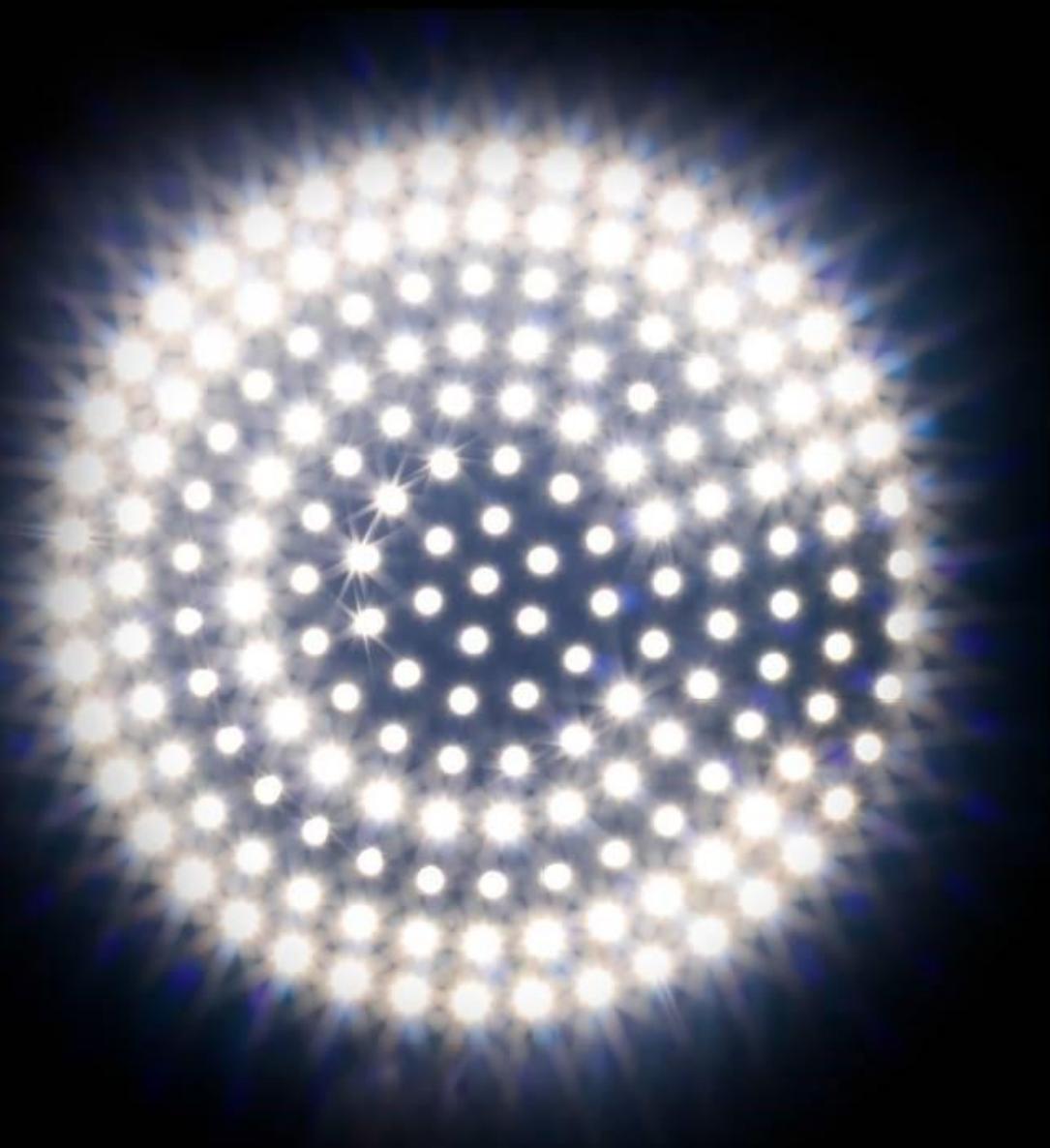


**Deloitte.**



**Taxation and Investment  
in Japan 2017**

# Contents

## **1.0 Investment climate**

- 1.1 Business environment
- 1.2 Currency
- 1.3 Banking and financing
- 1.4 Foreign investment
- 1.5 Tax incentives
- 1.6 Exchange controls

## **2.0 Setting up a business**

- 2.1 Principal forms of business entity
- 2.2 Regulation of business
- 2.3 Accounting, filing and auditing requirements

## **3.0 Business taxation**

- 3.1 Overview
- 3.2 Residence
- 3.3 Taxable income and rates
- 3.4 Capital gains taxation
- 3.5 Double taxation relief
- 3.6 Anti-avoidance rules
- 3.7 Administration
- 3.8 Other taxes on business

## **4.0 Withholding taxes**

- 4.1 Dividends
- 4.2 Interest
- 4.3 Royalties
- 4.4 Branch remittance tax
- 4.5 Wage tax/social security contributions
- 4.6 Other

## **5.0 Indirect taxes**

- 5.1 Consumption tax
- 5.2 Capital tax
- 5.3 Real estate tax
- 5.4 Transfer tax
- 5.5 Stamp duty
- 5.6 Customs and excise duties

## **6.0 Taxes on individuals**

- 6.1 Residence
- 6.2 Taxable income and rates
- 6.3 Inheritance and gift tax
- 6.4 Net wealth tax
- 6.5 Real property tax
- 6.6 Social security contributions
- 6.7 Other taxes
- 6.8 Compliance

## **7.0 Labor environment**

- 7.1 Employee rights and remuneration
- 7.2 Wages and benefits
- 7.3 Termination of employment
- 7.4 Labor-management relations
- 7.5 Employment of foreigners

## **8.0 Deloitte International Tax Source**

## **9.0 Contact us**

# 1.0 Investment climate

## 1.1 Business environment

Japan is a representative democracy. There are three branches of government: the executive, legislative and judicial. Executive power rests with the cabinet, which is responsible to the Diet (parliament). The Diet is Japan's legislative body, which consists of two houses: the House of Councilors and the House of Representatives, whose members are elected by popular vote. The Diet selects the prime minister, who serves as head of state. Locally, Japan is divided into 47 prefectures, each with its own governor and assembly. The prefectures are further divided into cities, towns and villages, which have mayors and local assemblies. Judicial power is vested in the courts. The main courts are the Supreme Court, the High Court and the District Court.

Manufacturing has been the mainstay of the Japanese economy since the 1960s, with electronics and the automobile industries dominating the sector. Japan is the world's second largest manufacturer of machine tools, many of which are exported to Korea and the US, and it also is one of the world's most important iron and steel makers.

The US is Japan's most important export market, followed by China, Korea, Taiwan and Hong Kong. The country has more diversified import sources, including China, the US, Australia, Saudi Arabia, Korea and Malaysia. Japan has forged bilateral trade agreements with some of these partners that trigger voluntary export restraints as a way to prevent a disruption of orderly trade.

Japan is not a member of any regional market or trading bloc, but it has been promoting bilateral free trade agreements with regional countries to strengthen regional economic ties. Japan is a member of the OECD and the World Trade Organization (WTO), and has actively participated in the Doha Development Round of multilateral trade talks.

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### OECD member countries

Australia	France	Korea (ROK)	Slovakia
Austria	Germany	Latvia	Slovenia
Belgium	Greece	Luxembourg	Spain
Canada	Hungary	Mexico	Sweden
Chile	Iceland	Netherlands	Switzerland
Czech Republic	Ireland	New Zealand	Turkey
Denmark	Israel	Norway	United Kingdom
Estonia	Italy	Poland	United States
Finland	Japan	Portugal	

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### Enhanced engagement countries

Brazil	India	Indonesia	South Africa
China			

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### OECD accession candidate countries

Colombia	Costa Rica	Lithuania	
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### Price controls

Price controls are applicable only to limited goods, such as rice. Rice also is subject to import quotas.

### Intellectual property

Various laws provide protection for intellectual property, including the Patent Law, Trademark Law, Copyright Law, Design Law, Utility Model Law and the Unfair Competition Prevention Law.

A company with patents, trademarks or other intellectual property may enter into a licensing agreement with a Japanese company. Such an agreement is private and if the contracting party is a foreign firm, that firm need not establish a presence in Japan. Licensing is most common in electronics, information technology, chemicals and pharmaceuticals.

Under the Foreign Exchange and Foreign Trade Law, a Japanese company generally must notify the Ministry of Finance (MOF) within 15 days of the execution of a licensing agreement with a foreign company. If the licensing agreement is regarding certain technologies, such as aerospace, weapons and nuclear energy, the Japanese company must notify the MOF in advance of the execution of the agreement.

## **Patents**

Patents in Japan are granted to the first person to file an application for a particular invention, rather than to the first person to invent it. A patent is valid for 20 years from the date an application is filed (a five-year extension may be granted to pharmaceutical products and agricultural chemicals, which require more time for a safety review). A separate Design Law protects designs for 20 years. A special court—the Intellectual Property High Court—handles disputes involving patents, utility models, trademarks, integrated circuit layouts and use, copyrights, publishing rights and related rights.

## **Utility models**

The Utility Model Law allows the registration of utility models, a minor patent form that provides for 10 years of protection from the filing date. Inventions subject to protection under the Utility Model Law are of the same nature as those protected under the Patent Law, but utility model rights are granted more expeditiously.

## **Trademarks and trade secrets**

The Trademark Law protects trademarks and service marks. Trademarks must be registered in Japan to ensure enforcement.

The only trademark protection available in Japan before registration is provided by the Unfair Competition Prevention Law, which is enforced by the Ministry of Economy, Trade and Industry. The law defines trade secrets as technical or business information useful in commercial activities, such as manufacturing or marketing methods, which is kept secret and not publicly known. The legislation covers various types of unfair competition, such as the unauthorized imitation of merchandise and false indications of the origin of goods. It also protects trade secrets against unauthorized disclosure or misappropriation.

## **Copyrights**

The Agency for Cultural Affairs oversees the country's copyright system under the Copyright Law, which has been amended frequently to align the law with international copyright rules. Japan is a member state of two conventions for the international protection of copyrights: the Berne Convention and the Universal Copyright Convention. Any work that is first published in a member state of either convention is protected in Japan under the Copyright Law. This legislation provides limitations on copyrights to permit fair exploitation of works, such as reproduction for educational and personal use, as well as the recognition of neighboring rights.

Copyrights for sound recordings are protected for 50 years and cinematographic works, animation and video games for 70 years.

## **1.2 Currency**

The currency in Japan is the yen (JPY).

## **1.3 Banking and financing**

The Financial Services Agency regulates all Japanese financial institutions. Government regulations still impose barriers on certain bank activities. The Financial Instruments and Exchange Law, for example, protects securities companies by prohibiting banks from selling stocks and bonds by themselves. Banks, for their part, are opposed to allowing other financial institutions to perform account settlement services. However, these barriers are not strict, since banks are allowed to have securities companies as their subsidiaries, and vice versa.

Tokyo is the main financial center.

## 1.4 Foreign investment

The government encourages direct foreign investment and has set up the Council for the Promotion of Foreign Direct Investment to make any regulatory changes needed to promote investment and to make Japan a global hub and an international trade and investment hub.

The government imposes few formal restrictions on inbound foreign direct investment, and it has removed or liberalized most legal restrictions on specific economic sectors. There are no export-balancing or other trade-related requirements on foreign firms seeking to establish or increase their presence in Japan.

Prior notification to the MOF of foreign direct investment is required only for investment in certain restricted sectors—including agriculture, broadcasting, forestry, fisheries, petroleum, utilities, aerospace, defense, telecommunications, aviation, nuclear energy, maritime transport and leather manufacturing. The government can restrict foreign direct investment in these sectors if it determines that it would “undermine national security, disrupt public order, impinge on public safety or have serious effects on the smooth operation of the national economy.” Foreign direct investment in unrestricted sectors must be reported only after the investment is made.

“Invest Japan” offices assist foreign companies with M&A transactions, investments in Japanese business establishments and other investment procedures.

The Foreign Exchange and Foreign Trade Law addresses specific categories of foreign direct investment, including:

- Transfer of ownership in nonpublic shares from residents to nonresidents;
- Foreign acquisition of shares publicly traded on an exchange and in over-the-counter markets that results in a foreign stake of 10% or more;
- Establishment of a branch, factory or other form of office, or changes in the business content of an established branch;
- Loans of more than JPY 200 million to a Japanese business for more than one year but no more than five years, and loans of more than JPY 100 million to a Japanese business for longer than five years (yen loans from financial institutions as part of normal operations are not included); and
- Foreign acquisition of privately placed bonds with a maturity of more than one year issued by a Japanese business.

## 1.5 Tax incentives

Tax incentives include the following:

- A 10% tax credit for the promotion of income growth where a company raises wages by at least 5% from the base year and meets certain other criteria (for fiscal years beginning on or after 1 April 2013 until 31 March 2017); and
- A tax credit for job creation (i.e. where a corporation hires new employees), which has been increased to JPY 400,000 per person for fiscal periods beginning on or after 1 April 2013 until 31 March 2018, where certain conditions are satisfied.

The tax credit for the promotion of income growth and the tax credit for job creation may be taken in the same fiscal year, if certain adjustments are made.

For fiscal periods beginning on or after 1 April 2015 until 31 March 2017, an R&D tax credit, of generally between 8% and 10% of R&D expenditure, is available up to 25% of corporate taxable income. For fiscal periods beginning on or after 1 April 2017, the R&D tax regime has been revised. Under the new rules, the R&D credit generally is between 6% and 10% of R&D expenditure (depending on the increase/decrease in R&D costs), but may be up to 14% under two-year transition rules. The credit generally will remain limited to 25% of corporate taxable income; however, two-year transition rules provide that if R&D costs exceed 10% of average sales, an additional tax credit of up to 10% may be available.

In addition, an 8%-15% tax credit or 25%-50% special depreciation for machinery acquired in national strategic special zones or in international strategic comprehensive special zones is available until the period ending 31 March 2018.

## 1.6 Exchange controls

The Foreign Exchange and Foreign Trade Law eliminated most exchange control restrictions. Companies and individuals may open an overseas checking account denominated in yen or an alternate currency and may freely engage in cross-border lending and borrowing. Domestic investors may buy and sell foreign securities from their overseas accounts. Notification is not required (with the exception of *ex post facto* reporting) for a nonresident's issue of domestic bonds (e.g. "samurai" or "shogun bonds"), or for a resident's issue of overseas bonds (e.g. Eurobonds). There are no restrictions on forex brokerage entities, including those engaged in derivatives trading or over-the-counter retail trading in foreign exchange.

Foreign companies can freely remit profits or capital abroad, subject to reporting requirements in certain instances.

# 2.0 Setting up a business

## 2.1 Principal forms of business entity

Businesses are broadly classified into two categories: corporations and partnerships (*kumiai*). There are several different types of corporations, although joint stock companies (*kabushiki kaisha* or KK) are the dominant form of doing business in Japan. Partnerships established under the Commercial Code are silent partnerships called *tokumei kumiai* (TK), as opposed to general partnerships (*nin-i kumiai*) set up under the Civil Code. The TK is based on a contractual agreement whose terms require the “silent” or “limited” partners to contribute monetary or other assets to the partnership. The investors’ liability in a general partnership is unlimited; partners assume all risks arising from the partnership’s business.

A limited liability partnership (LLP) law provides for the creation of LLPs, which provide investors with the same limited liability protection as an ordinary corporation, but with the benefits of a true partnership.

A foreign company also can set up a registered branch office.

### Formalities for setting up a company

Foreign entities doing business in Japan are subject to registration and other procedural requirements under the Company Law and the Commercial Registration Law under the jurisdiction of the Ministry of Justice.

Most major foreign investors do business through a joint stock company, which comes with complicated requirements. Also, some foreign companies conduct their business through a limited liability company (*go-do kaisha*), whose organizational structure is much simpler than that of a joint stock company. Setting up a wholly owned subsidiary is an effective way of obtaining better protection for proprietary information, obtaining credit and penetrating markets with subtle, but substantial, barriers to imports.

Joint stock companies need not have a board of directors, unless the companies meet certain criteria. Boards of six to 10 members are common among large corporations, and for a joint venture, parent companies usually are represented in proportion to their equity.

### Forms of entity

#### Requirements for a joint stock company (KK)

**Capital:** A company may be created with as little as JPY 1.

**Founders, shareholders:** There must be at least one founder/shareholder, who may be an individual or a legal person; it is not necessary that the founder/shareholder be a Japanese citizen or resident. Founders must sign the articles of incorporation, but residents holding a power of attorney for overseas interests may sign on behalf of nonresident founders. Since shares may be transferred from the original subscribers immediately after incorporation, lawyers and others involved in the incorporation may act as founders.

**Directors, management:** A KK must have at least one director. The Company Law limits the authority of the company chairman and president by requiring all directors to participate in decision-making on important matters (e.g. disposing of major assets; large borrowings; hiring/dismissing managers; and establishing, altering or liquidating the business). A director may call a board meeting. Labor need not be represented in management or on the board.

**Large corporations:** Companies with more than JPY 500 million of share capital (amount shown on the corporate register) or JPY 20 billion or more of liabilities must adopt a corporate governance system that complies with the Company Law and other regulations. This generally involves having an accounting auditor and either (i) a statutory auditor(s); (ii) a supervisory committee; or (iii) a three-board committee structure: a nomination committee, a compensation committee and an audit committee. Each committee must consist of at least three directors, and the majority of the members of each committee must be outside directors.

**Disclosure:** Financial statements, signed by a representative director, must be filed with the tax authorities within two months of the fiscal year-end (three months if a timely application for an extension is filed), and annually thereafter. Shareholders are entitled to receive an annual report containing a balance sheet, a profit-and-loss statement, a statement of changes in equity and a business report of the company. A group of shareholders owning at least 3% of the issued shares has the right to inspect the accounts.

**Taxes and fees:** Registration tax is proportionate to (stated) share capital (including subsequent increases, with a minimum tax of JPY 30,000). The tax is charged at a rate of 0.7% of the capital increase, with a minimum tax of JPY 150,000 for the incorporation of a KK. Bank commissions and legal fees may vary depending on the size of the company.

**Types of shares:** All types of shares may be issued. Corporations usually issue standard, registered, full-voting shares, with no preference, conversion or cumulative provisions, although it is possible to have shares with voting rights only on specific matters or ordinary shares without voting rights. There is no minimum share price requirement.

**Control:** Shareholders' and directors' meetings may be held in Japan or abroad. At least one ordinary meeting of shareholders must be held annually. Extraordinary meetings of shareholders may be convened upon demand by shareholders holding at least 3% of the total issued shares continuously for at least six months. Under the Company Law, shareholders owning at least 300 shares or at least 1% of a company continuously for at least six months have the right to make management proposals and recommend agenda items at shareholders' meetings. Shareholders may demand explanations from directors or statutory auditors at shareholders' meetings.

In principle, a quorum at a shareholders' meeting is more than 50% of the issued shares, and resolutions are adopted by majority vote of the shareholders present. The quorum requirement may be waived in the articles of association for ordinary resolutions, although the minimum quorum for electing directors is one-third of the shareholders. Proxies may be issued, but must be made out separately for each meeting. Companies may allow shareholders the option of voting online.

### Branch of a foreign corporation

A foreign company that wishes to conduct business in Japan but does not intend to set up a subsidiary may instead establish a branch office. It will be necessary to appoint a resident in Japan to represent the branch.

The registration formalities for a branch are simple. Application must be made in person or by proxy at the public registration office covering the locality of the intended place of business. Steps include appointing a Japanese representative and creating a place of business. Documents required include evidence of a head office, the qualifications of the representative and company statutes or other documents to show the nature of the foreign company.

Foreign companies planning to do business in industries deemed sensitive or important to national security must notify the minister of the relevant department of their business and financing plans 30 days before forming a branch, and also should notify the MOF. Failure to do so may result in either relevant ministry withholding or denying permission to bring in funds, based on the results of further investigation by the ministry.

The taxation of a branch and a KK is similar in most respects, including the rate of corporation tax; a branch office will be subject to Japanese corporation tax on income generated in Japan by the branch. The transfer of operating funds to a branch from its head office usually may be made without restriction and is not subject to withholding tax.

"Quasi-foreign corporations," which are corporations incorporated outside Japan but that conduct most of their business in the country, are prohibited. The rules on quasi-foreign corporations affect, in particular, foreign investment banks, brokerages, investment companies, law firms, trading companies and certain other businesses. These operations typically are incorporated offshore to take advantage of tax concessions and avoid Japanese regulations. The rationale underlying the rule is that, to conduct business in Japan, foreign companies should have clearly defined corporate status. As a result of the law, many foreign branches operating in Japan have been required to reincorporate as Japanese companies or close their Japanese operations.

## 2.2 Regulation of business

### Mergers and acquisitions

While the Financial Instruments and Exchange Law and the regulations of a particular stock exchange must be considered, the Company Law sets forth the procedures for corporate mergers in Japan. Moreover, since the Anti-Monopoly Law and other commercial legislation impose reporting and licensing requirements, it is necessary to prepare a merger schedule that takes the relevant regulations into account.

Certain corporate reorganizations—including statutory mergers, demergers and capital contributions in kind—may be achieved on a tax-free basis if certain requirements are fulfilled. In a tax-qualified merger, loss carryforwards of the merged company may be passed on to the merging company if additional requirements are met.

In principle, the Japan Fair Trade Commission (JFTC) must approve all mergers. A proposed merger that is subject to reporting under the Anti-Monopoly Law must be reported to the JFTC at least 30 days in advance. The JFTC must notify the parties of any problems within 30 days after such a consultation. In some cases, however, the JFTC may extend the waiting period to 120 days by requiring the companies to submit more detailed information.

Mergers that involve at least one corporate group with aggregated domestic revenues (i.e. the domestic revenue of the parent company and its subsidiaries) exceeding JPY 20 billion and another corporate group with aggregated domestic revenues exceeding JPY 5 billion must be reported by all companies involved in the transaction. For mergers between foreign companies, sales in Japan, rather than assets, are the criteria used to determine whether the reporting obligation is triggered. Notification requirements are waived for mergers between a parent company and its subsidiary if the parent company already owns more than 50% of the subsidiary. There are no reporting requirements for companies with interlocking directorates.

The scope of business transfers covered by the notification rules includes: (1) a transfer of an entire business from a company with aggregated domestic revenues exceeding JPY 3 billion; and (2) a transfer of a major portion of a business or fixed business assets that account for aggregated domestic revenues exceeding JPY 3 billion to a company with aggregated domestic revenues exceeding JPY 20 billion.

The JFTC also imposes shareholding notification requirements on companies with aggregated domestic revenues exceeding JPY 20 billion if they acquire shares of a company with aggregated domestic revenues exceeding JPY 5 billion and their shareholding ratio exceeds 20% or 50%.

### Monopolies and restraint of trade

The Anti-Monopoly Law enables the JFTC to break up companies it defines as monopolistic. The JFTC enforces various reporting and notification requirements for large business organizations under the Anti-Monopoly Law. These are broadly divided into two categories: one for going concerns, and the other for new companies.

A company and its subsidiaries with combined assets of JPY 2 trillion (JPY 600 billion for holding companies and JPY 8 trillion for banks, insurers and securities companies) must file annual reports on business operations with the JFTC within three months of the closing of the books. A newly established company that meets the same asset-size tests must declare to the JFTC the nature of its business operations, including any subsidiaries, within 30 days from the date of establishment.

The JFTC polices collusion in pricing and, under the Anti-Monopoly Law, the following unfair business practices: concerted refusal to deal; discriminatory pricing; discriminatory treatment relating to transaction terms; unjust low price sales; unjust high price purchasing; deceptive customer inducement; customer inducement by unjust benefits; tie-in sales; dealing on exclusive terms; resale price restrictions; dealing on restrictive terms; abuse of a dominant bargaining position; interference with a competitor's transactions; and interference with the internal operations of a competing company.

To prevent a concentration of economic power in the hands of certain banks, the Anti-Monopoly Law prohibits (subject to exemptions) financial institutions that are not part of a financial holding company from holding 5% or more of the outstanding shares in a domestic company (although insurance companies may own up to 10%).

## **2.3 Accounting, filing and auditing requirements**

Japanese GAAP applies. Financial statements must be prepared annually.

Companies with more than JPY 500 million of share capital or JPY 20 billion or more of liabilities are required to appoint an external auditor (a public certified accountant) or an auditing firm, and must be subject to an audit based on the Company Law, as must a company listed on the Japanese stock markets.

# 3.0 Business taxation

## 3.1 Overview

Taxes in Japan are levied by the central government and the prefectural and municipal authorities. The principal national taxes affecting companies are the corporate income tax, consumption tax, registration tax and stamp duties. The more important prefectural and municipal taxes are the enterprise tax and the inhabitants tax. Enterprise tax is levied on a corporation's income that is attributable to operations in Japan. If a corporate taxpayer's share capital is more than JPY 100 million, the corporate taxpayer also will be subject to a capital levy and a "value-added" levy under the enterprise tax regime. Inhabitants tax is levied on income, and on capital and the number of employees.

New tax legislation is drafted by the MOF and approved by the Diet. Any new legislation generally becomes effective on 1 April of each year.

The corporation tax law governs the principal taxes affecting corporations in Japan. The corporate tax burden is high compared with other countries in the region. However, Japan's annual tax reforms have steadily lowered corporate tax rates, as part of continuing efforts to revitalize the economy. The effective tax rate for corporations (inclusive of the inhabitants tax and the enterprise tax), based on the maximum rates applicable in Tokyo to a company whose paid-in capital is over JPY 100 million, is approximately 30%.

Japanese taxation is based on a self-assessment system: taxpayers must calculate their taxable income, file returns and pay taxes due. Taxpayers can choose between filing "blue returns" or "white returns." A corporation (or an individual who conducts a business) may file a tax return using the special blue form, which requires the taxpayer to maintain books and keep continuous accounting records that meet prescribed standards. In return, the taxpayer is entitled by law to a variety of benefits when calculating income and preferential treatment, including special depreciation allowances and loss carryovers.

Japan has transfer pricing, controlled foreign company (CFC), thin capitalization and earnings stripping rules. It also provides for a system for groups of companies to file a consolidated tax return.

To administer the self-assessment system, the tax authorities at the National Tax Agency (NTA) use a qualitative control system, under which corporations are classified and scrutinized based on their level of tax compliance. There are steep penalties for evasion (35%-40% of the additional tax assessed).

### Japan Quick Tax Facts for Companies

Corporate income tax rate (national tax)	23.4%
Branch tax rate	23.4%
Capital gains tax rate	23.4%
Enterprise tax rate (local tax)	Varies
Inhabitants tax rate (local tax)	Varies
Basis	Worldwide basis (attribution basis for branches)
Participation exemption	95% foreign dividend exemption

### Loss relief

• Carryforward	9 years
• Carryback	Generally suspended, but 1 year for SMEs and in the case of dissolution, etc.
Double taxation relief	Yes
Tax consolidation	Yes, but national tax only
Transfer pricing rules	Yes
Thin capitalization rules	Yes

Controlled foreign company rules	Yes
Tax year	Fiscal year
Advance payment of tax	Generally required
Return due date	Within 2 months of end of fiscal year, in the case of income tax returns (extension generally is allowed)
<b>Withholding tax</b>	
• Dividends	20%/15%, plus 2.1% surtax
• Interest	20%/15%, plus 2.1% surtax
• Royalties	20%, plus 2.1% surtax
• Branch remittance tax	No
Fixed asset tax	1.4% of adjusted official appraisal value (exact rate may vary slightly by municipality)
Business premises tax	JPY 600 per square meter of premises used in business and 0.25% of gross payroll
Capital tax	Included in inhabitants tax and enterprise tax
Social security contribution	Up to approximately 16.283%, assuming general business rates for labor insurance apply
Real estate acquisitions tax	3% or 4% (temporarily, 1.5%-2%)
Real estate registration tax	Up to 2%
Stamp duty	JPY 200 to JPY 600,000
Consumption tax	8%

## 3.2 Residence

A company that has its principal or main office in Japan is considered to be resident; Japan does not use the concept of the “effective place of management” or place of incorporation. Local management is not required.

## 3.3 Taxable income and rates

All corporate entities are liable for corporate income tax, including resident corporations and branches of foreign companies. Resident companies are liable for tax on their worldwide income, while foreign companies are taxed only on income from Japanese sources (unless otherwise provided in a tax treaty) and, for fiscal years beginning on or after 1 April 2016, on Japanese-source income attributed to a permanent establishment. Corporate income tax rates are the same for domestic and foreign companies.

The tax treatment of foreign income generally is the same as for Japanese-source income, i.e. it is subject to corporate income tax and the inhabitants tax. A foreign tax credit is available under domestic law to prevent the double taxation of such income (see below under 3.5).

### National corporate tax

The national standard corporation tax rate that applies to ordinary corporations with share capital exceeding JPY 100 million is 23.4% (reduced from 23.9% for tax years beginning on or after 1 April 2016). A special tax rate of 19% is available to small and medium-sized enterprises (SMEs—generally defined for corporate tax purposes as companies with share capital of JPY 100 million or less and that are not 100%-owned directly or indirectly by a company with share capital of JPY 500 million or more) for the first JPY 8 million of taxable income; however, the rate is temporarily decreased from 19% to 15% for fiscal years beginning up to 31 March 2017.

The national corporate tax rate will be further reduced to 23.2% for taxable years beginning on or after 1 April 2018.

## Inhabitants tax

Companies also must pay local inhabitants tax, which varies depending on the location and size of the corporation. The inhabitants tax, levied by both prefectures and municipalities, comprises a corporation tax levy (levied as a percentage of national corporation tax) and a per capita levy (determined based on the amount of capital and the number of employees). Each prefecture and municipality may elect an inhabitants tax rate, as follows:

- For prefectures: 3.2%-4.2% for fiscal years beginning up to 31 March 2017) (reducing to 1%-2% for fiscal years beginning on or after 1 April 2017); and
- For municipalities: 9.7%-12.1% for fiscal years beginning up to 31 March 2017 (reducing to 6%-8.4% for fiscal years beginning on or after 1 April 2017).

For the Tokyo metropolitan region, a combined rate of 12.9%-16.3% (7%-10.4% for fiscal years beginning on or after 1 April 2017) generally is applicable.

Each prefecture and municipality also levies a per capita tax of JPY 20,000-JPY 800,000 and JPY 50,000-JPY 3.6 million, respectively, on each office or place of business in its jurisdiction, depending on the number of employees and the higher amount of 1) the total of capital and capital surplus for accounting purposes, or 2) capital for tax purposes.

The corporation tax levy and per capita levy are not deductible in computing the national corporation tax liability.

## Enterprise tax

The local enterprise tax, another prefecture-level tax, may be either an income-only-based tax or a factor-based tax. The factor-based tax consists of the following: the income base, the value-added base and the capital base. Generally, the income base is taxed at progressive tax rates of up to 3.6% on taxable income, the value-added base is taxed at a rate of 1.2% on added value and the capital base is taxed at a rate of 0.5% on the higher amount of 1) the total of capital and capital surplus for accounting purposes, or 2) capital for tax purposes. SMEs are subject to only the income-based enterprise tax, at a rate of 9.6%. Each prefecture may increase the income-based enterprise tax rates to up to 200% of the standard rates mentioned above.

## Taxable income defined

The taxable income of a corporation for each accounting period is the excess of gross taxable revenue over total deductible business expenses.

Gross taxable revenue generally is defined as the realized increase in the value of assets accruing from every transaction other than gains from certain capital transactions, such as share registration and share retirement. Business expenses, broadly, are the realized decrease in the value of net assets from all transactions other than the reimbursement of capital or distribution of profits. Foreign exchange transactions generally are recognized when gains are realized or losses incurred. However, outstanding receivables and payables denominated in foreign currency at the end of the fiscal year should, in principle, be valued at the exchange rates prescribed by the tax code.

The treatment of dividends received by a resident corporation from another resident corporation depends on the recipient's shareholding percentage and ownership period:

- Dividends are entirely excluded from taxable income for corporation tax purposes if the recipient holds 100% of the shares in the dividend-paying corporation throughout the dividend calculation period of the dividend-paying corporation.
- If a corporation owns less than 100% but over one-third of the shares throughout the dividend calculation period of the dividend-paying corporation, the amount of the dividends (less a certain amount of interest expense allocated to such dividends) will be excluded from taxable income.
- If a corporation holds less than or equal to one-third of the shares but over 5% of shares throughout the dividend calculation period of the dividend-paying corporation, 50% of the dividends will be excluded from taxable income.
- If a corporation holds less than or equal to 5% of the shares on the dividend determination date, 20% of the dividends will be excluded from taxable income.

A foreign dividend exemption system exempts 95% of dividends received by a Japanese corporation from its qualifying shareholdings of 25% or more in a foreign corporation held for at least six months

immediately before the dividend determination date (these requirements may be reduced under an applicable tax treaty). However, the exemption is not available if the dividends are deductible in the country of the payer (see under 3.6, below).

## Deductions

Allowable deductions include material costs; manufacturing, trading and administration expenses; and interest, rents and royalties paid. Management fees paid to a foreign affiliate may be deductible to the extent they are considered reasonable for the specific benefits derived by the Japanese corporation.

The Corporation Tax Law allows other types of tax deductions and credits for normal business operations, as follows:

- Deductions may be taken against bad debts, goods returned, repairs, overseas investment losses, natural disasters and employee severance indemnities.
- Deductions are available for charitable donations up to an amount equal to the sum of 0.625% of taxable income and 0.0625% of capital for tax purposes. Higher levels of deductibility are available for donations to specified public interest-facilitating corporations and certain organizations designated by the government. Donations to foreign related parties are not deductible.
- For SMEs, the higher of 1) entertainment expenses of up to JPY 8 million per annum, or 2) 50% of the expenditure on meals with persons outside the corporation is deductible.
- For non-SME corporations, entertainment expenses are nondeductible, but 50% of meal expenses is deductible.
- Subject to certain conditions, bonuses paid to directors may be deductible.

## Depreciation

Companies operating in Japan may depreciate their capital assets based on the legal useful life of the assets. Salvage value for tangible assets is JPY 1, and it is zero for intangible assets. Companies can deduct depreciation expense either by fixed amounts (straight line) or by fixed rates (declining balance) under schedules published by the MOF. Annual tax reforms include periodic adjustments to depreciation rules. The 2016 tax reform eliminated the declining-balance method for equipment attached to buildings, structures or buildings for mining purposes acquired on or after 1 April 2016; only the straight-line method or production output method (for mining structures) is available for these assets.

Special depreciation, in the form of accelerated initial depreciation and additional depreciation, is available for different types of assets in specified categories. Small assets worth less than JPY 100,000 (or that are consumed within one year) may be deducted immediately and those with acquisition values of JPY 100,000 or more, but less than JPY 200,000, may be depreciated over three years.

Goodwill may be amortized over five years on a straight-line basis.

## Losses

Net operating losses (NOLs) are the losses in excess of taxable revenue and gains incurred in a given tax year. Where NOLs are incurred, they may be carried forward by a company to offset taxable income incurred in future tax years, provided the company has blue-form tax return filing status (or has incurred a casualty loss).

Only 60% of a company's taxable income may be offset by NOLs for fiscal years beginning on or after 1 April 2016 and up to 31 March 2017 (the offset ratio for NOLs is further reduced to 55% for fiscal years beginning from 1 April 2017 to 31 March 2018 and 50% for fiscal years beginning on or after 1 April 2018). SMEs, however, generally are exempt from such restrictions on the use of NOLs. NOL carryforwards may be further restricted in certain situations, including a change of ownership of more than 50% in connection with a discontinuance of an old business and commencement of a new business.

NOLs may be carried forward for nine years (increasing to 10 years for NOLs incurred during tax years beginning on or after 1 April 2018). The carryback of losses generally is suspended, although SMEs may carry back losses for one year and a one-year carryback also may be available in the case of dissolution, etc.

## 3.4 Capital gains taxation

Capital gains are taxable as ordinary income; capital losses are fully deductible, subject to certain conditions. There are no adjustments for the inflationary component of gains.

A nonresident investor is subject to Japanese income tax on gains realized on the sale of shares in a “real property-rich” corporation, if the nonresident investor, together with its related parties, holds at least 2% (or 5%, if the shares are publicly traded on stock exchanges, etc.) of the shares in the real property-rich corporation and transfers the shares in such corporation. A real property-rich corporation is a corporation that derives at least 50% of its value from 1) real property in Japan (land or a right to land, buildings and fixtures attached to buildings and structures in Japan, and 2) shares of a corporation that derives at least 50% of the total value of its assets from real property in Japan.

A nonresident corporation is subject to Japanese corporation tax on any gains realized on the transfer of shares in a Japanese company if the nonresident corporation transfers 5% or more of the shares in the Japanese company during a fiscal year and owns 25% or more of the shares in the Japanese company at any time during the three-year period prior to the end of the fiscal year of the transfer (often referred to as the “5/25 rule”).

For shareholdings held through a partnership, the shareholding test is effectively determined at the partnership level rather than at the level of the partners (however the test may be determined at the partner level if certain conditions are met). The rule does not affect a nonresident or a foreign corporate partner that is a qualified resident of a country that has concluded a tax treaty with Japan that excludes such income from taxation in the other country. Additionally, a 20.42% withholding tax is imposed on partnership income attributable to nonresident partners of a partnership that conducts business in Japan (see under 4.6, below).

## 3.5 Double taxation relief

### Unilateral relief

Domestic corporations are entitled to a foreign tax credit for taxes paid overseas, subject to certain limitations. Foreign taxes levied on Japanese corporations may be either deducted from taxable income or credited against Japanese corporation and local inhabitants tax (credit only). However, a company may not take both a credit and a deduction in the same tax year. A credit/deduction for foreign tax suffered is not available in respect of dividends qualifying for the 95% foreign dividend exemption. Excess FTC benefits generally may be carried forward for a period of three years.

An indirect foreign tax credit (deemed paid foreign tax credit) generally is unavailable.

### Tax treaties

Japan has an extensive tax treaty network, with most treaties following the OECD model treaty (although some of the older treaties predate the latest OECD version and, hence, contain different provisions). Japan’s treaties generally provide for relief from double taxation on most types of income, limit the taxation by one contracting state of companies resident in the other contracting state and protect companies resident in one state from discriminatory taxation in the other state. The treaties generally also contain OECD-compliant exchange of information provisions, or are being updated to include such provisions. Japan has entered into tax information exchange agreements with a number of countries with which it does not have a comprehensive tax treaty. Additionally, Japan has entered into a private-level bilateral agreement on taxation with Taiwan.

The prescribed tax treaty forms must be submitted for a taxpayer to enjoy reduced tax rates under an applicable tax treaty.

Japan was one of the 68 countries that signed the OECD multilateral instrument on 7 June 2017.

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Japan Tax Treaty Network			
Armenia	Finland	Mexico	South Africa
Australia	France	Moldova	Spain
Austria	Georgia	Netherlands	Sri Lanka
Azerbaijan	Germany	New Zealand	Sweden

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Bangladesh	Hong Kong	Norway	Switzerland
Belarus	Hungary	Oman	Tajikistan
Belgium	India	Pakistan	Thailand
Brazil	Indonesia	Philippines	Turkey
Brunei	Ireland	Poland	Turkmenistan
Bulgaria	Israel	Portugal	Ukraine
Canada	Italy	Qatar	United Arab Emirates
Chile	Kazakhstan	Romania	United Kingdom
China	Korea (ROK)	Russia	United States
Czech Republic	Kuwait	Saudi Arabia	Uzbekistan
Denmark	Kyrgyzstan	Singapore	Vietnam
Egypt	Luxembourg	Slovakia	Zambia
Fiji	Malaysia		

### 3.6 Anti-avoidance rules

#### Transfer pricing

Japan's transfer pricing rules apply to "foreign related transactions," which are transactions between a Japanese entity and a foreign related entity (the term "entity" is used in this publication; the Japanese term "*hojin*" includes corporations, limited liability companies and other legal entities). The definition of a "related entity" includes entities with a special relationship with the Japanese taxpayer. A "special relationship" includes direct or indirect legal control (through shareholding), control in substance (through personnel, transactional, financial or similar dependence factors) or a combination of both.

Japan's transfer pricing rules are based on the arm's length principle, and generally are consistent with the OECD transfer pricing guidelines. Acceptable transfer pricing methodologies include the comparable uncontrolled price, resale price, cost plus, profit split and transactional net margin methods. The Japanese rules require the taxpayer to use the "most appropriate method."

Advance pricing agreements (APAs) that consider the reasonableness of the taxpayer's methodology and results may be obtained from the tax authorities. Both unilateral and bilateral APAs are available. Cost contribution arrangements and cost sharing agreements also may be accepted.

Related party transactions must be reported on schedule 17-4 of the corporate tax return.

Japan's 2016 tax reform introduced the OECD's country-by-country (CbC) reporting, master file and local file framework under BEPS action 13.

**CbC reporting:** Japanese companies that are the ultimate parents of multinational groups and that meet the filing threshold of group revenue of JPY 100 billion or more in the previous year must file a CbC report. The requirement applies for tax years beginning on or after 1 April 2016, and the report must be filed electronically in English within one year after the end of the group's fiscal year.

A Japanese subsidiary of a multinational group or a Japanese permanent establishment of a non-Japanese group company in a group in which the ultimate parent is not a Japanese company may be required to file the CbC report if a report has not been received from the government of another jurisdiction.

**Master file:** Japanese companies or permanent establishments of non-Japanese companies that are members of a multinational group that meets the filing threshold of group revenue of JPY 100 billion in the previous year must file a master file. The master file to be submitted in Japan is required to include the information described in Japan's legislation. The master file must be filed electronically with the NTA for tax years beginning on or after 1 April 2016 and is due within one year after the year end of the ultimate parent company.

**Local file:** For fiscal years beginning on or after 1 April 2017, Japanese companies (and Japanese permanent establishments of foreign companies) must prepare a local file. (For prior periods, Japan's existing documentation rules apply.) Japanese legislation prescribes the information that needs to be

included in the local file. Based on the legislation, the local file is to be prepared by the time the entity's income tax return is filed (subject to certain thresholds), but there are no specific penalties for a failure to prepare documentation by such deadline. In practice, the local file must be readily available to the tax authorities if requested in an audit.

**Penalties:** In addition to ordinary corporate tax penalties, a JPY 300,000 penalty may be imposed on a company for failure to submit a CbC report or a master file. A company's officers or employees also may be subject to a similar penalty for failure to provide the CbC report, the master file or the local file.

### Thin capitalization

Japan's thin capitalization rule primarily restricts the deductibility of interest payable (including certain guarantee fees) by a Japanese corporation, or a foreign corporation liable to pay corporate income tax in Japan, to its foreign controlling shareholder (or certain third parties) if the interest is not subject to Japanese tax in the hands of the recipient.

A foreign controlling shareholder is defined as a foreign corporation or nonresident individual that:

- Directly or indirectly owns 50% or more of the total outstanding shares of the Japanese corporation (i.e. a parent-subsidiary relationship);
- Is a foreign corporation in which 50% or more of the total outstanding shares are directly or indirectly owned by the same shareholder that directly or indirectly owns 50% or more of the shares of the relevant Japanese entity (i.e. a brother-sister relationship); or
- Otherwise exercises control over the Japanese entity.

The thin capitalization rule also is applicable in situations involving certain third parties, including where:

- A third party provides a loan to the Japanese entity that is funded by a back-to-back loan arrangement with a foreign controlling shareholder;
- A third party provides a loan to the Japanese entity that is guaranteed by a foreign controlling shareholder; or
- A third party provides a loan to the Japanese entity based on arrangements involving bonds and certain repo transactions.

There is a debt-to-equity safe harbor ratio of 3:1 (2:1 for certain repo transactions). This effectively means that there will be a restriction only if the debt from the foreign controlling shareholder (or specified third party) exceeds three times the amount of net equity that the shareholder/third party owns and the total debt exceeds three times the equity. In such a situation, interest expenses calculated on the excess debt are treated as nondeductible expenses for Japanese corporate income tax purposes. If the taxpayer can demonstrate the existence of comparable Japanese corporations that have a higher debt-to-equity ratio, that higher ratio may be used.

### Earnings stripping

The earnings stripping rules limit deductions for excessive net interest payments made to related parties.

Under the earnings stripping rules, interest paid to certain related parties is limited to 50% of adjusted taxable income, and the deductibility restriction applies in addition to the existing thin capitalization rules. For these purposes, "related parties" are broadly defined, and include similar controlling and third party relationships to those discussed under "Thin capitalization," above. Interest paid by a corporation whose debt is guaranteed by such a related party also is subject to the limitation.

De minimis rules apply where net interest payments to related parties are JPY 10 million or less, or if interest payments to related parties are 50% or less of total interest expenses (excluding interest payments that are subject to Japanese corporation tax in the hands of the related parties), such that a Japanese company is not required to apply the above rules.

If both the thin capitalization and the earnings stripping rules would apply to disallow an interest deduction, the rule that denies the larger amount will apply.

To the extent the application of the above rules gives rise to nondeductible related party interest, such interest expense may be carried forward and deducted within the limitation of the difference between adjusted taxable income and related party interest arising during the following seven fiscal years.

## Controlled foreign companies

The CFC rules limit the deferral of taxation of income earned by a CFC. If the CFC has profits in any fiscal year, each Japanese resident individual or Japanese corporation that (together with its associated persons) owns directly or indirectly 10% or more of the outstanding shares (or voting shares or dividend rights, if any) of the CFC (a "Japanese 10% shareholder") is required to report its pro rata share of the taxable profits of the CFC.

A non-Japanese corporation is a CFC if both of the following tests are met:

- The non-Japanese corporation is more than 50% controlled, directly or indirectly, by Japanese shareholders (i.e. Japanese resident individuals and/or Japanese corporations). A CFC is considered "controlled" by Japanese shareholders if Japanese shareholders own (directly or indirectly) more than 50% of the outstanding shares, the voting shares or the dividend rights; and
- There are no income taxes in the country in which the CFC is located or the effective tax rate of the CFC is less than 20%. The effective tax rate is calculated by making some adjustments to the local tax rate, and is computed for each fiscal year.

Dividends paid by a CFC are not included in the taxable income of a recipient Japanese 10% shareholder to the extent that shareholder already has been subject to tax on such dividends under the CFC rules.

If the CFC meets all of the following requirements, only certain passive income (e.g. dividends, interest, royalties and capital gains) is subject to CFC taxation:

- *Active business test:* The main business of the corporation is not the holding of shares or debt securities; the licensing of intellectual property rights, know-how or copyrights; or the leasing of vessels or aircraft (except for a qualifying regional headquarters corporation);
- *Substance test:* The corporation has a fixed place of business in the foreign country in which its head office is located;
- *Local management and control test:* The corporation manages, controls and operates its business in the country where the head office is located; and
- *Unrelated party transaction test or local business test:* Under the unrelated party transaction test, the main business of the company is that of wholesale, banking, a trust company, securities, insurance, shipping or air freight, and more than 50% of its business is conducted with unrelated parties. If the main business is not of a type listed for the unrelated party transaction test, then, under the local business test, the corporation must conduct its business mainly in the country where the headquarters are located.

In line with the revision of the "foreign dividend exemption system" mentioned below, a CFC that receives dividends from a 25% or more shareholding that were deductible in the source country no longer may exclude such dividends from its income when calculating the amount to be included in a Japanese shareholder's taxable income under the CFC rules. This revision is applicable starting in the first tax year in which the CFC's income may be included in a Japanese shareholder's taxable income for tax years beginning on or after 1 April 2016.

The 2017 tax reform enacted by Japan's National Diet on 27 March 2017 makes fundamental changes to the CFC rules, in light of the OECD's final report on action 3 of the BEPS project and to address aspects of the existing rules that potentially lead to the under- or over-inclusion of income. The new rules will become effective for accounting years of a foreign related company that begin on or after 1 April 2018.

## Disallowance of foreign dividend exemption

With respect to hybrid mismatch arrangements, the foreign dividend exemption (see under 3.3, above) no longer will be applicable to foreign dividends that are deductible in the source country. These revisions will be applicable to dividends received by Japanese companies from their foreign subsidiaries for tax years beginning on or after 1 April 2016. However, if dividends are received from shares held before 1 April 2016, the revision will not apply to such dividends during tax years beginning from 1 April 2016 to 31 March 2018.

## General anti-avoidance rule

Japan does not have a GAAR; instead, it has several specific anti-avoidance rules that target potential or perceived manipulation of the tax legislation in the following situations:

- *M&A transactions*: Anti-avoidance rules apply to certain transactions that result in utilization of expiring tax losses and creation of new tax-deductible goodwill.
- *Tax consolidation*: Anti-avoidance rules apply to certain situations in which capital losses are created due to group company transactions and those losses are offset against taxable income of subsidiaries in the tax consolidation.
- *Companies treated as "family corporations"*: A family corporation is a company where 50% or more of the shares are held, directly or indirectly, by three or fewer individual shareholders. All affiliated companies and individuals are considered to be one shareholder for these purposes. Such family corporations are subject to the "denial of transactions" rule. Under this anti-avoidance rule, transactions, especially those with the family corporation's shareholders or related entities, may be disregarded for tax purposes if they have the result of unreasonably reducing the family corporation's tax liability.

## BEPS

The Japanese government generally supports the OECD BEPS initiative. The following table summarizes the steps Japan has taken to implement the BEPS recommendations:

Action	Notes on local country implementation	Expected timing of implementation
VAT on business to customers digital services (Action 1)	This issue was addressed in the 2015 tax reform and certain inbound digital services are now subject to Japanese consumption tax.	1 October 2015
Hybrids (Action 2)	This issue was addressed in the 2015 tax reform, with the result that deductible dividends will not be considered exempt for Japanese tax purposes.	1 April 2016
CFCs (Action 3)	This issue is addressed in the 2017 tax reform and certain non-active companies (e.g. cash box) will be subject to stricter rules.	1 April 2018
Interest deductions (Action 4)	Existing earnings stripping rules restrict the deduction of interest where it exceeds 50% of adjusted taxable income. The 50% limitation may be further reduced in the future as a result of the action 4 recommendations.	Not yet known
Harmful tax practices (Action 5)	Japan does not have any regimes that would be considered harmful tax practices (such as a patent box or harmful ruling system).	N/A
Prevent treaty abuse (Action 6)	The government has been updating Japan's tax treaties with various treaty partners to include limitation on benefits and information exchange clauses. Japan's provisional list of reservations and notifications at the time of signing the multilateral instrument on 7 June 2017 indicates the intent to	Ongoing

	include a principal purpose test within its covered tax agreements.	
Permanent establishment status (Action 7)	Japan has committed to actively participate in the G20/OECD follow-up discussion expected to take place with respect to profit attribution to a permanent establishment.	Not yet known
Transfer pricing (Actions 8-10)	Japan is looking to the further discussions at the G20/OECD that are expected to take place.	Not yet known
Disclosure of aggressive tax planning (Action 12)	The government is discussing whether a mandatory disclosure rule and a GAAR need to be introduced. There is an existing disclosure rule in the Certified Public Tax Accountant Law, but because the disclosure is voluntary rather than mandatory, it is not often used.	Not yet known
Transfer pricing documentation and CbC reporting (Action 13)	This issue was addressed in the 2016 tax reform and Japanese companies are required to prepare and maintain transfer pricing documentation. A <i>de minimis</i> exception will apply to certain nonmaterial intercompany transactions.	1 April 2017/1 April 2016
Dispute resolution (Action 14)	Japan is one of the countries committed to binding arbitration.	Ongoing
Multilateral instrument (Action 15)	Japan is one of the 68 countries that signed the multilateral instrument on 7 June 2017.	Not yet known

## 3.7 Administration

### Tax year

A Japanese corporation selects its fiscal year when it begins operations in Japan—the tax year may be the calendar year or another period not exceeding 12 months. A branch generally must adopt the same tax year used by its head office.

### Filing and payment

Corporations in Japan must file a tax return for corporate income tax, inhabitants tax and enterprise tax. A corporation must file a tax return and pay tax within two months of the close of its fiscal year. An extension to the filing deadline is available upon request (generally one month for a Japanese corporation). No extension is available for the payment of tax. In addition, an installment payment is required during the year, in an amount equal to 50% of the tax liability for the previous year. Alternatively, in certain cases, a corporation may elect to pay an amount equal to 50% of the expected current year tax liability. The rules governing the filing of returns generally are the same for both foreign and domestic corporations.

A corporation may file either a “blue” or a “white” return. The blue return filing carries a wide range of benefits, including tax loss carryforwards and accelerated depreciation privileges. To use a blue return, a firm must apply before the beginning of the applicable tax year, it must meet certain standards in relation to its accounting system and recordkeeping and it must have the approval of the tax authorities.

### Consolidated returns

A Japanese domestic parent corporation and its 100%-owned domestic subsidiaries may elect to file a consolidated tax return for national tax purposes. Once such a group has been approved to enter into the consolidated tax regime, in principle, the group cannot voluntarily revoke this status.

Consolidated taxable income is calculated for the consolidated group as a single tax unit, based on the aggregated separate taxable income of each subsidiary in the group and applying necessary adjustments. Consolidated tax liability is calculated based on consolidated taxable income multiplied by the applicable tax rate, adjusted through various tax credits. The group's consolidated tax liability is allocated to the individual corporations in the group based on the taxable income or loss of each corporation.

In principle, when forming/joining the consolidated group, existing subsidiaries are subject to a mark-to-market rule and forfeiture of their existing NOLs. There are some exceptions whereby mark-to-market would not apply and a separate return limitation year rule (under which a subsidiary's NOLs incurred before joining the group can be carried forward and offset only against its own taxable income) would be available for subsidiaries held for more than five years and subsidiaries that meet certain requirements.

### **Statute of limitations**

The tax authorities can issue an additional assessment to a tax return within five years from the date the corporate tax return was due. The period is extended to six years for transfer pricing adjustments, seven years in the case of fraud or tax evasion and nine years for companies with NOLs (10 years for tax losses incurred in fiscal periods beginning on or after 1 April 2018).

### **Tax authorities**

Administration of the national tax laws is the responsibility of the NTA. While not officially part of the MOF, the NTA administers national tax collection under its supervision. There are 12 regional tax bureaus that report to the NTA, and over 500 local tax offices that are under the direct control of their respective regional tax bureau.

The NTA frequently issues circulars to clarify existing tax laws and ordinances.

### **Rulings**

Japan has a limited advance ruling system. Rulings generally are available to the public, and the availability of a ruling is subject to certain restrictions (e.g. no hypothetical cases). APAs also are available.

## **3.8 Other taxes on business**

### **Surtax**

A 2.1% surtax applies on the withholding tax for certain income, as discussed under section 4, below.

### **Fixed asset tax**

In general, fixed asset tax is levied on land, buildings, ships, aircraft or any other kind of depreciable asset (not including intangible assets, goodwill, etc.) that is in use as of 1 January each year. However, the tax is not levied if the fixed asset amounts do not exceed certain thresholds for the municipality. The standard fixed asset tax rate is 1.4% of the adjusted official appraisal value of the asset; the exact tax rate may vary slightly from municipality to municipality. This tax is deductible for corporation tax purposes.

For certain areas, city planning tax also applies, at a maximum rate of 0.3%.

### **Business premises tax**

Business premises tax is levied by Japan's large cities. However, where the premises' floor space is 1,000 square meters or less and the number of employees is 100 or less, the establishment is exempt from this tax. The tax is based on JPY 600 per square meter of premises used in the business, and 0.25% of the gross payroll. A return must be filed within two months after the end of a company's fiscal year end, and tax paid accordingly.

### **Business and license taxes**

Registration and license tax is levied on registrations in official books or documents in connection with the acquisition, creation, transfer, alteration or lapse of rights; for the practice of certain professions; and for obtaining a business license. Taxable registrations and licenses include registration of real estate and ships; registration of commercial companies; registration of patent rights, design rights, utility model rights and trademarks; registration for practice by qualified lawyers, doctors, accountants

and appraisers; a license to operate in the banking business; and a liquor business license. Registration and license tax rates vary according to the value of the property, etc.

# 4.0 Withholding taxes

## 4.1 Dividends

A 20% withholding tax normally is levied on dividends paid to a nonresident, unless the rate is reduced under a tax treaty. A 2.1% surtax increases the rate to 20.42%. The withholding tax on dividends received from listed companies, including the surtax, is 15.315% for a nonresident and 20.315% for a resident (including the 5% local tax that is applicable only for Japanese residents).

## 4.2 Interest

Interest on loans paid to a nonresident corporation generally is subject to a 20% withholding tax, while the rate on deposits and bonds is 15% (usually reduced to 10% in Japan's tax treaties). Due to the 2.1% surtax, the rates are 20.42% and 15.315%, respectively.

## 4.3 Royalties

Royalties paid to a nonresident for patents, trademarks, know-how or copyrights and service fees are subject to a 20% withholding tax, unless reduced under a tax treaty. Due to the 2.1% surtax, the effective rate is 20.42%.

## 4.4 Branch remittance tax

Japan does not impose a branch remittance tax.

## 4.5 Wage tax/social security contributions

The employer must withhold the employee's contribution and make its own contributions to social security, which has several components and income caps. The employer portion (assuming general business rates for labor insurance apply) may be up to 16.283%, and the employee's portion up to 15.451%.

## 4.6 Other

A 20.42% withholding tax is imposed on partnership income attributable to nonresident partners of a partnership that conducts business in Japan. Nonresident partners that have a permanent establishment through means other than the partnership interest may be exempt from the withholding tax because they are required to file Japanese income tax returns.

# 5.0 Indirect taxes

## 5.1 Consumption tax

Japan's national and local indirect tax, known as the Japanese consumption tax (JCT), applies to (i) the transfer/lease of goods and the provision of services rendered in Japan by enterprises for business purposes, and (ii) foreign goods removed from bonded areas. It is a broad-based value added tax that is imposed on each stage of the manufacturing, wholesale, retail and service process, with the tax ultimately passed on to end consumers of the goods or services.

The tax rate is 8% (with 6.3% treated as a national consumption tax and 1.7% as a local consumption tax).

Retailers and service providers must display price tags that include the 8% JCT.

The JCT rate is scheduled to increase to 10% as from 1 October 2019 and, at the same time, a reduced JCT rate of 8% for certain goods (i.e. store-bought food items and nonalcoholic drinks, newspaper subscriptions, etc.) is scheduled to be implemented. New invoicing requirements also will be introduced to deal with multiple JCT rates.

The following are examples of domestic transactions that are subject to JCT: (1) the transfer of tangible assets and intangible property rights; (2) services such as transport, contracting and processing; (3) services provided by professionals such as certified public accountants or attorneys; and (4) leasing by businesses (not limited to leasing companies).

The following general criteria basically are used to determine whether a transaction is domestic, and thus subject to JCT: for the transfer or lease of an asset, the physical location of the asset that is the subject of the transaction; and for the performance of services, the performance location. For services provided via the internet (e.g. sale of e-books, etc.), the place of supply is where the head office or domicile of the recipient is located.

Intangible assets purchased abroad are taxable only when the transaction is considered a "domestic" transaction. For example, a royalty payment made for the use of patents or trademarks that are registered only in Japan is subject to JCT, even if the payment is made to a company outside Japan.

Digital services and content provided by foreign enterprises to customers in Japan are subject to JCT. The place of supply of such services will be deemed to be the place where the recipient is located, i.e. in Japan. For business-to-business (B2B) supplies, the tax is collected under a reverse-charge mechanism, under which the Japanese business customer must account for the JCT on the purchase of digital services from the foreign provider. Where a foreign supplier makes business-to-consumer (B2C) supplies, it is required to account for JCT. Foreign suppliers making B2C supplies may register for JCT purposes if they are a JCT taxpayer, have an office or representative in Japan and have no outstanding JCT liability. Business customers will be able to deduct input JCT only on digital services purchased from registered foreign suppliers. Special invoicing requirements apply to B2C supplies by registered foreign suppliers.

The following transactions are exempt from JCT: transfer or leasing of land; transfer of securities; transfer of monetary claims; interest on loans, guarantee fees and insurance premiums; medical care covered by insurance; and leasing of residential buildings, etc. As from 1 July 2017, the supply of virtual currency also is exempt from JCT. Export transactions are zero rated, provided evidence of export is retained. The following defines export transactions: export of tangible goods out of Japan; transfer/lease of foreign goods; transfer or lease of intangible assets to a nonresident of Japan; performance of services for a nonresident of Japan (except when services are consumed within Japan (e.g. accommodations, transportation, etc.); international transport of passengers or freight, and international telecommunications services, etc.

### JCT taxpayers

There is no registration system for JCT purposes, and an enterprise needs to self-assess its JCT status (whether it is a JCT taxpayer or JCT-exempt enterprise) based on several tests. Basically, an enterprise will be regarded as a JCT taxpayer for the current fiscal year if the amount of its JCT taxable sales during the "base period" (generally the fiscal year two fiscal years prior to the current fiscal year) exceeds JPY 10 million. A JCT taxpayer must file a JCT return and pay the balance of output JCT and input JCT to the tax office. On the other hand, a JCT-exempt enterprise is allowed to keep collected output JCT as its revenue, but cannot treat input JCT incurred on JCT taxable purchases

as creditable or refundable. A JCT-exempt enterprise may elect to become a voluntary JCT taxpayer by filing a notification with the jurisdictional tax office.

JCT taxpayers are allowed to treat input JCT as creditable against output JCT. Whether input JCT is fully creditable depends on the volume of taxable sales and the taxable sales ratio during the relevant taxable period. The taxable sales ratio is calculated by the following formula:  $(8\% \text{ taxable sales} + \text{zero-rated sales}) / (8\% \text{ taxable sales} + \text{zero-rated sales} + \text{exempt sales})$ .

- For JCT taxpayers with taxable sales of JPY 500 million or less and a taxable sales ratio of 95% or more, input JCT is fully creditable.
- Other enterprises must elect either the proportional method or the itemized method to calculate the amount of creditable input JCT.
  - Under the proportional method, the amount of creditable input JCT is calculated by multiplying the total input JCT by the taxable sales ratio.
  - Under the itemized method, input JCT is categorized into (a) input JCT attributable to taxable sales or foreign transactions; (b) input JCT attributable to exempt sales; and (c) input JCT attributable in common to taxable sales and exempt sales, and the amount of creditable input JCT is calculated as:  $(a) + (c) \times \text{taxable sales ratio}$ .

To take an input JCT credit, JCT taxpayers must maintain the relevant books and invoices for seven years.

JCT taxpayers whose taxable sales during the base period are JPY 50 million or less may adopt the simplified method for calculating JCT, under which the amount of creditable input JCT is calculated as a certain percentage of the amount of output JCT for the relevant taxable period. The applicable percentage varies depending on the industries in which the JCT taxpayer is active.

## Return filing

A JCT return is due two months after the end of the taxable period. A taxable period basically coincides with the taxpayer's fiscal year, but shortening taxable periods to one month or three months also is allowed. Based on the amount of JCT liability for the previous taxable period, JCT taxpayers may be required to make half-yearly, quarterly or monthly interim JCT payments.

## 5.2 Capital tax

Capital duty is included in the local inhabitants tax (per capita levy) and the factor-based local enterprise tax as a levy on capital.

## 5.3 Real estate tax

Real estate acquisitions tax applies to the transfer of real property at a rate of 3% of the assessed value for land and residential buildings and 4% for nonresidential buildings (temporarily, 1.5%-2%) at the time the land or buildings are acquired. Real estate registration tax is imposed on the assessed value of real property at rates ranging from 0.4% to 2%, depending on the type of transfer.

## 5.4 Transfer tax

The transfer of certain assets is subject to stamp duties on contracts.

## 5.5 Stamp duty

Stamp duty of JPY 200 to JPY 600,000 is imposed on the execution of taxable documents, such as deeds of contract and certificates.

## 5.6 Customs and excise duties

Customs duties are imposed on imports into Japan, mainly at *ad valorem* rates, which cover about 90% of all tariff items. Nevertheless, specific tariffs apply to a range of imported products, including vegetable oils, foodstuffs, alcoholic beverages and petroleum products. Japan uses high tariffs to protect its high-cost but politically sensitive farming sector.

A simplified tariff system for low-value imported freight valued at less than JPY 100,000 (e.g. small packages for personal imports) simplifies the determination of tariff rates, eliminates the extra time

necessary to determine the type of product and the precise value and minimizes customs brokers' handling charges. Importers may choose either the normal rate or the simple tariff, which may be higher or lower. An advance ruling may be obtained on tariff classification and duty rates from a local customs office.

Other than the customs duty and stamp duty, there are various national excise tax systems for liquor tax, tobacco tax, gasoline tax, petroleum gas tax, aviation fuel tax, petroleum and coal tax, automobile weight tax and promotion of power resources development tax, etc.

# 6.0 Taxes on individuals

The main taxes affecting individuals in Japan are the national income tax, local inhabitants tax, social security tax and, potentially, the exit tax.

## Japan Quick Tax Facts for Individuals

Income tax rates	Progressive to 45%
Local inhabitants tax rate	10%
Earthquake surtax	2.1%
Capital gains tax rates	20%/39%
Basis	Worldwide income
Double taxation relief	Yes
Tax year	Calendar year
Return due date	15 March following the tax year (if required)

### Withholding tax

<ul style="list-style-type: none"><li>Dividends</li><li>Interest</li><li>Royalties</li></ul>	20%, plus 2.1% surtax 20% (residents)/15% (nonresidents), plus 2.1% surtax 20%, plus 2.1% surtax
Social security	Up to 15.451%, assuming general business rates for labor insurance apply
Net wealth tax	No
Inheritance tax	Progressive rates up to 55%
Fixed assets levy	1.4%
Real estate acquisitions tax	3%-4% (temporarily, 1.5%-2%)
Real estate registration tax	0.4%-2%
Exit tax	15.315% (including earthquake surtax)
Consumption tax	8%

## 6.1 Residence

An individual that has a domicile in Japan may be a permanent resident or a nonpermanent resident. Permanent residents are subject to tax on their worldwide income. Until 31 December 2016, nonpermanent residents were taxed only on Japanese-source income, provided foreign-source income was not paid in or remitted to Japan. Under new domestic rules, as from 1 January 2017, nonpermanent residents are taxed on all income except foreign-source income that is not paid in or remitted to Japan. Capital gains arising from the sale of shares and securities after 1 April 2017 that were acquired by nonpermanent residents on or before 1 April 2017 are able to be excluded when determining taxable income for nonpermanent residents.

An individual who is domiciled or who has an abode in Japan for one year or more is considered a resident. A non-Japanese national who has spent five years or less in Japan in the preceding 10-year period is regarded as a nonpermanent resident. A resident other than a nonpermanent resident is regarded as a permanent resident. A nonpermanent resident must report Japanese-source income and foreign-source income paid in or remitted to Japan as taxable income.

An individual who does not qualify as a permanent or nonpermanent resident is a nonresident. A nonresident pays tax only on Japanese-source income. Salaries, wages, bonuses and other allowances are viewed as income from sources in Japan if services are performed in Japan.

Individuals entering Japan as employees are presumed to be residents on the day after entry, unless evidence shows that their stay in Japan is to be for less than one year. A nonresident who is a resident of another country may be exempt from Japanese tax under an applicable tax treaty.

An individual who is a registered resident of his/her ward office as of 1 January of the following year will be assessed for local inhabitants tax. Unlike national income tax, the local inhabitants tax is levied on income derived in the previous year.

## 6.2 Taxable income and rates

Residents are liable to income tax on their worldwide income, while nonresidents generally are liable to tax only on Japan-source income.

### Taxable income

Taxable income of individuals is based on the calendar year. Income tax is levied on a self-assessment basis, with the income tax liability determined by the taxpayer's declaration based on proper records of the tax base and the tax amount due.

There are 12 separate classes of income defined under the tax law. It is important to ascertain the classification of income and the source of income to determine how it should be taxed.

National income tax on employment income is withheld at source, according to various tax tables, based on a taxpayer's income and personal deductions. There are separate tables on salary for withholding national income tax for periodic employment income, bonuses and other special payments. Taxable income for the local inhabitants tax is calculated under rules in the Income Tax Law, unless otherwise specified by local tax laws.

Employment income includes salaries, wages, bonuses and other allowances (such as cost of living, housing, tax, children's education or medical) received as compensation for services provided as an employee. Some allowances (such as commuting expenses, subject to a cap of JPY 150,000 per month) are not taxable, but low-interest loans provided by an employer for an employee's purchase of a home and other expenditure may be taxable as employment income.

### Investment income

Taxable dividend income received by resident taxpayers generally is taxed at marginal rates. A 20% (15% national, 5% local) withholding tax may be imposed on dividends paid from Japanese companies. The withholding tax may be reduced under a tax treaty. Any tax withheld from dividends paid by Japanese companies to nonresident individual taxpayers is considered a final tax.

A 20% withholding tax (15% national, 5% local) is levied on Japanese bank interest paid to individual resident taxpayers. The normal withholding tax on interest paid to nonresidents is 15%, but the rate may be lowered under an applicable tax treaty.

Where a final withholding tax is applied at source, a 2.1% surtax also will be payable.

### Share options

The NTA generally treats share option gains as employment income. The difference between the grant price and fair market value at the exercise is taxed at the time the share options are exercised. In practice, the NTA accepts a time-apportionment basis for the sourcing of a gain relating to share options exercised by an individual who was resident in Japan at any time during the period between grant and exercise. Therefore, where nonresident or nonpermanent resident taxpayers exercise share options, only a portion of the gain may be subject to tax if the options relate to overseas stocks and are not delivered in Japan.

There generally are no withholding requirements on the exercise of shares of non-Japanese companies, and the individual is required to report the income on his/her annual personal national income tax return. Compliance requirements for companies using approved Japanese stock option plans can be onerous when option holders travel outside of Japan and trigger reporting obligations in a host location, in addition to any reporting and tax obligations in Japan.

Branches and qualifying subsidiaries of overseas parent companies are required to disclose to the tax office details of equity-related income (including cash payments such as bonuses that are linked to the company share price). This report should be submitted by 31 March following the relevant tax year.

## Special expatriate tax regime

There is no special expatriate tax regime in Japan. However, most expatriates fall into the nonpermanent resident category discussed above. A nonpermanent resident is taxed on all income from Japanese sources, and on non-Japanese source income to the extent the non-Japanese source income is remitted into or paid in Japan.

Japanese-source employment income is determined by a ratio calculated as follows: 365 days (or the number of days worked if less than 365) minus home leave and foreign working days, divided by 365 days (or the number of days worked if less than 365), minus home leave days.

## Deductions and reliefs

In computing taxable income, an individual is entitled to certain allowances and deductions for national income tax purposes. A resident taxpayer is entitled to a basic personal deduction and exemptions for a dependent spouse and other qualifying dependents. Special exemptions exist for the disabled. Similar exemptions and deductions are available for purposes of the local inhabitants tax.

In addition, a cumulative employment income deduction may be taken according to the following schedule: 40% of gross employment income up to JPY 1.8 million, with a minimum of JPY 650,000; 30% on income exceeding JPY 1.8 million and up to JPY 3.6 million; 20% on income exceeding JPY 3.6 million and up to JPY 6.6 million; 10% on income exceeding JPY 6.6 million and up to JPY 10 million; and 5% on income exceeding JPY 10 million. The maximum allowable employment deduction is capped at JPY 2.3 million for the year 2016 and JPY 2.2 million for the year 2017.

Social insurance premiums paid to the Japanese government are fully deductible, and life insurance premiums paid to Japanese companies may be deducted up to JPY 40,000. Taxpayers may deduct earthquake insurance premiums of up to JPY 50,000.

Medical expenses and contributions to qualifying charities are partially deductible. The first JPY 2,000 in qualifying charitable contributions is not deductible; amounts exceeding that amount may be deducted up to a maximum of 40% of gross taxable income. Qualifying contributions include those made to governments, municipalities, organizations, corporations, the Japanese Red Cross and foundations for educational, social welfare, scientific or similar purposes. Qualified medical expenses are deductible up to JPY 2 million, after deducting the lower of 5% of gross income or JPY 100,000. Other deductions also may be available.

A tax credit on housing loans may be available for 10 years under certain conditions. The amount of the credit is determined by the year in which a taxpayer began residing on the property and the mortgage balance at the end of the year. Other tax credits may be available for home improvements for energy savings or disabled access.

Foreign income taxes paid by residents may be credited against their Japanese tax.

## Rates

National income tax rates are progressive and increase from 5% to 45%; the rates are uniform and are not dependent on marital or other status. Local inhabitants tax is assessed on income at a flat rate of 10%.

An earthquake surtax of 2.1% of tax due applies on all payments of national tax. Combined, these taxes mean that the highest effective tax rate that an individual may be subject to is 55.945%.

Individuals are taxed on gains from the sale of shares at 20%. Long-term gains of individuals from the sale of real property are taxed at 20%, and short-term gains are taxed at 39%.

## 6.3 Inheritance and gift tax

Inheritances and gifts that exceed basic exempt amounts are taxable at steeply graduated rates (generally 10%-55%).

## 6.4 Net wealth tax

Japan does not impose a net wealth tax.

## 6.5 Real property tax

A municipal fixed assets levy is assessed at an annual rate of 1.4%. City planning tax is levied on land and buildings in certain urban areas as a surtax to the fixed asset tax. Additionally, a real estate acquisitions tax of 3%-4% (temporarily, 1.5%-2%) of the assessed value applies at the time land or buildings are acquired, and a real estate registration tax is imposed on the assessed value of real property at rates ranging from 0.4% to 2%, depending on the type of transfer.

## 6.6 Social security contributions

Social security tax comprises several components. The employee's portion can be up to 15.451% and the employer's portion can be up to 16.283% (assuming the general business rates for labor insurance apply). The employer must withhold the employee's contribution.

## 6.7 Other taxes

### Earthquake reconstruction surtax

An earthquake reconstruction surtax is in effect from January 2013 to December 2037. During this 25-year period, individuals will be subject to a 2.1% surtax that will be applied to any national income tax due during the year. In addition a JPY 1,000 charge will be levied on individuals when they settle their local taxes for the year.

### Exit tax

When covered persons (Japanese resident individuals, including foreign nationals) break residency with Japan and certain conditions are fulfilled, income tax of 15.315% (including the earthquake surtax) will be imposed on the unrealized gains on their covered financial assets, as if these assets were disposed of on the departure date.

A Japanese tax resident, regardless of his/her nationality, will be subject to the exit tax if the individual fulfills the following conditions:

- He/she holds covered assets of JPY 100 million or more at the time of breaking residency; and
- He/she has stayed in Japan for more than five out of the previous 10 years at the time of breaking residency.

For a foreign national resident in Japan, certain periods may be excluded from the residence period when determining whether the "five years out of 10" condition is satisfied, if the individual holds a certain type of working visa (including, but not limited to, those for a journalist, investor/business manager, engineer, specialist in humanities, international services, etc.). Under a transition rule for foreign nationals, no periods in Japan prior to 1 July 2015 will be counted and, therefore, no foreign nationals will be caught by the new exit tax before 1 July 2020, regardless of their visa status.

Local inhabitants tax will not be imposed.

## 6.8 Compliance

The tax year for individuals is the calendar year.

Income derived from employment, dividends, interest and retirement in Japan is taxed at source at the time of payment. When salaries, wages and other allowances are paid, the employer withholds national income tax at source. Because the employer also makes year-end adjustments of withholding tax in final payments for the year, individual taxpayers generally are not required to file final tax returns. There are a few exceptions, however, when an employee must itself report earned income (i.e. when total employment income receipts exceed JPY 20 million or the individual earns employment income from abroad). The Income Tax Law provides the rules for individual income tax on a withholding or self-assessment basis. If a taxpayer must file a return, the due date is 15 March following the end of the tax year. Joint filing by spouses is not permitted.

Japan imposes various penalties on taxpayers who underreport their total tax due and who fail to timely submit tax payments and tax returns. Penalties are not deductible for Japanese tax purposes.

## Assets and liabilities reporting

Japanese tax residents (excluding nonpermanent residents) who own assets outside of Japan with a combined value of JPY 50 million or more as of 31 December must submit a statement to the tax office (a "Foreign Asset Report") to declare those assets.

With effect from 1 January 2016, individuals in receipt of earned income over JPY 20 million and holding assets with a fair value of JPY 300 million or more, or assets subject to the exit tax amounting to JPY 100 million or more, as of 31 December are required to file a "Statement of Assets & Liabilities" report on a worldwide basis (i.e. assets and liabilities in Japan are included).

The due date for submission of both reports will be in line with the tax return filing deadline (15 March following the end of the tax year, i.e. by 15 March 2018 for assets owned as of 31 December 2017).

The reports are separate from any requirement to file a tax return, and a penalty will apply for noncompliance. The disclosure is not limited to financial assets and any overseas land or property held by a qualifying individual also should be included in the reports.

# 7.0 Labor environment

## 7.1 Employee rights and remuneration

Major Japanese labor statutes include the following: the Labor Standards Law, which regulates the minimum working conditions; the Labor Union Law, which guarantees workers the rights to organize, bargain collectively and act collectively; the Labor Relations Adjustment Law, which specifies adjustments and covers resolution of labor disputes; the Minimum Wage Law, which stipulates the minimum amount of wages; the Industrial Safety and Health Law, which provides instructions to establish standards for hazard prevention and other means to prevent industrial accidents; and the Labor Contract Law, which provides for the formation, amendment and termination of labor contracts.

The labor and social insurance systems are well established. There are four different systems that companies must participate in, in principle: workers' accident compensation insurance, employment insurance, health insurance and employees' pension insurance, all of which are supported by Japanese laws and regulations.

Laws to facilitate equality and diversity in the Japanese working environment include the Equal Employment Opportunity Law, the Law on Employment Security for Elderly Workers and the Law Promoting Employment of the Handicapped, among others.

These laws apply to all businesses located in Japan, regardless of whether they are domestic or foreign funded. In addition, these laws protect foreign workers, as long as they fall under the definition of "workers" or "employees" in the relevant law.

The Ministry of Health, Labor and Welfare (MHLW) publishes a variety of administrative guidelines on issues such as applying and interpreting labor-related laws and enforcing safety rules in the workplace.

### Working hours

In terms of statutory working hours, the Labor Standards Law requires companies to limit working hours to eight per day and 40 per week. In special cases, a limit of 44 work hours per week is allowed (movie theaters and health and hygiene companies, as well as restaurants and entertainment companies with 10 or fewer employees).

There is a limitation to the period of time that employers may require workers to work in excess of the statutory working hours; for example, the limit is a total of 15 hours for one week, 27 hours for two weeks, etc.

The required increase rate in wages for overtime work also is specified: it is 25% when an employee works in excess of the statutory working hours; 25% when an employee works late at night (from 10 pm to 5 am); 50% when an employee works late at night in excess of the statutory working hours, 35% when an employee works on national holidays; and 60% when an employee works late at night on national holidays.

If an employee has worked for six consecutive months from the time of hiring and has worked for at least 80% of scheduled work days, he/she must be granted a minimum of 10 paid leave days. The number of paid leave days granted to employees with additional years of service are as follows:

Years of Service	0.5	1.5	2.5	3.5	4.5	5.5	6.5
Paid Leave Days	10	11	12	14	16	18	20

## 7.2 Wages and benefits

The salary structure of Japanese corporations often is based on seniority. There has been an increase in the percentage of salary tied to job performance, but pay remains closely linked to the age of the employee and the number of years of service. Foreign-owned firms are popular among younger workers, partly because they give less priority to seniority. Leading Japanese companies also are beginning to change their compensation practices.

More Japanese companies are adopting stock options as noncash incentives for their employees. Stock options were first permitted under the Commercial Code in 1997, and recent reforms have increased their flexibility. For example, companies may grant share options to directors and employees, as well as to anyone outside of the company, if approved by shareholders.

Japanese companies traditionally provide a much wider range of fringe benefits than companies in other countries. Some are required by law (e.g. the four different types of social and labor welfare systems mentioned above). Larger companies also offer family allowances, subsidized medical and dental care, subsidized meals, holidays and excursions, housing and recreational facilities.

The total annual compensation package usually consists of 12 regular monthly payments and two bonuses (summer and winter) that are separate from monthly wages. The decisive factors in determining the amount of the bonus are the performance of the company at large, and the evaluation of the individual. Although the amount of bonus is regarded as fairly stable in Japan, some foreign firms do not adhere to the bonus system (and they are not legally obliged to do so).

Bonuses generally are paid as a multiple of the monthly base salary. Many Japanese companies disclose to employees the number that will be multiplied to each of their monthly wages. The total amount paid throughout the year typically amounts to four to five months' salary (which is why the payment of bonuses is regarded as one of the most important features of the Japanese wage practices).

Japan has a multi-layered minimum wage system, which varies by region and industry. Hence, 47 minimum wages are set annually for the local prefectures, and 235 industry-based minimum wages also are set. If an employee is eligible for two different types of minimum wage, the higher wage is applied. The MHLW issues recommendations to local governments on minimum wage policies.

### **Retirement allowances**

There is no law in Japan requiring employers to provide retirement allowances. However, many companies stipulate the mandatory retirement age in their internal rules, as well as the retirement allowances that will be paid at the time of retirement. The amount of an allowance is determined based on the years of service and the contribution of the employee.

### **Labor insurance**

Companies (including sole proprietorships with one or more employees) must take part in the workers' accident compensation insurance system once they hire one or more employees. The insurance covers employees' injuries, illness or death resulting from work or while commuting to the workplace.

Unemployment insurance is another form of labor insurance that companies (including sole proprietorships with one or more employees) must take part in. Currently, the premiums are shared between the company and the employee. To qualify for unemployment insurance, an employee's working hours (for part-time workers, in particular) must not be less than 20 hours per week and the employee must expect to be employed for no less than 31 days. The period for which employees may receive unemployment benefits ranges from 90 to 360 days and is determined based on the years of service, the reason for unemployment, etc.

### **Social insurance and pensions**

Health insurance in Japan is designed so that anyone can afford medical treatment when he/she is sick, injured, etc. It entitles employees and their dependent family members to receive medical treatment at a cost of 30% of the actual medical fees.

Employees' pension insurance provides pension benefits when employees reach the age of 65 or become disabled.

All incorporated companies or sole proprietorships with five or more regular employees are legally obliged to take part in health insurance and employees' pension insurance for the benefit of employees. For these purposes, Japanese sales offices and branches of foreign companies are regarded as companies incorporated in Japan, and representative offices are regarded as sole proprietorships.

## **7.3 Termination of employment**

If a labor contract provides no specific terms on resignation or termination of employment, an employee may resign on any grounds by providing two weeks' prior notice, while an employer may dismiss an employee if the dismissal does not lack objective and reasonable grounds and is considered

to be appropriate in general social terms. In addition, according to the Labor Standards Law, the company must specify the grounds for dismissal in the firm's internal work rules (*shugyo-kisoku*).

Thirty days' prior notice must be given for dismissals. In lieu of such notice, the employer must pay the average wage of that employee, in advance, for a period of no less than 30 days.

## **7.4 Labor-management relations**

According to the MHLW statistics (as of 30 June 2015), the union membership ratio is approximately 17.4%. Most labor unions in Japan are company-based, and industry-wide unions are actually federations of such company-based unions.

Most enterprise unions cover a range of regular employees, including blue- and white-collar workers. Union officials almost always retain their status as company employees.

According to the Trade Union Law, a "union shop" provision is allowed, if the specific union represents a majority of workers at work. However, Japanese court decisions, in which the courts have carefully reviewed the workers' freedom of association provided for in the Constitution of Japan, have limited the application of union shop provisions by adding further requirements for such provisions to be accepted.

## **7.5 Employment of foreigners**

A foreign national who wishes to work in Japan must first apply for a Certificate of Eligibility (COE) at the Ministry of Japan (the immigration office). The applicant then must bring the issued COE to the relevant Japanese embassy or consulate to have a visa issued. Although the COE is not a guarantee of issuance of a visa, it usually takes no more than a week to have the visa issued after the application, once the COE is issued. The COE certifies the activity in which the applicant is permitted to engage in Japan. Usually, no further work permits are required for foreigners with a proper working visa.

Since 2012, the government has held a policy of encouraging highly skilled foreign professionals or specialists as workers, to enhance the status and improve the efficiency of the Japanese labor market.

# 8.0 Deloitte International Tax Source

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