

Doing Business in Japan

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AIC Tax Co.

Preface

In the preparation of this pamphlet, every effort has been made to offer current, correct and clearly expressed information. However, the information in the text is intended to afford general guidelines only. This publication is distributed with the understanding that AIC Tax Co. is not responsible for the result of any action taken on the basis of information in this publication, nor for any errors or omissions contained herein.

Readers are encouraged to consult with a professional advisor concerning specific matters before making any decision.

If you have any questions regarding tax and accounting, please contact us. We would be happy to help you.

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**Sadao Kanezaki, CPA
Managing Partner
AIC Tax Co.**

We are a member of INPACT Asia Pacific <http://www.inpactap.com>

<Address>

**(Tokyo office)
Square-building 2F, 3-5-16
Shibuya, Shibuya-ku Tokyo 150-0002
TEL 03-4500-1258 FAX 03-6893-3924**

**(Osaka office)
Wako-building 4th floor 2-2-17
Shibata, Kita-ku Osaka 530-0012
TEL 06-6292-0586 FAX 06-6292-0587**

**info@aictax.com
<http://www.aictax.com/>**

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1. Establishment form

1) Organization form for foreign investors in Japan

1-1) Companies

A subsidiary or joint venture can take either one of the following two corporate forms recognized under the Japanese law: a Joint Stock Company (*Kabushiki-Kaisha*) or a Membership Company (*Mochibun-Kaisha*) that includes General Partnership Company (*Gomei-Kaisha*), Limited Partnership Company (*Goshi-Kaisha*), Limited Liability Company (LLC, *Godo-Kaisha*).

The major difference between these corporate forms is based on how and to what extent a shareholder or partner is liable for the company's debts and obligations, or whether investment and management is from the same source or not.

There used to be a type of company called a Limited Liability Company (*Yugen Kaisha*) under the Limited Liability Company Law until April 2006, but it was abolished and merged with Joint-stock company when the commercial code was amended in May, 2006.

Joint Stock Company

The Joint Stock Company (*Kabushiki Kaisha*, or KK) is the most widely used form in Japan. It is also used by foreign investors for a wholly owned subsidiary or joint venture with Japanese partners. It consists of a large number of shareholders whose liabilities are limited to the capital invested. The incorporation procedure and management, accounting, and auditing requirements of a joint stock company are provided in detail under the Companies Act. In general, a joint stock company has greater advantages in business than other forms. For example, a joint stock company enjoys financial and business credibility and a better public image.

Establishment of a joint stock company used to have a minimum capital requirement of ¥10 million, but the regulation changed which made it possible to establish a company with any amount of capital. A company established in Japan must have at least one director who is a Japanese resident.

Membership Company

The Membership Company (Mochibun-Kaisha) includes following three forms, General Partnership Company (Gomei-Kaisha), Limited Partnership Company (Goshi-Kaisha), Limited Liability Company (LLC, Godo-Kaisha).

While the management of joint stock companies is definitely detached from the investors, membership companies have the characteristics that the investors are also directors who carry out operation, that is to say, investment and management is from the same source.

The merit of these types of companies is that they are established by investors at the same time directors who enjoy mutual trust, thus they are good for small business.

General Partnership Company (Gomei-Kaisha) and Limited Partnership Company (Goshi-Kaisha) exist in the old Commercial Act. They enjoy the merits of internal self-governing and simple formalities when established. But because of the unlimited liabilities of directors, few of them exist at present.

On the other hand, Limited Liability Company (LLC, Godo-Kaisha) is lately institutionalized by the new Companies Act. The merits of Membership Company remain and the limited liabilities of directors are recognized.

Difference between Joint Stock Companies (KK) and LLC

Form	KK	LLC
Investors	Stock holders	Directors with limited liabilities
Indispensible board	Stockholders' meeting, directors	Agreement of directors
Business operator	Managing director etc.	Directors
Minimum capital requirement	None	None
Equity transfer	Free in principle	Directors' consent
Change in articles of incorporation	Special resolution in stockholders' meeting	Agreement from all directors
Change in organization	Possible	Possible

1-2) Branch of foreign company

Registration—

A foreign investor may set up a branch of a foreign company to engage in any commercial activities in Japan by filing a notification with the government office under the Foreign Exchange and Foreign Trade Law. To conduct business in Japan, a branch must also be registered under the Commercial Registration Law. Although a branch operation is acceptable in any business category, it is considered most suitable for purchase, sales and service operations. A branch of a foreign company must be established in compliance with the legal requirements of the Companies Act. Under the Act, a foreign company continually engaging in commercial transactions in Japan must appoint a representative in Japan (branch manager), set up a place of business and register with the local registry office of the Legal Affairs Bureau of the Ministry of Justice. The registered representative is authorized under Japanese law to perform all acts on behalf of the branch. If the branch manager changes, that change must be registered.

Conversion to a subsidiary

Converting a branch to subsidiary is legally possible, but requires careful consideration. It is a rather time-consuming and costly process. The foreign corporation may set up a subsidiary and then transfer the branch's assets to the subsidiary. If a foreign investor plans to conduct business in Japan over a long period, setting up a subsidiary at the outset may be more desirable.

1-3) Representative office

A representative office is not a legal entity and is not required to obtain commercial registration. Consequently, foreign investors can generally open a representative office without filing any report with government ministries. (The opening of an office of a foreign bank, foreign securities company or foreign insurance company, however, requires notification to the Ministry of Finance.) The only document required for its establishment is a notification to the relevant tax office in the case of the establishment of an office employing salaried workers. Also joining social insurance may be required in the case of employing salaried workers.

Because of its lack of legal status, a representative office is not allowed to engage in any commercial transactions nor set up a bank account. Its activities are limited solely to purchasing or storing items and other liaison activity like gathering information, market research and publicity etc. for the head office of a foreign corporation; a representative office is not subject to Japanese corporate tax for its liaison activities on behalf of a foreign corporation. If its performance was beyond those permitted, however, a representative office could become a taxable entity.

A representative office can bring in funds as operating expenses without restriction. The restrictions imposed on the activities of a representative office make that status generally suitable only for temporal operations for a foreign investor who intends to establish a branch or subsidiary in the near future. Therefore this approach is often used by a foreign investor who requires a great big deal of market research before developing a legally recognized branch operation.

2) Differences between Company (subsidiary), branches of foreign company and representative offices

2-1) Company (subsidiary) vs. Branch

The main differences in the tax treatment between Japanese branches and Japanese subsidiaries are as follows.

Expense allocation

Expense incurred by the head office for the benefit of a Japanese branch may be allocated to the Japanese branch and deducted by the Japanese branch on its Japanese tax return.

In case of Company (subsidiary), direct allocation will not be allowed without a contract between parent company and subsidiary.

Dividends

Dividends paid by a Japanese subsidiary to a foreign shareholder are subject to Japanese withholding tax while remittance of branch profits after tax to its head office in a foreign country is not subject to Japanese withholding tax.

Interest or royalty

Interest or royalty paid by a Japanese subsidiary to a foreign corporation is deductible for the Japanese subsidiary unless it is excessive, although it is subject to Japanese withholding tax.

On the other hand, interest or royalty paid by a Japanese branch to the foreign head office is not tax deductible.

However, if it can be demonstrated that the head office has paid interest on a loan or royalty for industrial property, etc. that is utilized in the Japan branch’s operation, such interest or royalty may be deducted by the Japanese branch although such interest or royalty is subject to Japanese withholding tax.

	Branch	Company (subsidiary)
Expense allocation	Possible if not excessive	Not possible in principle
Dividends	Remittance of after-tax profit not subject to Japanese withholding tax	Subject to Japanese withholding tax
Interest or royalty	Not tax deductible in principle	Tax deductible, subject to withholding tax

2-2) A representative office

The tax authorities may review the activities of the representative office to determine whether they are merely auxiliary or preparatory. If they were recognized as business activities, the Japan source income was subject to Japanese corporate income tax.

2-3) “105%” Service Company

However, the tax authorities might not challenge an arrangement where a legally separate entity in Japan provides service to other legally separate foreign corporation(s) for a reasonable service fee determined under a written agreement (e.g., a service fee may range from 105% to 110% of the expenses incurred for the said services).

2. Accounting & Taxes for Company

1) The report for corporate tax

Please note that each report in the following table can be applied to either companies or branches unless otherwise stated separately.

Reporting for tax purposes is required after company establishment or opening branch for legal purposes. Following is a list of documents to be filed with the tax offices.

National Tax Office (See *1)	Documents necessary	Filing due
1. Report on establishment of company (company only)	Copy of articles of incorporation Copy of registry Lists of stockholders / partners B/S at establishment	Within 2 months after establishment
2. Report on establishment of a foreign corporation (branch only)	Copy of articles of incorporation in Japanese Copy of registry Headquarter B/S of previous fiscal year Business outlines in Japan	Within 2 months after commencement
3. Application for approval of filing a blue tax return	None	Within 3 months after establishment or the first fiscal year-end, whichever is earlier
4. Application for extension of corporate tax return filing due date—if necessary	None	The end of the fiscal year
5. Report on commencement of payroll payment	None	Within 1 month after paying salary
6. Application for approval of paying withholding tax by every July 10 and January 10	None	Any time if the number of employees is less than 10
7. Report on method of depreciation to be used	None	When first tax return is due
8. Report on method of evaluation of inventory assets	None	Same as 7 above
Local Tax Office(See *2)	Documents necessary	
9. Report on establishment of company or branch	Copy of articles of incorporation Copy of registry Lists of stockholders / employees	Within 15 days after starting business (See *3)
10. Application for extension of enterprise and inhabitant tax return filing due date—if necessary	None	Same as 4 above

*1 In addition report on consumption tax may be necessary.

*2 Required for both prefectural tax and municipal tax.

*3 It depends on autonomy; could be within one month after starting business.

2) Closing accounts and filing tax return

2-1) Accounting Period

The accounting period for corporation tax purposes is the accounting period provided on the Articles of Incorporation of the corporation. However, the period must not exceed 12 months.

In principle, the Japanese branch of a foreign corporation must use the same accounting period as the head office. Japanese corporations generally decide their accounting period from April 1st to March 31st.

2-2) Accounting income vs. Taxable income

Accounting for tax purposes follows, in principle, accounting principles generally accepted in Japan. An appropriately determined accounting standard must be consistently applied.

There is generally no significant difference between the pre-tax income for accounting purposes and the taxable income for corporate income tax purposes. However, in order to determine income for corporate tax purposes, certain adjustments must be made to the pre-tax accounting income.

For example, if expenses such as for entertainment, depreciation, donation and executive remuneration exceed tax limits, they would be added to taxable income.

2-3) Filing and paying income tax

A corporation must file tax return and pay the tax within two months after the end of its fiscal year. One month extension would be permitted for Japanese companies, if the application is submitted by the due. A few more month extension may be possible for foreign corporations.

Except for newly established corporations, if the fiscal year is longer than six months, the corporation must file an interim return within two months of the end of the first six months and make an advance payment at the time of filing the interim return of either 50% of its prior year's tax liability or 100% of its estimated tax liability for the first six months of the current year.

2-4) "Blue form Return" system

There is a "Blue form Return" system in order to encourage taxpayers to declare taxable income based upon accurate accounting records.

This system provides special benefits such as taking special depreciation, establishment of certain reserves, carry forward of tax losses for seven years, carry back of tax losses and claiming tax credits under the Special Taxation Measures Law. In addition, a tax examination is conducted based upon the taxpayer's books of account.

All types of taxpayers (including foreign corporations) may apply for permission to use a blue form return. To be permitted, the taxpayer must satisfy certain requirements such as keeping proper accounting books. But once it is approved and as long as the accounting system is in order, the taxpayer can usually receive special benefits above.

For a new corporation or a new Japan branch, an application must be submitted within 3 months of the date of establishment or the last day of the first accounting period, whichever comes first.

3) Taxes on corporate income and gains**3-1) Corporation tax**

The taxable income for corporation tax purposes is determined based on the net income stated in the income statement of the corporation and after taking into account necessary reconciling items.

Corporation tax is calculated by applying the corporation tax rate of 30% to the taxable income. For corporations capitalized at ¥100 million or less, the rate is 18% if taxable income is ¥8 million or less.

Certain tax credits, if applicable, are credited against the computed corporation tax.

3-2) Local inhabitants' tax

Local inhabitants' tax (i.e., prefectural tax and municipal tax) consists of the tax based on the corporate income tax liability plus per capita tax.

The per capita tax is determined based on the paid-in capital (including capital surplus) and the number of employees.

The tax based on the corporation tax liability is calculated by applying prefectural tax rates and municipal tax rates to the amount of the corporate income tax allocated each to the prefecture and municipality based on the number of employees.

Per capita tax

Paid-in capital + Capital surplus	Number of employee	Municipal tax	Prefectural tax
Above ¥5,000M	Above 50	3,000,000	800,000
	Up to 50	410,000	[1,600,000]
Above ¥1000M Up to ¥5000M	Above 50	1,750,000	540,000
	Up to 50	410,000	[1,080,000]
Above ¥100M Up to ¥1000M	Above 50	400,000	130,000
	Up to 50	160,000	[260,000]
Above ¥10M up to ¥100M	Above 50	150,000	50,000
	Up to 50	130,000	[75,000]
Up to ¥10M	Above 50	120,000	20,000
	Up to 50	50,000	[20,000]

*[] indicates the prefectural tax for Osaka prefecture.

*Applicable tax rate is specified by ordinance of each municipality.

Tax based on corporation tax

Taxable base is the amount of national corporation tax.

Tax rate	Municipal tax		Prefectural tax	
	Standard	Upper limit	Standard	Upper limit
Any corporation	12.3%	14.7%	5.0%	6.0%

*Applicable tax rate is specified by ordinance of each municipality.

*As a purpose to encourage plant investment within Osaka, Osaka has prepared a reduced per capita tax rate.

Target Corporations	Manufacturers capitalized at 30 million yen or less that made plant investment between April 1, 2007 and March 31, 2012
Reduction	9/10 of the present rate
Applicable year	Accounting year that the equipment was placed in service
Application and Inspection	Submit application 15 days ahead of tax return or interim return due. Result of inspection will be notified.

*The above reduced rate is not applicable when the following preference(P15) is applied.

3-3) Enterprise tax and Special local corporation tax

Corporations are also subject to prefectural enterprise tax.

Net taxable income for enterprise tax purposes is not necessarily the same as that for corporation tax purposes.

For example, for enterprise tax purposes, foreign source net business income earned through a fixed place of business abroad is excluded from taxable income.

Also, the reserve for losses from overseas investments and the special deduction for certain overseas technical service transactions provided for in the Special Taxation Measures Law are not available.

The enterprise tax rate depends on the amount of taxable income allocated to each prefecture and is determined by each prefecture. Besides, from the accounting year starting October 1, 2008, enterprise tax is severed, special local corporation tax is founded to ease the maldistribution between prefectures.

Enterprise tax (Example of ordinary corporation located within Osaka prefecture)

Classification of corporation		Taxable base	Tax rate (*1)	
Corporations with a capital base of ¥100 M Or less	Other than those below	Annual income of ¥4 M or less	2.95(2.7)%	
		Annual income of more than ¥ 4 M and ¥8 M or less	4.365(4)%	
		Annual income of more than ¥8 M and Liquidation income	5.78(5.3)%	
	Corporations with active offices and/or business establishments in 3 prefectures or more and that have a capital base of ¥10 M or more	Annual income	5.78(5.3)%	
Corporations subject to size-based tax system (Corporations with a capital base of over ¥100 M)		Per income levy	Annual income of ¥4 M or less	1.69%
			Annual income of more than ¥ 4 M and ¥8 M or less	2.48%
			Annual income of more than ¥8 M	3.26%
			Corporations with active offices and/or business establishments in 3 prefectures or more	3.26%
		Added value levy	Added value: (Salary + interest paid + rent exp. + profit for the year)	0.504%
		Capital levy	Paid-in capital + Capital surplus	0.21%

(*1) () indicates standard tax rate..

*Applicable tax rate is specified by ordinance of each prefecture.

Special local corporation tax

Tax on income rate assessed on corporations (corporate enterprise tax) based on their income and liquidation income	81%
Tax on income rate for corporations assessed using the dual corporate tax system (companies assessed for taxes based on the total of added value, capital appropriation, and income)	148%

*As a purpose to invite investment to Osaka, Osaka has prepared a reduced per capita tax rate.

Target Corporations	Manufacturers capitalized 10 million or less established between April 1, 2007 and March 31, 2012, with business operated in Osaka after establishment
Reduction	9/10 of the present rate
Applicable year	Each accounting year within 5 calendar years
Application and Inspection	Submit application 15 days ahead of tax return or interim return due. Result of inspection will be notified.

*The above reduced rate is not applicable when the aforementioned preference(P12) is applied.

Corporate tax calculation (example)

<Assumptions>

1. Subsidiary company, located in Osaka, Japan, has 30 employees with paid-in capital of ¥10 million.
2. The company which operates business in Osaka prefecture.
3. Its taxable income for the year ending December 31, 2003 is ¥30 million.

	¥	Tax rate	¥	¥
National tax	8,000,000	18%	1,440,000	
	22,000,000	30%	6,600,000	
	30,000,000			8,040,000
Enterprise tax	4,000,000	2.7%	108,000	
	4,000,000	4%	160,000	
	22,000,000	5.3%	1,166,000	
	30,000,000			1,434,000
Special local corporation tax	1,434,000	81%		1,161,500
Inhabitant tax				
Prefectural tax				
Corporate tax	8,040,000	5%	402,000	
Per capita tax			20,000	
				422,000
Municipal tax				
Corporation tax	8,040,000	12.3%	988,900	
Per capita tax			50,000	1,038,900
Total income taxes due				12,096,400

4) Basics of Depreciation

4-1) Depreciable assets and depreciation

Tangible assets used for business (e.g. buildings, building improvements, structures, tools, and motor vehicles) and intangible assets such as software generally lose their value as time passes. These types of assets are called depreciable assets. On the other hand, assets that do not lose value such as land or antiques are not subject to depreciation.

The acquisition cost for depreciable assets shall be allocated periodically over the usable period instead of being expensed at the time of acquisition. A number of usable years are designated by law for each type of asset.

4-2) Depreciation methods

There are two types of depreciation method, the “straight-line method” and the “declining-balance method”. A company has to report to the tax office which method will be used for each asset. If it’s not reported, the declining-balance method shall be applied. Intangible assets must be amortized using the straight-line method.

Assets in use after April 1, 2007, are subject to the new depreciation method. This also affects the depreciation method for assets acquired before April 2007. The table below explains the details.

Depreciation formulas

	Assets in use before 31 March, 2007	Assets in use after 1 April, 2007
Straight-line method	(Acquisition cost – salvage cost (= acquisition cost × 10%)) ÷ old depreciation rate ^(*1)	Acquisition value × depreciation rate
Declining-balance method	Un-depreciated cost in the beginning of the fiscal year × old depreciation rate ^(*1)	Un-depreciated cost at the beginning of the fiscal year × depreciation rate. Once the depreciated cost falls below the insured amount ^(*2) , the formula “revised acquisition value ^(*3) × revised depreciation rate ^(*4) ” shall be used instead.

(*1) Once the depreciated cost falls below the 5% of the acquisition cost, the rest shall be depreciated equally over 5 years.

(*2) Acquisition cost × a specific rate according to the number of usable years.

(*3) Un-depreciated cost when the original depreciation cost first falls below the insured amount.

(*4) The rate depends the usable period of the asset such that the same depreciation cost would be applied in the future.

If the tangible asset was acquired in the middle of the fiscal year, the number of months of actual use is subject to depreciation. For certain tangible assets, the special depreciation shall be applied according to the Act on Special Measures Concerning Taxation.

4-3) Usable period

Japan Tax Law defines a number of usable years depending on asset type, structure, and purposes of use. If the asset is neither used for more than a year nor costs more than ¥100,000, it can be expensed in the year of acquisition.

Table of depreciation rates

Number of Usable Years	Straight-line method	Declining-balance method			Usable Years	Straight-line method	Declining-line method		
		Rate	Revised rate	Insured rate			Rate	Revised rate	Insured rate
2	0.500	1.000	-	-	18	0.056	0.139	0.143	0.02757
3	0.334	0.833	1.000	0.02789	19	0.053	0.132	0.143	0.02616
4	0.250	0.625	1.000	0.05274	20	0.050	0.125	0.143	0.02517
5	0.200	0.500	1.000	0.06249	21	0.048	0.119	0.125	0.02408
6	0.167	0.417	0.500	0.05776	22	0.046	0.114	0.125	0.02296
7	0.143	0.357	0.500	0.05496	23	0.044	0.109	0.112	0.02226
8	0.125	0.313	0.334	0.5111	24	0.042	0.104	0.112	0.02157
9	0.112	0.278	0.334	0.04731	25	0.040	0.100	0.112	0.02058
10	0.100	0.250	0.334	0.04448	26	0.039	0.096	0.100	0.01989
11	0.091	0.227	0.250	0.04123	27	0.038	0.093	0.100	0.01902
12	0.084	0.208	0.250	0.03870	28	0.036	0.089	0.091	0.01866
13	0.077	0.192	0.200	0.03633	29	0.035	0.086	0.091	0.01803
14	0.072	0.179	0.200	0.03389	30	0.034	0.083	0.084	0.01766
15	0.067	0.167	0.200	0.03217	40	0.025	0.063	0.067	0.01317
16	0.063	0.156	0.167	0.03063	50	0.020	0.050	0.053	0.01072
17	0.059	0.147	0.167	0.02905					

Example of depreciation

Assumptions:

* Acquisition cost of ¥1,000,000. The usable period is 10 years.

* The asset is assumed to be used for 1 year.

	Straight-line method	Declining-line method
Number of usable years	10	10
Rate	0.100	0.250
New rate	—	0.334
Insured rate	—	0.04448
Insured amount of depreciation	—	¥44,480 (= 1,000,000 × 0.04448)
Depreciation cost for 1 st year	¥100,000 (= 1,000,000 × 0.100)	¥250,000 (= 1,000,000 × 0.250)
2 nd to 7 th year	¥100,000 (= 1,000,000 × 0.100)	(1,000,000 — the total depreciation cost over the past years) × 0.250
8 th year	¥100,000 (= 1,000,000 × 0.100)	¥44,584 (= revised acquisition cost ¥133,483 × 0.334)
		<p>Key points on calculation</p> <p>(1) How to calculate the depreciation cost before revision: (1,000,000 — the total depreciation cost in the past years) × 0.250 = 33,371</p> <p>(2) The above ¥33,371 is less than the insured amount ¥44,480, so the depreciation cost shall be calculated as revised acquisition cost: (1,000,000 — the total amount of depreciation cost until the past years) × revised rate.</p>
9 th year	¥100,000 (= 1,000,000 × 0.100)	¥44,584 Revised acquisition cost × 0.334
10 th year	¥99,999 remaining amount at the beginning of the year — ¥1 < 1,000,000 × 0.100	¥44,314 remaining amount at the beginning of the year — ¥1 < Revised acquisition cost × 0.334

4-4) Special tax treatment for small sum depreciable properties

Small business, that use the “Blue form Return” system and acquired depreciable properties amounting 300,000 yen or less between April 1, 2003 and March 31, 2012, can allocate the expense to the year of acquisition. The maximum of each year is 300 million yen.

In the case of properties over 100,000 yen and less than 200,000 yen, the acquisition expenses are allowed to be allocated equally over 3 years with no scrap value.

5) Expenditures that can't be allocated as expense

5-1) Entertainment expenses and donation expenses

Under the Corporation Tax Law, the tax-deductibility of entertainment expenses is strictly limited. Expenditures which are categorized as donations, welfare expenses, publication expenses, and salary are not regarded as entertainment expenses.

A corporation with paid-in capital of more than ¥100 million may not deduct any entertainment expenses.

A corporation with paid-in capital of ¥100 million or less may deduct up to ¥5.4 million or 10% of entertainment expenses.

The paid-in capital of a Japan branch of a foreign corporation for this purpose is calculated as the paid-in capital of the foreign corporation multiplied by the ratio of the total assets of the Japan branch over the total assets of the foreign corporation.

Starting on April 1, 2006, entertainment expenses of ¥5,000 or less per person is all allowed as deductible expenses under the new taxation standard. But you must keep evidence such as receipts.

Contributions made by a corporation to public welfare organizations, corporations, or other organizations which do not directly benefit the business of the said corporation are considered “donations” for tax purposes.

The tax-deductibility of donations is generally limited to the sum of 1.25% of taxable income (before deduction of donations) plus 0.125% of paid-in capital and capital surplus of the corporation.

Also, write-off of collectible receivables and interest in excess of the arm's length rate paid to related corporations in Japan are also considered "donations" for tax purposes.

5-2) Directors' remuneration

There are restrictions on the tax-deductibility of directors' remuneration. The board members of a corporation are considered directors under the Corporation Tax Law and they are classified into two groups: directors without employee status and directors with employee status.

For tax restriction purposes, the remuneration for a director with employee status consists of both the compensation earned as a director and as an employee.

A person appointed as a branch representative in Japan of a foreign corporation is normally regarded as an employee, rather than a director, unless he is a board member of the foreign corporation.

A director's regular salary is tax-deductible unless it is in excess of the amount that the tax authorities consider reasonable. If the amount of the director's remuneration is provided for in the articles of incorporation or authorized by a resolution at a general shareholder's meeting, any amount in excess of this authorization is not deductible.

Directors' bonuses are not deductible. However, the bonus to a director with employee status may be deductible if the bonus is paid at the same time as other employees. However, the deductible amount is limited to the amount of the bonus paid to a comparable employee.

Generally, any economic benefits given to directors are regarded as either salary or bonuses. Economic benefits include transfers of assets to directors on advantageous terms, free provision of company houses to directors, interest-free loans to directors, assumption of liabilities on behalf of directors, etc. However, fixed amounts of economic benefits paid on a monthly basis are fully deductible unless they are excessive.

6) Consumption tax

Basic Principles

Consumption tax is a value-added tax which is collected at several stages.

It is levied on the consumption of goods and services and charged by sellers at the time of the sale of goods or the provision of services.

Periodically, sellers must total the tax collected on sales, deduct from this the tax paid on purchases and pay the balance to the tax authorities.

The result is that the consumer ultimately bears the tax, but the tax has been collected in a series of installments from each business enterprise

involved in the chain of production and distribution depending on their value added.

The import of goods by individuals and business enterprises is subject to import consumption tax.

The export of goods, international transportation services, etc. are exempt from consumption tax (i.e., zero-rated) and the consumption tax imposed on related purchases may be claimed for refund.

Sales or lease of land, sales of securities, interest on loans, guarantee fees, insurance premiums, provision of public services, education, medical services, social welfare services, and other specified items are classified as non-taxable transactions.

However, the consumption tax on purchases relating to the above non-taxable items is not refundable.

Business enterprises whose yearly taxable sales amount of the base period (two fiscal years before the current year) was 10 million yen or less, and also whose taxable sales amount of the 1st half of the last fiscal year was 10 million yen or less, are not obligated to file a consumption tax return for the current year. (Consumption tax- exempt enterprise)*

* This regulation is applicable from the fiscal year starting on or after October 1st, 2012 for corporations, from 2013 for sole proprietors.

10 million yen ceiling of the base period's taxable sales is the current requirement to be a tax-exempt enterprise.

Structure of Consumption Tax

The tax base for domestic transactions is the sales price.

For imports, the tax base is the delivery price inclusive of customs duties and taxes such as liquor tax, gasoline tax, etc. The tax rate is 5%.

Since the consumption tax is a value-added tax levied at each stage of distributions of goods and services, the tax already paid at the former stage is deducted.

An enterprise deducts the consumption tax paid on purchases (input tax) from the consumption tax collected on sales (output tax) based on its accounting records and periodically pays the balance to the tax authorities by filing a tax return with the district national tax office.

To substantiate the above self-assessment, an enterprise must retain records such as statements of delivery or bills. The enterprises whose

taxable sales in the taxable year are ¥50 million or less can forego the input tax creditable and calculate and pay tax at a certain rate of sale turnover.

(Table 2-6)

Type of Business	rate
Wholesales	0.5%
Retailers	1.0%
Manufactures, Constructors, Agricultures	1.5%
Restaurants(Eating and drinking industry)and Financial Services	2.0%
Real Estates, Transportations and Communication Industries (except restaurants)	2.5%

The tax period is a calendar year for personal enterprises and a business year for corporations. However, they can also use quarterly tax periods (each months beginning on or after April 1, 2004).

An enterprise whose previous year's tax due exceeded ¥480,000 must file and pay provisional tax at 50% of the consumption tax reported on the final tax return of the previous tax period within two months of after the first six months past in the tax year.

If the previous year's tax due exceeded ¥4,000,000. , quarterly filing and payment is required. If the previous year's tax due exceeded ¥48,000,000, an enterprise must file and pay tax at 1/12 of previous year's tax effective tax year's beginning on or after April 1, 2004.

If the amount of paid tax exceeds the received tax on the tax period closing, the excess is refunded after the final tax return is filed with the tax office.

3. Salary and Taxes for Employees

1) Employment income and deductions for compensation

Individuals with employment income are subject to income tax. Employment income includes salaries, wages, director’s remuneration, bonuses and other compensation of a similar nature. Benefit in kind provided by the employer, including the private use of an employment-provided automobile, permanent company housing, tuition for dependent children, life insurance premiums, private medical insurance premiums and private pension contributions, are included in employment income. However, certain employer-paid benefits, including moving expenses, loans interest above market rate and, for resident foreigners and nonresidents, home-leave expenses, are excluded from taxable income.

If the employer enters into a lease directly with a landlord to provide housing for an employee, the employee is subject to tax on the value of the economic benefit only, instead of the actual cost to the employer. The formula to compute the economic benefit is based on the taxable value of the building and land, plus an amount for the floor space. The taxable amount for an employee who is not a director is generally 10% or less of the actual rent. The taxable rent for a director is substantially higher than that for an employee, ranging from 35% to 50% of the actual rental value. The 35% rate applies if a director periodically uses the residence for business purposes, such as entertaining customers.

Employment income equals gross receipts minus an employment income deduction, as computed in the following table.

Rapid calculation table for deduction for employment income

Gross Receipts		Amount of employment Income deduction (¥)
Exceeding	Not exceeding	
0	650,000	100%
650,000	1,625,000	650,000
1,625,000	1,800,000	Gross receipts \times 40%
1,800,000	3,600,000	Gross receipts \times 30% + 180,000
3,600,000	6,600,000	Gross receipts \times 20% + 540,000
6,600,000	10,000,000	Gross receipts \times 10% + 1,200,000
10,000,000		Gross receipts \times 5% + 1,700,000

2) Salary to directors who live overseas

Director's remuneration paid by a Japanese corporation to a nonresident is considered Japanese-source income and is subject to tax in Japan, even if the services are performed outside Japan.

3) Deductions**3-1) Deductible expenses**

If the aggregate amount of specific employment-related expenditures incurred during a year exceeds the amount of the employment income deduction (see Employment Income and Deduction, Page 23), the excess may be deducted in addition to the employment income deduction. Specially allowed expenditures include commuting expenses, moving expenses for a company transfer, and training expenses for technological skills or certain qualification directly required in the performance of duties. Expenditures must be documented and certified by the employer. The deduction of specific expenditures may be claimed only by filing a tax return.

3-2) Insurance premiums

Social insurance premiums are fully deductible. Life insurance and individual pension premiums are deductible up to a maximum ¥50,000 each. (Added to deductions above, nursing/medical-care premium deduction will be established after 2011 and ¥40,000 deduction will be the maximum for each premium.)

For casualty insurance premiums, the deductible amount is ¥50,000 for earthquake insurance premiums and ¥15,000 for former long-term casualty insurance. The deductible amount of combined earthquake and former long-term casualty insurance premiums may not exceed ¥50,000.

3-3) Personal exemptions

Personal exemptions are available for purposes of income tax and inhabitant tax. The following table outlines personal exemptions.

Type (outline)	Amount for national tax	Amount for inhabitant tax
Basic exemption	¥380,000	¥330,000
Exemption for spouse	¥380,000	¥330,000
Special exemption for spouse	Up to ¥380,000	Up to ¥330,000
Exemption for dependents		
Younger than 16 years old (See *1)	¥380,000	¥330,000
16 - 18 years old (See *2)	¥630,000	¥450,000
19 - 23 years old	¥380,000	¥330,000
70 years old or older	¥480,000	¥380,000

*1. After 2011, dependents younger than age of 16 are not entitled to dependency tax exemption.

*2. After 2011, the exemption amount is 380,000 yen for national tax and 330,000 yen for inhabitant tax.

4) Taxes withheld from salaries

Salaries paid to residents are subject to income tax withholding at the source.

The amount to be withheld may be determined using the "Tax Withholding Table" provided as an attachment to the Income Tax Law according to the nature of the salary, the period of payment, and the number of dependents the income earner has. However, nonresidents are generally subject to withholding of 20% of income tax irrespective of the amount of the salary, period and dependents (refer to the following table).

In order to withhold income tax properly, salary recipients must submit to the tax authorities, through their employer, "a statement concerning exemptions for dependents, etc." giving the names of dependents and other necessary particulars.

For salaries paid monthly, the tax amount is obtained from the "Monthly Table" according to the amount of salary paid and the number of dependents.

Monthly table (excerpt)

Monthly salary amount after deduction of –social insurance premiums		Number of dependents				
Over(¥)	But not over(¥)	0	1	2	3	4
		Amount of withholding tax(¥)				
:	:	:	:	:	:	:
587,000	590,000	43,970	37,640	31,300	24,970	19,010
590,000	593,000	44,510	38,180	31,840	25,510	19,720
593,000	596,000	45,050	38,720	32,380	26,050	19,720
596,000	599,000	45,590	39,260	32,920	26,590	20,260
599,000	602,000	46,130	39,800	33,460	27,130	20,800
602,000	605,000	46,670	40,340	34,000	27,670	21,340
605,000	608,000	47,210	40,800	34,540	28,210	21,880
:	:	:	:	:	:	:

Calculation of tax withheld from a salary paid monthly (example)

<Assumption>

* Resident taxpayer, married with two children (both children are age 16 or older)

* Monthly salary amount after deduction of social insurance premiums is ¥604,000

Withholding tax -----¥27,670

5) Tax rate

Individual income taxes consist of national income tax and local inhabitant tax. Individuals are also subject to a local enterprise tax on income derived from business at rates ranging from 3% to 5%.

Normally, a 20% withholding tax is levied on nonresidents, with no deductions available; however, depending on the type of income, tax may be levied at progressive rates through self-assessment (refer to 3-8). Dividends and salaries paid by Japanese companies, interest income, annuities and prizes are subject to a 20% withholding tax if paid to nonresidents.

National income tax rates are progressive. The rates range from 5% (on taxable income of up to ¥1.95 million) to 40% (on taxable income exceeding ¥18 million), as shown in the following table.

Taxable income		Tax on lower amount(¥)	Rate on excess(%)
Exceeding(¥)	Not exceeding(¥)		
	1,950,000	0	5
1,950,000	3,300,000	97,500	10
3,300,000	6,950,000	427,500	20
6,950,000	9,000,000	636,000	23
9,000,000	18,000,000	1,536,000	33
18,000,000	-	2,796,000	40

Local inhabitant taxes, both prefectural and municipal, consist of per capita and income levies. The amount of per capita tax is ¥4,000 per year per person (¥1,000 for prefectural and ¥3,000 for municipal). The percentage of per income levy is 10% (4% for prefectural and 6% for municipal).

Nonresidents are not subject to local inhabitant tax.

6) Social insurance

Social insurance programs in Japan include health insurance, nursing care insurance, welfare pension insurance, unemployment insurance and worker’s accident compensation insurance.

The premium rates of each program are shown in the following table.

Premium rates of social insurance programs

Health insurance	Monthly standard remuneration x 95.6/1,000(note2,3)
Nursing care insurance(note 1)	Monthly standard remuneration x 15.1/1,000(note2,3)
Welfare pension insurance	Monthly standard remuneration x 160.58/1,000(note2,4)
Unemployment insurance	Monthly standard remuneration x 15.5/1,000(note5)
Worker’s accident compensation insurance	Monthly standard remuneration x 3~103/1,000(note 6)

1. The employees who are age 40 to 65 are subject to the nursing care insurance system.
2. The premiums are borne equally by employers and employees.
3. These rates are applicable to the companies who join Japan Health Insurance Association Osaka Branch between Mar. 2011 and Feb. 2012.
4. This rate is applicable between Sep. 2010 and Aug. 2011.
5. Employers pay 9.5/1000 and employees pay 6/1000. Different rates

are applied to some specific industries.

6. The premium rate may vary with the type of business and be reviewed from year to year. The employers bear it entirely.

7) Filing and payment procedures

Individual income taxation in Japan is based on the self-assessment principle. In general, taxpayers must file tax returns to declare income and deductions and to pay the tax due. However, the national income tax liability of individuals compensated in yen at gross annual amounts not exceeding ¥20 million is settled through employer withholding if income other than main income source does not exceed ¥200,000. For a nonresident, if tax is withheld from payments and the amount withheld satisfies the liability, income tax return does not need to be filed. Married persons are taxed separately, not jointly, on all types of income.

Income tax returns must be filed, and the final tax paid, between February 16 and March 15 for income accrued during the previous calendar year. For those taxpayers who filed tax returns for the preceding year and who reported tax liabilities of ¥150,000 or more after withholding, prepayment of income tax for the current year is due on 31 July and 30 November. Each prepayment normally equals one-third of the previous year's total tax liability, less amounts withheld at the source. If prepaid and withheld payments exceed the total tax due, they are refundable if a return is filed.

8) Resident status and scope of taxable income.

An individual's tax status governs the types of income that are subject to national income tax and local inhabitants' tax as well as deductions and tax rates.

A nonresident taxpayer (an individual other than the resident who has a domicile or owns a residence continuously for more than one year) is subject to Japanese income tax on Japan-source income regardless of where it is paid.

Most tax treaties, however, provide for an exemption from Japanese tax on employment income of a nonresident taxpayer present in Japan for 183 days or less during a calendar year, if certain other conditions are satisfied. One has to prepare a certain application and submit it to the tax office in order to obtain a tax exemption.

An individual of non-Japanese nationality having a domicile or residence in Japan for an aggregate period of five years or less within the last ten years is further classified as a nonpermanent resident taxpayer. A nonpermanent resident taxpayer is subject to Japanese income tax on Japan-source income plus that part of non-Japan source income that is paid in and/or remitted to Japan.

Non-Japanese individuals who are neither nonresidents nor nonpermanent residents are classified as permanent residents.

A permanent resident taxpayer is subject to Japanese income taxes on his or her world-wide income. If he or she has to pay double taxes to different countries, he or she may be allowed a tax deduction.

Classification		Japanese nationality	Period of having a residence	Aggregate period of having domicile or residence within last 10 years	Division of resident status
Having domicile		Yes	/	Over 5 years	Permanent resident
		No			
		Yes		5 years or less	Non-permanent resident
		No			
Not having domicile	Having residence	Yes	Duration of a year or more	Over 5 years	Permanent resident
		No			
		Yes		5 years or less	Non-permanent resident
		No			
	Not having	/	Less than a year	/	Non-resident

Division of resident status

	residence		
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Scope of taxable income for each division of resident status

		Japan-source income		Non Japan-source income		
		Paid in Japan	Paid in abroad	Paid in Japan	Paid in abroad	
					Portion deemed remitted to Japan	Remainder retained abroad
Resident	Permanent resident	T a x a b l e				
	Non-permanent resident					
Non-resident		N o n t a x a b l e				

4. Appendix

Useful addresses and telephone numbers

Several governments and private organizations provide advice and assistance to foreign investors planning to enter business in Tokyo or Osaka.

JETRO (INVEST JAPAN 対日投資・ビジネスサポートセンター)

<http://www.jetro.go.jp/investjapan/index.html>

TEL 03-3582-4684(Tokyo) / 06-6447-2309(Osaka)

財団法人対日貿易投資交流促進協会 (MIPRO)

<http://www.mipro.or.jp/english/>

TEL 03-3989-5151 (Tokyo)

Osaka Business and Investment Center

<http://o-bic.net>

TEL 06-6944-6298

IBPC Osaka

<http://www.investosaka.jp/>

TEL 06-6615-7130

The Japan Institute of Certified Public Accountants association (JICPA)

<http://www.hp.jicpa.or.jp/english/index.html>

TEL 03-3515-1120

JICPA Tokyo Chapter

<http://tokyo.jicpa.or.jp/>

TEL 03-3515-1180

JICPA Kinki Chapter

<http://www.jicpa-kin.ne.jp/about/english.html>

TEL 06-6271-0400

Japan Federation of Certified Public Tax Accountants Association

<http://www.nichizeiren.or.jp/eng/index.html>

TEL 03-5435-0931

Tokyo Certified Public Tax Accountants Association

<http://www.tokyozeirishikai.or.jp/index.html>

TEL 03-3356-4461

Kinki Certified Public Tax Accountants Association

<http://www.kinzei.or.jp>

TEL 06-6941-6886

Business Support for Foreign-Affiliated Firms

<http://www.tokyo-business.jp/eng/index.html>

TEL 03-5320-4889

National Tax Agency Japan

http://www.nta.go.jp/foreign_language/

Ministry of Finance

<http://www.mof.go.jp/english/index.htm>

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Website: www.inpactap.com

