corporations with a capital exceeding JPY 100 million. For such large corporations, enterprise tax consists of the traditional enterprise tax levied based on taxable income and on capital, etc. as well as on value added (wages, interest and rental expenses).

Scope of Taxable Income for Individuals

Resident Status of Foreigners

- Non-permanent resident

  A resident is an individual who has a domicile (centre of living) in Japan or has had a residence in Japan for one year or longer.

  A resident who has no Japanese citizenship and has no intention to reside permanently in Japan but has a domicile or residence consistently in Japan for less than five years within a 10 year period is a non-permanent resident.

- Permanent resident

  A resident other than a non-permanent resident is a permanent resident.

- Non-resident

  An individual other than a resident is a non-resident.

Taxation of Individuals

The scope of taxable income of individuals is as follows:

- Permanent resident
  - Worldwide income: total of Japan-sourced and foreign-sourced income
- Non-permanent resident
  - Japan-sourced income and foreign-sourced income paid in or remitted to Japan
- Non-resident
  - Japan-sourced income

A resident taxpayer including a non-permanent resident is subject to assessment of income tax by way of filing a tax return. Withholding tax levied on certain types of income is creditable against the assessment of income tax. A non-resident's tax liability is generally settled by way of withholding tax, except on real estate income or capital gains from land transfers, etc.

Individual Income Tax

Type of Income and Taxation of a Resident

- Business income

  Business income is income derived from activities of wholesale, retail, manufacturing and income of attorneys and certified public accountants, etc.

  Generally accepted accounting principles are applicable to the computation of business income, subject to a few exceptions. The following descriptions indicate some rules applicable to individuals, some of which are different from the rules applicable to corporations:

  - Payments to a taxpayer's family members are deductible only within certain limits, whatever their nature might be (salaries, rent, interest, etc.).
  - Entertainment expenses for carrying on a business and those directly related to the business are deductible, and not subject to restrictions as is the case for corporation tax purposes.
  - If the taxpayer is a blue return taxpayer and keeps accounting records in compliance with the principles of orderly bookkeeping, the blue return special deduction of a certain amount is allowed.

- Employment income

  Employment income consists of total salary and bonuses after deducting certain employment income items. An employer making salary payments is required to withhold a certain tax amount from the salary and bonuses when a payment is made and to remit the tax withheld to the tax office by the 10th of the following month. For small businesses employing fewer than 10 people, a special measure is provided for which allows them to pay withholding tax in six-month instalments twice a year (by 10 July and by 20 January).

  An employer making salary payments must make a year-end adjustment for an employee whose annual salary does not exceed JPY 20 million.

- Real estate income

  Real estate income is income derived from the rental of real estate (land, buildings), ships, aircrafts, etc. A taxpayer may deduct depreciation costs, interest expenses, fixed asset taxes, etc. from the real estate income.

Other than the items mentioned above, the following are other types of income:

- interest income
- dividend income
- retirement income
- capital gain from the sale of shares or land and buildings, etc.
- occasional income (gifts from a corporation, rewards, etc.)
- timber income
- miscellaneous income (income which is not classified as any other income).

Primary Income Deductions for Income Tax Purposes

Some deductions may be made from the amount of ordinary income. The main income deductions are:

- deduction for medical expenses
- deduction for social insurance premiums
- deduction for life insurance premiums
- deduction for certain donations
- exemption for spouses
- exemption for dependants
- basic exemption.

Final Tax Return

A resident taxpayer must file a final tax return for income of a calendar year between 16 February and 15 March of the subsequent year, unless the income does not exceed the amount of total income deductions or unless the resident only has employment income of JPY 20 million or less which was subject to withholding tax. If a taxpayer is required to file a final tax return, the excess of the annual tax liability over the total of prepayments of assessed income tax and withholding tax should be paid on or before 15 March in the year following the taxable year. In principle, if a taxpayer is no longer a resident of Japan, the taxpayer must file the final tax return with the tax office and pay income tax before leaving Japan.

Expatriate Taxation (Exit Tax)

There are currently no special rules for outward expatriates. From 1 July 2015, an exit tax (**kokugai tenshutsuji kazei seido**) applies whereby resident individuals departing Japan (and breaking domicile) will be assessed on deemed capital gains arising from investment holdings (stocks, securities or derivatives) of JPY 100 million and above. The investment holdings will be deemed to be disposed of at fair market value and a tax will be imposed on the deemed gains. The tax will be revoked should the individual subsequently return to Japan within five years and continue to hold the same investments on which the deemed tax was paid.

Individual Inhabitant Tax

Individual inhabitant tax consists of prefectural inhabitant tax and municipal inhabitant tax levied on a resident who has a domicile in Japan as of 1 January in each year. Unlike the income tax, inhabitant tax is levied on income derived in the previous year. Taxable income is calculated in accordance with the income tax law rules unless particularly specified under local tax law.

An inhabitant tax return is not required to be filed in principle if an income tax return has been filed. A taxpayer receives an inhabitant tax bill from the local tax office. The tax levied on the income of the previous year must be paid in four instalments in June, August, October and January of the following year. However, inhabitant tax on employment income is withheld by an employer over 12 months starting from June to May of the following year.

Consumption Tax and Special Local Consumption Tax

Consumption tax is categorised as a value added tax applied to almost every domestic transaction and every import transaction except for financial transactions, capital transactions, medical services, welfare services and educational services.

The basic formula for calculating the tax due is as follows:

Tax due = total amount of consumption tax on sales

– total amount of consumption tax on purchases

Taxable Transactions

- Domestic transactions

  Domestic transactions in which consideration is paid for the transfer or lease of assets or the provision of services for business purposes will be subject to taxation.

- Import transactions

  Foreign goods received or retrieved from a bonded zone will be subject to taxation.

Non-taxable Transactions

- Transfers and leases of land
- Transfers of securities and payments prescribed in the foreign exchange and trade law
- Leases of assets with interest
- Transfers of postage stamps and merchandise coupons
- Services rendered by the government, local governments, public corporations and public interest corporations
- International postal services and foreign exchange services
- Medical services under the social medical system and sale of assets by a social welfare organisation

- School tuition, entrance fees and textbooks
- Rent of residential houses.

Tax Exemption for Export Transactions

The export of goods, international communication and overseas transportation conducted by an enterprise are tax-exempt.

Export sales are not subject to consumption tax. The consumption tax component included in the purchase cost is creditable against the taxpayer's consumption tax liability, so that all export activities are tax-free. On the other hand, in a non-taxable transaction, the consumption tax component of the purchase cost cannot be credited.

Taxpayer

A taxpayer for a domestic transaction is an enterprise (including a non-resident and a foreign company) which sells taxable assets and performs other taxable transactions. A company or an individual removing imported goods from a bonded area is also classified as a taxpayer for consumption tax purposes.

Tax Exemption for Small-scale Enterprises

Where the amount of taxable sales of an enterprise in its base period (the calendar year two years prior to the current year for an individual; the business year two business years prior to the current business year for a company) is not more than JPY 10 million, the enterprise will be exempt from tax on the transfer of taxable assets, etc. during the taxable period. In the case of a newly established company, sales in the first and second business year are exempt from consumption tax. However, a newly established company whose capital amount is JPY 10 million or more is subject to consumption tax in the first two years.

Return and Payment of Consumption Tax

- Interim return and tax prepayment

  A taxable enterprise, whose final tax amount of the previous tax period is more than a certain amount must file an interim return and pay the relevant prepaid tax.

- Final return and final payment or refund

  A taxable enterprise is required to file a final tax return within two months after the end of its tax period. The consumption tax liability, minus the amount of prepayment, must be paid to the tax office within two months of the end of its taxation period. When the consumption tax on the tax base is less than the consumption tax on purchases, or where the consumption tax after crediting the consumption tax on purchases is less than the interim consumption tax prepayment, the shortfall can be refunded upon the filing of a final tax return.

Establishment of Qualified Invoice System

The invoice system started in October 2023. The invoice system is a 'qualified invoice' issued by the seller to the buyer that strictly states the consumption tax rate and the amount of consumption tax levied, and both the seller and the buyer preserve the invoice.

Since the invoice system started, the ‘invoice’ issued by the seller is required in order for the buyer to deduct the tax on purchases (to deduct the consumption tax paid), and if there is no invoice that strictly states the consumption tax rate and tax amount, the buyer cannot deduct the tax on purchases.

A ‘qualified invoice’ is a document that the seller (order taker) provides to the buyer (order receiver) as evidence in the calculation of the consumption tax by that business. For this purpose, the National Tax Agency clearly defines the contents to be included on the invoice as follows:

(1) name or title of the issuer

(2) date of transaction

(3) details of the transaction

(4) amount of consideration

(5) name or title of the recipient

(6) a seal indicating that the goods are subject to the reduced tax rate

(7) applicable tax rate

(8) consumption tax amount per tax rate

(9) total taxable value for each tax rate

(10) registration number of the qualified invoicing business.

These details must be included on the invoice. However, the 2023 Tax Reform has reduced the burden on small businesses. Even if they become taxable businesses, they need only pay 20% of the consumption tax received until 2026. For the first six years, businesses with taxable sales of JPY 100 million or less can receive a tax credit for transactions of less than JPY 10,000 without an invoice.

Electronic Books Preservation Act

The Electronic Books Preservation Act covers all businesses that file income and corporate income tax returns. The Electronic Books Preservation Act was enacted to reduce the burden associated with the storage and processing of documents such as books, receipts and invoices, and also allowed the storage of electronic data through photocopying, etc. However, with the enactment of the revised Electronic Books Preservation Act, data storage of electronic transaction data is completely mandatory from 1 January 2024. The Electronic Books Preservation Act covers national tax bookkeeping documents, which are classified into three categories: ‘X. Electronic Bookkeeping’, ‘Y. Scanner Preservation’ and ‘Z. Electronic Transactions’.

In addition, for electronic transaction data, paper printouts could be stored as originals until recently. However, from 1 January 2024, in principle, it will no longer be possible to print and store invoice documents received in electronic data, and transaction information must be stored in electronic form in accordance with the requirements of the Electronic Books and Records Preservation Law.

Retention requirements for X. Electronic Bookkeeping:

1. A history of corrections and deletions must be kept
2. If entries are made after the normal business processing period, the fact of such entries can be confirmed.
3. The relationship between the entries recorded in the ledger and the entries recorded in other related ledgers can be verified.
4. Documents related to the system are available.
5. Search conditions
   - Search by transaction year, month, date, transaction amount, or counterparty
   - Search by date, date and amount
   - Search by a combination of two or more arbitrary record items.
6. Downloading of electronic data.

Retention Requirements for Y. Scanner Preservation:

As described above, there is a wide range of requirements, but the requirements differ slightly for 'important documents' such as contracts, delivery slips, invoices and receipts, and for 'general documents' such as quotations, purchase orders and acceptance inspection forms. For example, 'important documents' need to be interrelated with ledgers and there are restrictions on input organisations and requirements for colour images.

Retention requirements for Z. Electronic Transactions:

Two preservation requirements must be addressed: truthfulness and visibility.

Truthfulness requirements

Any of the following four requirements must be addressed:

1. Electronic transaction data is exchanged after being timestamped (issuer).
2. Timestamped within a maximum of two months and seven business days after electronic transaction data is exchanged (receiver).
3. Use a system that retains a record of any correction or deletion of electronic transaction data, or a system that does not allow correction or deletion.
4. Determine office processing rules regarding the prevention of correction or deletion, and implement the rules.

Visibility requirements

All of the following requirements must be met:

1. In case of a self-developed system, a summary document of the system should be provided.
2. PCs, etc. and their operation manuals are provided at the storage location, and can be promptly output on-screen or in writing.

3. Ensure a search function so that stored transaction information can be retrieved and immediately displayed*.

* Small businesses with net sales of JPY 50 million or less are not required to comply with the search requirement if they can respond to requests for downloading by the tax office.

However, some companies are not subject to the Electronic Books Preservation Act. It applies to all companies and sole proprietors, but data storage is only required for national tax-related documents exchanged through electronic transactions, i.e. companies and businesses that do not conduct electronic transactions or receive documents in paper form are not required to preserve data.

Inheritance and Gift Taxes

Japan adopts the comprehensive succession principle, under which the rights and obligations of the deceased are comprehensively passed on to the heirs upon commencement of inheritance. Therefore, the succession of inheritance and obligations is not limited to the scope of inherited property.

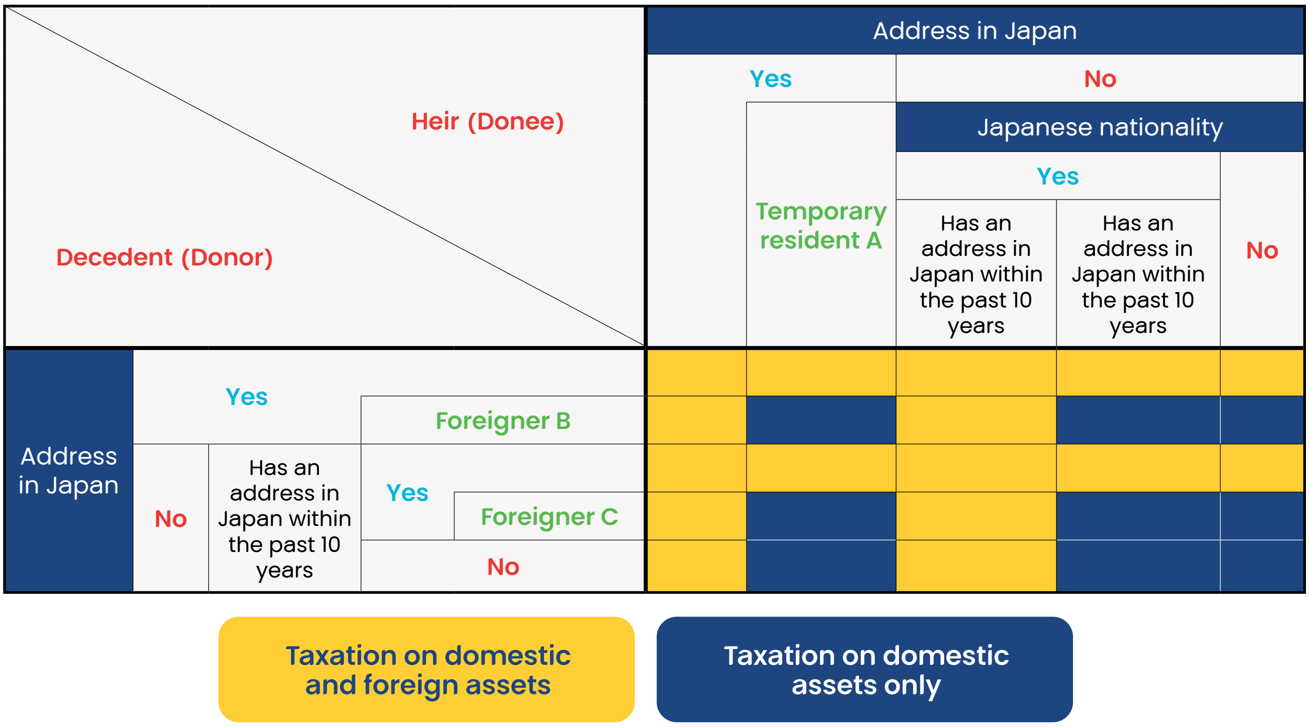
In Japan, the taxation system is based on the 'estate taxation system', which means that the tax is borne by the 'heirs' who acquire the property. However, the actual calculation is a combination of the 'estate taxation method' and the 'estate acquisition tax method'. In this method, the total amount of inheritance tax is first calculated based on the number of legal heirs and the legal inheritance share, and then the amount of tax to be paid is determined according to the amount of property acquired by each individual.

In Japan, inheritance tax and gift tax are levied separately, but when inheritance begins, the amount of property gifted in the past is added back to the total and recalculated.

Japan's domestic property acquisition principle determines the scope of taxation based on the combination of the location of the person and the location of the property. In addition, gift tax in Japan is set at a higher tax rate than inheritance tax in order to curb avoidance of inheritance tax.

Simplified chart		
Amount of acquisition corresponding to the statutory share of inheritance	Tax rate	Deductions
Less than JPY 10,000,000	10%	-
Between JPY 10,000,000, and 30,000,000	15%	JPY 500,000
Between JPY 30,000,000 and 50,000,000	20%	JPY 2,000,000
Between JPY 50,000,000 and 100,000,000	30%	JPY 7,000,000
Between JPY 100,000,000 and 200,000,000	40%	JPY 17,000,000
Between JPY 200,000,000 and 300,000,000	45%	JPY 27,000,000
Between JPY 300,000,000 and 600,000,000	50%	JPY 42,000,000
Over JPY 600,000,000	55%	JPY 72,000,000

Taxpayers in Japan liable for inheritance and gift taxes are shown in the table below.



Temporary resident A: Those who have a status of residence at the time of inheritance and have had a domicile in Japan for less than 10 years within 15 years prior to the date of inheritance.

Foreigner B: Those who have a status of residence at the time of inheritance or donation and had a domicile in Japan within 15 years prior to the date of inheritance or donation.

Foreigner C: Those who did not have an address in Japan at the time of inheritance or donation, but had an address in Japan at any time within 10 years prior to the date of inheritance or donation. Persons who did not have Japanese nationality but who had a domicile in Japan at any time within 10 years prior to the date of the donation.

Withholding Tax on Payments to Non-residents

A non-resident or a foreign company is subject to withholding tax at the rate of 20.42% on the payment of various Japanese-sourced types of income. However, the application of a tax treaty supersedes domestic tax law provisions so a lower rate may be applicable.

Tax Treaties

Japan has concluded tax treaties with 154 countries (as of 1 January 2024). The purpose of tax treaties is to avoid international double taxation on the same income and to prevent tax avoidance. In general, tax treaties include the following rules:

- definition of a resident, non-discrimination rule, source of income rule
- permanent establishment and taxation of business income, income from international transportation
- definition and taxation rule for dividends, interest, royalties, real estate income and capital gains
- independent professional income, employment income and tax exemption on short stay visitors, professors, students, government officers, diplomats
- mutual consultation by competent authorities, exchange of information.

Status of Residence

Entry Procedures

Foreigners wishing to enter Japan must have a valid passport and, in principle, a visa which suits the purpose of their visit, issued in advance by a Japanese diplomatic mission.

Upon arriving in Japan, foreign nationals must be examined by their port of entry, obtain any entry permit and have their status of residence and period of stay determined.

Types and Categories of Visa and Working Status

The main types of status of residence relating to inward investment in Japan and the activities allowed by each type are as follows:

Business Manager

Activities in connection with commencing international trade or other business, or operating or managing international trade or other business on behalf of foreign nationals (including foreign corporations) who have begun such activities. Such roles may include a business manager acting as the company's CEO or representative, and directors and head of department reporting to a CEO or representative. The business in question must meet certain conditions of scale. Applicants who wish to engage in business management must fulfil certain conditions concerning their work status and personal history.

Intra-company Transferee

Activities undertaken by personnel who are transferred to business offices in Japan for a limited period of time from business offices that are established in foreign countries by public or private organisations with head offices, branch offices or other business offices in Japan and who engage at these business offices in activities categorised as 'Engineer/Specialist in Humanities/International Services' (see below for further details). Applicants must fulfil certain conditions concerning their personal history and work status.

Legal/Accounting Services

Activities relating to a legal or accounting business. Applicants must be attorneys or public accountants certified to perform their duties in Japan, or must hold other legal qualifications recognised by Japan.

Engineer/Specialist in Humanities/International Services

Activities in connection with services that require technological skill and/or knowledge pertinent to physical science, engineering or other natural science fields, on the basis of a contract with a public or private organisation in Japan. Applicants must fulfil certain conditions concerning their personal history and work status.

Activities relating to services that require knowledge pertinent to jurisprudence, economics, sociology or other human science fields.

Activities in respect of services that require specific ways of thought or sensitivity based on experience with foreign cultures, such as interpreting, translation, copywriting, fashion design, interior design, sales, overseas business, information processing, international finance, design or public relations and advertising, based on a contract with a public or private organisation in Japan. Applicants must fulfil certain conditions concerning their personal history and work status.

Skilled Labour

Activities relating to services that require industrial techniques or skills belonging to special fields on the basis of a contract with a public or private organisation in Japan. Applicants must fulfil certain conditions concerning their personal history and work status.

Relationship Between Types of Operation in Japan and Working Status

A foreign company establishing a presence in Japan may do so generally in one of three ways: by establishing a representative office, a branch office or a corporation.

The relationship between each type of operation and the working status of the representative will depend on the requirements and criteria for each status. Generally, however, the relationship is as follows:

Representative of representative office or branch office – intra-company transferee

Representative of corporation – business manager

The working status of a foreign national employed by a representative office, branch office or corporation will either be an 'intra-company transferee' or a status suited to their academic and occupational background and their employment duties in Japan.

Protection of Intellectual and Industrial Property

Legislation on Trademarks and Design

Japan's trademark system provides for the protection of the marks and logos that are used in the sale of goods or services. By enabling trademarks to identify the source of goods or services, and to identify their qualities and publicise them, the trademark system protects the commercial reputation of persons using trademarks, thereby contributing to the development of Japan's industries and protecting the interests of consumers. Japan's trademark system is regulated by the Trademark Law.

Japan's Trademark System

Equality for both Japanese and Foreign Nationals

Japan's Trademark Law offers equal protection for both Japanese and foreign nationals. The same trademark registration process and conditions apply to those resident in Japan and overseas. Therefore, by offering proper trademark protection to people who do not currently live in Japan and companies presently without head offices or branches in the country, Japan's trademark system encourages future expansion into the Japanese market by overseas businesses.

First-to-file Rule

Trademarks do not have to be currently in use (either in Japan or overseas) in order to be registered in Japan. If the trademark owner has the intention of using the trademark in the future, it can be registered in Japan as long as certain criteria are met. Thus, it is very important for any foreign business that thinks it might expand into Japan at some time in the future to consider applying for registration of trademarks in Japan before entering the Japanese market. Note, however, that trademarks must be used within three years of registration, or they may be nullified. Using a trademark just once within those three years is enough to prevent trademark rights from being cancelled.

Useful Contacts

Japan External Trade Organisation (JETRO)	https://www.jetro.go.jp/en/
National Tax Agency (NTA)	https://www.nta.go.jp/english/
Ministry of Economy, Trade and Industry (METI)	https://www.meti.go.jp/english/
Ministry of Finance	https://www.mof.go.jp/english/index.htm

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