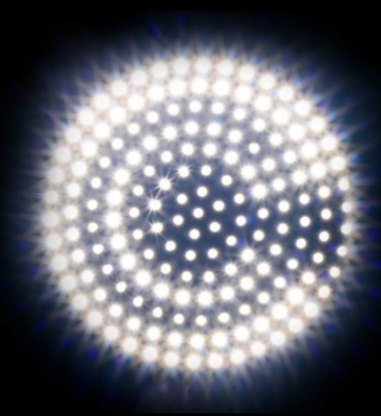
International Tax
Japan Highlights 2017



Investment basics:

Currency – Japanese Yen (JPY)

Foreign exchange control – There are no controls, but some reporting requirements apply.

Accounting principles/financial statements – Japanese GAAP. Financial statements must be prepared annually.

Principal business entities – These are the joint stock company, limited liability company, partnership and branch of a foreign corporation.

Corporate taxation:

Residence – A company that has its principal or main office in Japan is considered to be resident. Local management is not required.

Basis – A resident corporation is taxed on worldwide income; a foreign corporation generally is taxed only on certain Japan-source income. The corporate tax rate for a branch is the same as for a subsidiary.

Taxable income – The taxable income of a corporation in each accounting period is the excess of gross taxable revenue over total deductible business expenses. No gain or loss generally is recognized for certain assets transferred between 100% subsidiaries.

Taxation of dividends – Dividends received by a resident corporation from another resident corporation are excluded from taxable income for corporation tax purposes if the recipient holds 100% of the dividend-paying corporation for a certain period. If a corporation owns more than 33.3% of the shares in a dividend-paying corporation for at least six months before the date the right to receive a dividend is determined, the dividend (less the dividend-receiving resident corporation's interest expense allocated to the dividend) is excluded from taxable income. If a corporation holds 33.3% or less of the shares but more than 5% of shares, or holds more than 33.3% of the shares but for less than six months before the dividend determination, 50% of the dividend is excluded from taxable income. If a corporation owns 5% or less of the shares, 20% of the dividend is excluded from taxable income. A foreign dividend exemption system exempts 95% of dividends received by a Japanese company from its qualifying shareholdings of 25% or more in foreign companies that have been held for at least six months before the dividend determination date. However, foreign dividends that are deductible in the source country are excluded from the exemption and are fully includable in taxable income.

Capital gains – Capital gains are taxable as ordinary income; capital losses generally are deductible.

Losses – Only 60% of a company's taxable income may be offset by net operating losses (NOLs). A small or medium-sized enterprise (SME) with share capital of no more than JPY 100 million is exempt from the NOL restriction, unless the SME is owned by a large corporation. 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.

The NOL carryforward period is nine years for NOLs incurred during fiscal years ended on or after 1 April 2008. SMEs may carry back losses for one year.

Rate – The national standard corporation tax rate of 23.4% applies to ordinary corporations with share capital exceeding JPY 100 million.

Companies also must pay local inhabitants tax, which varies with the location and size of the firm. The inhabitants tax, charged by both prefectures and municipalities, comprises the corporation tax levy (levied as a percentage of national corporation tax) and a per capita levy (determined based on capital and the number of employees).

The local enterprise tax, another tax imposed by the prefectures, is classified as an income-based tax and factor-based tax. The factor-based enterprise tax has three components: progressive rates of up to 3.6% of taxable profits, 1.2% of a “value-added” factor and 0.5% of share capital and capital surplus.

The effective tax rate for corporations (inclusive of the inhabitants and local enterprise taxes), based upon the maximum rates applicable in Tokyo to a company whose paid-in capital is over JPY 100 million, is approximately 30%.

Surtax – A 2.1% surtax applies on the withholding tax for certain Japan-source income, as discussed below under “Withholding tax.”

Alternative minimum tax – No

Foreign tax credit – Foreign tax paid may be credited against Japanese tax, subject to certain limitations. An indirect foreign tax credit (deemed paid foreign tax credit) generally is unavailable.

Participation exemption – There is no participation exemption in respect of capital gains, but there is a 95% foreign dividend exemption (see above under “Taxation of dividends”).

Holding company regime – No

Incentives – Various tax credits are available, including an R&D credit.

There is a tax incentive for investment in productivity improving assets (PIAs), which are depreciable assets that are directly used for production, sales or service provision activities or other revenue-producing activities conducted by companies. PIAs do not include assets used in head office or back office functions. Under this incentive, taxpayers may take special depreciation or a tax credit for investments in PIAs if certain requirements are met.

Other tax incentives available for increasing wages and salaries (for fiscal years starting between 1 April 2013 and 31 March 2018) and for job creation (effective until 31 March 2018) may be taken in the same fiscal year if certain adjustments are made.

Special tax incentives have been introduced for qualified companies doing business in designated regions/zones.

Withholding tax:

Dividends – A 20% withholding tax normally is levied on dividends paid to a nonresident, unless the rate is reduced under a tax treaty. The rate is 15% for dividends paid by a listed company to a nonresident. A 2.1% surtax increases the domestic rates to 20.42% and 15.315%.

Interest – Interest on loans paid to a nonresident corporation generally is subject to a 20% withholding tax, while that on deposits and bonds is 15%. A 2.1% surtax effectively increases the rates to 20.42% and 15.315%. The rate often is reduced under a tax treaty.

Royalties – Royalties paid to a nonresident are subject to a 20% withholding tax, unless the rate is reduced under a tax treaty. A 2.1% surtax effectively increases the domestic rate to 20.42%.

Technical service fees – A 20% withholding tax generally is levied on Japan-source service fees, unless exempt under a tax treaty. A 2.1% surtax effectively increases the domestic rate to 20.42%.

Branch remittance tax – No

Other taxes on corporations:

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

Payroll tax – The employer must withhold income tax and social security contributions at source.

Real property tax – The municipal fixed assets levy is assessed at an annual rate of 1.4%. 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.

Social security – The employer must withhold the employee's contribution and make its own contributions to social security tax, which has several components. The highest combined employer portion is approximately 16.248%.

Stamp duty – Stamp duty of JPY 200 to JPY 600,000 is imposed on the execution of taxable documents.

Transfer tax – The transfer of certain assets is subject to stamp duty on contracts executed in Japan.

Other – Other taxes include registration and license taxes. Share registration tax is assessed on the registration of new or additional share capital, at 0.7%.

Anti-avoidance rules:

Transfer pricing – The prices of goods and services exchanged between internationally affiliated entities must be consistent with the arm’s length principle. Internationally affiliated entities are defined, among others, as those with a relationship consisting of a direct or indirect foreign shareholding of 50% or more, or a "control in substance" relationship. The burden is on the taxpayer to demonstrate that the pricing is reasonable. Failure to do so may give rise to a transfer pricing adjustment, at the discretion of the tax authorities. Advance pricing agreements on the reasonableness of the taxpayer's methodology and results may be obtained from the tax authorities. (See also under "Disclosure requirements.")

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 corporation 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 (1) directly or indirectly owns 50% or more of the total outstanding shares of the Japanese corporation (i.e. a parent-subsidiary relationship); (2) 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 (3) otherwise exercises control over the Japanese entity. This rule also is applicable in situations involving certain third parties, including situations where: (1) a third party provides a loan to the Japanese entity that is funded by a back-to-back loan arrangement with the foreign controlling shareholder; (2) a third party provides a loan to the Japanese entity that is guaranteed by a foreign controlling shareholder; or (3) 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 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.

Earning stripping rules – Where net interest payments to related persons (i.e. interest payments to related persons, less relevant interest income) exceed 50% of adjusted taxable income in a fiscal year, the excess portion is nondeductible. For these purposes, "related persons" is defined broadly, and includes similar controlling and affiliate relationships to those discussed under "Thin capitalization." The rules also can apply to interest payments to certain third parties (e.g. where a third party provides a loan that is guaranteed by a related person). To summarize, "adjusted taxable income" is taxable income without applying certain provisions (including offsetting brought-forward tax losses, the dividends received deduction, the foreign dividend exemption, etc.), and adding back net interest payments to related persons and certain other expenses. De minimis exceptions to the application of the earnings stripping rules exist for: (1) net interest payments to related parties not exceeding JPY 10 million, or (2) net interest payments to related parties that are not more than 50% of the total interest expenses. Where both the earning stripping and the thin capitalization rules are applicable, the larger of the two potential disallowances 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) against taxable income arising during the following seven fiscal years.

Controlled foreign companies – For Japanese tax purposes, a CFC may include any non-Japanese company that has an effective tax rate of less than 20%, if the company is more than 50% controlled, directly or indirectly, by Japanese shareholders. A CFC is considered "controlled" by Japanese shareholders where Japanese shareholders own directly or indirectly more than 50% of the outstanding shares.

Japanese companies that hold (together with their associated persons) 10% or more of the outstanding shares of a CFC must report their share of the taxable profits of the CFC on a current basis. When a company is classified as a CFC, the Japanese company generally is taxed on the taxable profits of the CFC on a pro rata basis corresponding to its shareholding. The CFC rules may be waived if a foreign subsidiary has fixed facilities engaged in business in the foreign country and conducts business activities in that country. Even if a CFC satisfies the above conditions, certain passive income is subject to tax in the hands of the Japanese parent company.

Disclosure requirements – Disclosure requirements apply to the 10%-or-more shareholders of CFCs. Transactions with foreign related parties should be disclosed (on Form 17(4)) and submitted with the tax return.

Other – Broadly applicable anti-avoidance rules are in place.

Compliance for corporations:

Tax year – A corporation selects its fiscal year when it begins operations in Japan. The accounting period must not exceed 12 months. A branch's tax year generally is the same as the tax year of its head office.

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 only, i.e. local taxation is calculated on a stand-alone basis. 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, by aggregating the 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 for 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 the mark-to-market rule, and the 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). There are some exceptions to these rules for subsidiaries held for more than five years and subsidiaries that meet certain requirements.

Filing requirements – A corporation or a branch must file a final tax return within two months after the close of its fiscal year. Taxes must be prepaid within two months from the end of the sixth month of the tax year in an amount equal to either (1) 50% of the tax payable on the previous year's earnings; or (2) the actual tax liability for the first six months.

Companies may file either a blue or a white return. The blue return carries a wide range of privileges, such as deductions, including tax loss carryforwards and accelerated depreciation. To use this form, firms must apply before the beginning of the applicable tax year (or, for a newly formed company, apply before the end of the first year) and must meet certain requirements in relation to their accounting systems and recordkeeping.

Penalties – Various penalties are imposed on taxpayers that underreport their total tax due and that fail to timely submit tax payments and tax returns. Penalties are not deductible for Japanese tax purposes.

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

Personal taxation:

Basis – An individual who is domiciled or who has a residence in Japan for one year or more is 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.

Residence – Permanent residents are taxed on their worldwide income. Nonpermanent residents are taxed on their Japanese-source income and on foreign-source income paid in or remitted into Japan. Nonresidents are taxed on their Japanese-source income.

Filing status – Joint filing is not permitted. Additionally, the tax rates are uniform and are not dependent on marital or other status.

Taxable income – Most income, including employment income and investment income, is taxable. Specified deductions, allowances and credits are available to reduce tax.

Capital gains – 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%.

Deductions and allowances – Subject to certain restrictions, deductions are granted for social insurance premiums paid under Japanese government plans, life insurance premiums, earthquake insurance premiums, charitable contributions, qualified medical expenses, etc. Personal deductions are allowed for the individual, a dependent spouse and children aged 16 or older. Exemptions exist for the disabled and the elderly.

Rates – Progressive rates up to 55% apply (combined national and local inhabitants tax). A surtax of 2.1% applies to national tax due, to help pay for recovery following the 2011 earthquake.

Other taxes on individuals:

Capital duty – No

Stamp duty – Stamp duty of JPY 200 to JPY 600,000 is imposed on the execution of taxable documents.

Capital acquisitions tax – See "Real property tax," below.

Real property tax – A municipal fixed assets levy is assessed at an annual rate of 1.4%. Additionally, a real estate acquisitions tax of 3% to 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.

Inheritance/estate tax – Progressive rates up to 55% apply for inheritance/estate/gift tax.

Net wealth/net worth tax – No

Social security – Social security tax comprises several components. The highest combined employee's portion is approximately 15.446%. The employer must withhold the employee's contribution.

Compliance for individuals:

Tax year – Calendar year

Filing and payment – Employment income and investment income generally are withheld at source. Self-employment business income is calculated in a similar manner as for corporations, and must be self-reported.

Penalties – 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.

Consumption tax:

Taxable transactions – Japanese consumption tax, similar to a European-style VAT, is levied on the supply of goods and services in Japan; the sale or lease of certain assets in Japan; the import of goods; and certain digital services provided in Japan by nonresidents.

Rates – The current rate is 8% (combined national and local tax rate) for taxable transactions and 0% in certain circumstances (e.g. export transactions).

Registration – An existing company may elect to be a consumption taxpayer if taxable sales for consumption tax purposes do not exceed JPY 10 million in the "base period" (two years before the current year, or the first six months of the prior year), subject to certain other conditions. A new company with share capital of less than JPY 10 million should be automatically exempt from filing consumption tax returns until taxable sales exceed JPY 10 million in the base period or a timely consumption taxpayer election is filed. The election is binding for two taxable years. Other than this election, no registration procedures exist.

Filing and payment – A company must file a consumption tax return and remit the applicable tax to the tax authorities if the company is a consumption taxpayer (see under "Registration," above). The frequency of remittances depends on the total consumption tax collected. The amount of creditable input JCT generally depends on total sales, the taxable sales ratio and the method to determine input JCT. Other thresholds/tests also may be applicable.

Source of tax law: Corporation Tax Law, Income Tax Law, Consumption Tax Law, Special Taxation Measures Law

Tax treaties: Japan has concluded 65 income tax treaties.

Tax authorities: National Tax Agency (NTA)

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