



Accountants &  
business advisers

# Doing business in Japan



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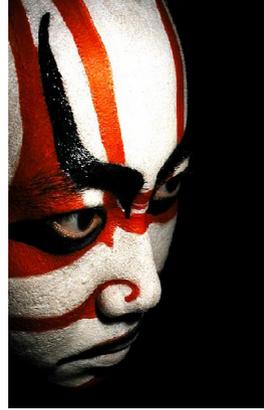
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# Foreword



This booklet is produced as a service to the clients of the PKF International member firm in Japan, and as an introduction to the fiscal and commercial environment of Japan for those who are considering doing business within its jurisdiction. The contents provide a guide for understanding the business processes, not a complete description of everything a business or entity needs to know. This booklet should not be used as the basis for laws of Japan are constantly being modified – both legislatively and judicially – clients are advised to seek specific professional advice from PKF Japan network member firm before proceeding with any activities involving Japan.

Nakamoto and Company and PKF International Limited provide other booklets regarding taxation – Worldwide Tax Guide, and, International Tax Alert. These booklets are updated periodically. Recent taxation information can be found from them.



# Introduction



## Geography and Populations

Japan is situated in north eastern Asia between the North Pacific and the Sea of Japan. The area of Japan is 377,873 square kilometres, nearly equivalent to Germany and Switzerland combined or slightly smaller than California. Japan consists of four major islands, surrounded by more than 4,000 islands.

Japan's population is over 126 million. Most Japanese reside in densely populated urban areas. Japan's capital city is Tokyo. The population of the Tokyo Metropolitan Area including the city, some of its suburbs and the surrounding area is approximately 12million.

## Constitution

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

## Legal System

Legal system of Japan is in a framework of a parliamentary representative democratic monarchy, where the Prime Minister of Japan is the head of government, and of a multi-party system. Executive power is exercised by the government. Legislative power is vested in both the government and the two chambers of parliament; the Diet with the House of Representatives and the House of Councillors. The Judiciary is independent of the executive and the legislature. In academic studies, Japan is generally considered a constitutional monarchy.

## Communications

Internal and external communications and transportation are excellent. The telephone direct dialling system gives instantaneous international communication from both fixed and mobile units.

## Language and Currency

Only one official language spoken in Japan is Japanese. However, many Japanese are able to understand English to a certain extent since English is the foreign language that everyone must learn as part of compulsory education.

The currency used is Japanese Yen (JPY).

## Major Exports and Imports

Major trading partners are, for exports, the United States of America, and several countries in Asia, such as China, South Korea, Taiwan and Hong Kong, for imports, China, the United States of America, Saudi Arabia, UAE, Australia and so on.

Major trading items are, for exports, cars, electric devices, machinery for imports, natural resources, such as oil, iron ore and foods etc..

## Advantages of Investing in Japan

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

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

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

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

## Programs and Support to Promote Investment into Japan

Foreign – capitalized firms operating in Japan are eligible to borrow loans from government-affiliated financial institutions for the purpose of acquiring land, buildings, machinery and equipment, and for research and development.

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

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

## Import Control

The Government levies customs duties on some goods entering Japan. Customs clearance must be obtained to import any goods. There are import and quarantine controls on certain goods.

## Exchange Control

The vast majority of industries have been liberalized and opened up for foreign direct investment. Such investment is treated as 'foreign direct investment in Japan' under the Foreign Exchange and Foreign Trade Law and differentiated from financial and portfolio investment. In principle, the submission of ex post facto notification to the Minister of Finance and the Minister(s) with authority over a particular industry is sufficient.

## Source of Finance

Japan is a major international financial center with a deregulated environment attracting the cream of the world's financial institutions, offering a full range of competitive financial services. Japan is a member of the World Bank and the Asian Development Bank.

# Business Structures



## Types of Business Structures

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

- *Representative office*
- *Branch office*
- *Subsidiary company*
- *Limited liability partnership (LLP)*

## Representative Office

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

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

## Branch Office

Foreign companies wishing to engage in business operations in Japan must establish a branch office or a subsidiary company. The simplest means for a foreign company to establish a base for business operations in Japan is to set up a branch office.

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

## Subsidiary Company

A foreign company establishing a subsidiary company in Japan must choose to establish the subsidiary company as a joint-stock corporation (Kabushiki-Gaisha (K.K.)), limited liability company (Godo-Gaisha (LLC)), or similar entity stipulated by Japan's Corporate Law.

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

Other methods by which a foreign company may invest in Japan using a Japanese corporation but without establishing a subsidiary are by establishing a joint venture with a Japanese enterprise or investment company and by equity participation in a Japanese enterprise.

## Limited Liability Partnership (LLP)

It is also possible to do business by using a Yugen Sekinin Jigyo Kumiai. This type of entity considered the Japanese version of limited liability partnership (LLP), is not a corporation, but a partnership formed only by the equity participants who have limited liability.

LLPs are also distinguished by the fact that internal rules can be freely determined by agreement between the equity participants, and that taxes are levied on profits allocated to equity participants without LLPs themselves being liable for taxation.

## Comparison of Types of Business Operation

Legal differences between each of above business operation are summarized in the following table.

	Rep. office	Branch office (office of foreign company)	Subsidiary company (Joint stock corporation)	LLP
Business Activity	Not available	Available	Available	Available
Registration	N/A	Necessary	Necessary	Necessary
Capital	N/A	N/A	No minimum capitalization requirement	
Representative Director	N/A	Branch representative required	At least 1	No legally stipulated minimum
Director	N/A	N/A	At least 1	
Corporate Auditor	N/A	N/A	1 or more may be appointed	
Accounting	N/A	Aggregation with income In home country required	Completed by accounting of Japanese partnership	

## Joint Ventures

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

# Accounting



## Disclosure System

The principle objective of the disclosure requirement of a joint stock corporation (Kabushiki-Gaisha) under the Corporation Law is to protect the interests of both creditors and shareholders.

A joint stock corporation is required to hold a general meeting of the shareholders within three months after the end date of each fiscal year to deliberate on certain corporate matters, including the approval of its financial statements. Typically, the notification of a general meeting of the shareholders must be accompanied by a business report and financial documents attested by the corporate statutory auditor or the audit committee, which is an internal organization of a corporation not required to be or composed of certified public accountants (CPA). The financial statements are required to be submitted to and approved by the shareholders at the general meeting.

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

## Reporting Standards

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

The financial documents prepared and submitted by a corporation to its annual general meeting of the shareholders are as follows.

- Balance sheet
- Statement of income
- Statement of changes in net assets
- Notes financial statements

From the fiscal years ending after March 31, 2004, corporations which are defined as a large corporations under the Corporation Law, capitalized at JPY500 million or more or whose liabilities are JPY20,000 million or more at the fiscal year end, and which file their financial statements with the Financial Services Agency(FSA) are required to prepare consolidated financial documents and disclose these in their annual reports.

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

## Accounting Standards - Japanese GAAP and IFRS

The process of setting accounting standards, previously driven by the Ministry of Finance, and the Financial Services Agency after the reorganization of government ministries and agencies, has been gradually changing.

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

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

In this report, based on the proposal concerning a time-framed approach in light of EU equivalence assessment, titled “Towards the International Convergence of Accounting Standards” issued by the Planning and Coordination Committee of the BAC in July, 2006, primary emphasis was placed on mapping out the work planned to be achieved through the end of 2007, and also on classifying the prospects of convergence status as of the beginning of 2008 concerning the initiatives to be undertaken with respect to the 26 issues for which the remedies were advised by the Committee of European Securities Regulators (“CESR”).

In August 8, 2007, the ASBJ and the ISAB jointly announced an agreement (known as the Tokyo agreement) to accelerate convergence between Japanese GAAP and IFRS’ s, a process that was started in March 2005. As part of the agreement, the two boards will seek to eliminate by 2008 major differences between Japanese GAAP and IFRS, with the remaining differences being removed on or before June 30, 2011. Whilst the target date of 2011 does not apply to any major new IFRS now being developed, that will become effective after 2011, both boards will work closely to ensure the acceptance of the international approach in Japan when new standards become effective.

The new project plan was issued in December 2007, in accordance with the content of the Tokyo Agreement. It classifies the project items into three categories (short-term, medium-term and long term) and indicates the schedule for each item.

## Auditing System

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

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

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

Statutory audits are required mainly under the Financial Instruments and Exchange Law and the Corporation Law. Financial statements of public corporation must be audited by independent CPAs under the Financial Instruments and Exchange Law. And the Corporation Law requires certain corporation, for example, large corporation, capitalized at JPY500 million or more or whose liabilities are JPY20,000 million or more at the fiscal year end, to be audited by independent CPAs regarding its financial documents sent together with the invitation letter to the annual general meeting of the shareholders.

The Corporation Law also provides that the corporate statutory auditor or the audit committee has a duty to examine the financial documents prior to the annual general shareholders' meeting. The corporate statutory auditor or equivalent is also responsible for monitoring the activities of the annual as a part of corporate governance.

Some corporations request voluntary audits in order to obtain independent assurance regarding the accuracy and reliability of their financial statements in order to strength management's accountability or to facilitate activities.



# Taxation



## Introduction

Japanese taxes consist of national and local taxes.

### National Taxes

- Tax on income and profits
  - Individual income tax
  - Corporate tax
- Tax on consumption
  - Consumption tax
  - Other taxes (Liquor tax, Gasoline tax and Local road tax etc)
- Tax on inheritance and gifts
  - Inheritance tax
  - Gift tax
- Taxes on property
  - Automobile tonnage tax
- Tax on transactions
  - Stamp tax, Registration and license tax, Customs duty etc

### Local Taxes

- Tax on income and profits
  - Prefectural inhabitant tax
  - Enterprise tax
  - Municipal inhabitant tax
- Tax on consumption
  - Special local consumption tax
  - Other taxes (Tobacco tax, Golf course tax, Bathing tax etc)
- Taxes on property
  - Fixed assets tax
  - Business office tax
  - Other taxes (Automobile tax, Special land holding tax etc)

- Other

Real property acquisition tax, Automobile acquisition tax etc.

## Tax Administration System

National taxes are levied and collected by the National Tax Agency (NTA), which is a semi-independent organization under the Ministry of Finance. NTA has one central office, 12 regional national tax bureaus and 524 national tax offices.

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

## Scope of Taxable Income for Corporation

### Japanese Company (subsidiary)

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

### Foreign Company (branch office)

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

Foreign companies, those are companies, which do not have their head office in Japan, are classified into the following four types for tax purposes.

- Foreign company carrying on business through a branch office, factory, or other fixed place of business ('permanent establishment') situated in Japan

Subject to tax on all domestic source income and must file a tax return.

- Foreign company carrying business not through permanent establishments but through undertaking construction, installation or assembly activities in Japan for longer than one year or supervising such activities undertaken in Japan for longer than one year or an agent in Japan who has habitually exercises, the authority to conclude contracts for or on behalf of a foreign company

Subject to tax on income derived from such business in Japan and on certain other domestic source income and must file a tax return.

- Foreign company having no permanent establishment and not carrying on business as stated above but having certain domestic source income such as income from providing personal service in Japan, income from rent for the use of real estate and the like property in Japan, income from sale of real property in Japan, income from sale of stock of a Japanese company etc...

Subject to tax levied on such income and must file a tax return. But there may be different rules in a tax treaty.

- For a foreign company other than above

Certain incomes such as income, dividend and royalties are subject to Japanese withholding income tax. But there may be different rules in a tax treaty.

## Representative Office

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

## Taxation on Corporation

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

## Corporate Tax

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

The tax base for ordinary income tax is the corporation's net income for each business year. Net income is the excess of "gross income" over "total costs" for each business year. Gross income and total expenses are calculated according to the Japanese generally accepted accounting principles, such as an accrual basis. There are some items which are not deductible without being recorded as expenses (depreciation costs, provision for certain allowances and reserves etc) and other items on which deduction is limited or restricted (entertainment expenses, donation expenses, certain taxes etc).

## Gross Income

- Dividends received

Dividends received by domestic corporations from other domestic corporations, less the interest chargeable to the shares on which those dividends were paid, are fully excluded from gross income in computing the amount of ordinary income. However, if a domestic corporation owns less than 25% of the shares of another domestic corporation which pays dividends, 50% of those dividends received, less the interest chargeable to the shares on which those dividends were paid, is exempt.

- Ordinary sales

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

- Instalment sales

A taxpayer has the option of keeping its accounts on an instalment basis, provided that it is consistently applied to certain deferred payment transactions with deferred payment clauses.

Deferred payment transactions with deferred payment clauses are sales of properties, contract for construction work or provision services, but nevertheless meet the following conditions:

- payment must be made in three or more instalments, either monthly, annually or otherwise periodically
- the period from the date of delivery of the object of the sales or contract to the due for the last instalment must be at least two years
- the amount of payable by the date of delivery must not exceed two-thirds of the total liability for the sales or contract

- Long term contract

Net profit accruing from a contract is, in principle, reported in the business year in which the contract is fulfilled, despite the fact that it may cover more than one business year. This rule may be referred to as the completed contract rule.

However, a large scale construction contract whose contract amount is one billion or more, the percentage of completion rule must be applied if the term of construction is one year or more and certain conditions are met.

## Total Cost

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

- Taxes paid

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

- Salaries, wages and bonuses

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

- Entertainment expenses

Entertainment expenses are not deductible, even though such expenses are necessary for carrying business.

However, small enterprises are allowed to deduct entertainment expenses within the following amounts.

corporation with capital of JPY100million or less

90% of entertainment expenses

(maximum JPY3.6million per annum)

- Donation expenses

Contributions to the national and local government and other designed contributions for public purposes are fully deductible.

Other contributions are deductible up to amount of the sum of 1.25% of taxable income and 0.125% of capital and capital surplus.

- Bad debt loss

Receivables to be written off determined as part of a reconstruction plan or composition which was admissible under legal procedures or as agreed in a creditors meeting and receivables which are totally uncollectable due to the financial position of the obligator are able to deductible as a bad debt loss.

- Depreciation cost

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

A corporation may choose one depreciation method for each group of its depreciable assets or for each office, shop factory etc. from among the depreciation methods such as reducing balance method, straight line method, unit of production method and so on. The method which should be applicable, in principle, when a corporation has not notified a tax office of its choice is:

Tangible assets            reducing balance method

(excluding buildings)

Buildings                    straight line method

Intangible assets            straight line method

The depreciable assets whose acquisition cost per unit is less than JPY200,000 may be deductible each business year in equal amount over three years. The minor assets whose acquisition cost per unit is less than JPY100,000 may be immediately deducted as expenses in the business year of acquisition.

### Credit for Foreign Tax

In order to eliminate international double taxation on income, foreign tax levied on a Japanese domestic corporation, in ordinary course of its business, may be credited against Japanese corporation tax within certain limitations. This is called an ordinary foreign tax credit.

Furthermore, in order to treat investment abroad through a foreign subsidiary in the same manner as investment abroad through a branch, foreign taxes levied on a foreign subsidiary of a Japanese domestic corporation may be credited against Japanese corporation tax levied on the Japanese parent corporation. This is called an indirect foreign tax credit. The credit for foreign taxes is granted unilaterally.

### Place for Tax Payment

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

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

### Blue Returns

A corporation may file a blue tax return with the approval of the tax office. A blue return corporation must keep a journal, a general ledger and other necessary books, and record all transactions affecting assets liabilities and capital in the books clearly and in good order according to the principles of double entry so that its taxable income can be calculated correctly. And the corporation must settle accounts on the basis of the records, prepare balance sheets, profit and loss statements and other statements, and keep almost of all books and documents for seven years.

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

A corporation is required to apply for approval to file a blue return by the day before the first day of commencement of the business year. With respect to the first business year of a new corporation, the application for approval must be made by the day within three months from the date of incorporation or by the last day of the first business year, whichever earlier.

## Return and Payment of Corporate Tax

- Interim return and tax prepayment

A corporation, except for it applies to certain conditions, whose business year is longer than six months should file an interim return as of the end of the first six months of the business year. The return should be filed and the tax amount should be paid to the tax office within two months after the end of the first six months.

- Final return and final payment or refund

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

## Corporate Inhabitant Tax

Corporate inhabitant tax is local tax, levied on a Japanese company and a foreign company having a permanent establishment in Japan. Corporate inhabitant tax includes a per capital levy which amounts are fixed based on the capital amount and the number of the employees, and a corporate tax levy of certain tax rates of the corporate tax amount.

## Corporate enterprise tax

Corporate enterprise tax is local tax, levied on a Japanese company and a foreign company having a permanent establishment in Japan and conducting business activities continuously in Japan. Corporate enterprise tax is basically levied on the taxable income in each business year as per corporation tax law with some exceptions. However, the size-based taxation is applied to large corporation with capital of 100 million JPY and over. For such large corporations, enterprise tax consists of the traditional enterprise tax levied based on the taxable income and based on the capital, etc and value added (wages, interest and rental expenses).

## Scope of taxable income for individual

### Resident status of foreigners

- Non-permanent resident

A resident is an individual who has a domicile (center of living) in Japan or has had a residence (the individual's presence in Japan) in Japan for one year or longer.

A resident who has no Japanese citizenship and has no intention to reside permanently in Japan, but has a domicile or residence consistently in Japan for less than 5 years within the period of 10 years is a non-permanent resident.

- Permanent resident

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

- Non resident

An individual other than resident is non resident.

## Taxation on individuals

The scope of taxable income of individuals is as follows:

- Permanent resident  
World wide income : total of Japanese source and foreign source income.
- Non-permanent resident  
Japanese source income and foreign source income paid in or remitted to Japan.
- Non resident  
Japanese source income.

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

## Individual income tax

### Type of income and taxation of a resident

- Business income  
Business income is income derived from activities of wholesale, retail, manufacturing and income of attorneys and certified public accountants etc.  
Generally accepted accounting principles are applicable to the computation of business income, with a few exceptions. The following descriptions indicate some rules applicable to individuals, some of which are different from the rules applicable to corporations:
  - Payments to taxpayer's family members are deductible only within certain limits, whatever their nature might be salaries, rent, interest etc..
  - Entertainment expenses for carrying on business and those directly related to the business are deductible, and not subject to restrictions as in the case of the corporation tax

- If the taxpayer is a blue return taxpayer and keeps an accounting book in compliance with Principle of orderly bookkeeping, the blue return special deduction of certain amount is allowed.

- Employment income

Employment income is the total salary and bonus after deducting certain employment income deduction. An employer making salary payments is required to withhold a certain tax amount from salary and bonus when a payment is made and to remit the withholding tax to the tax office by the 10<sup>th</sup> of the following month. An employer making salary payments must make a year-end adjustment for an employee whose annual salary is not more than JPY20 million.

- Real estate income

Real estate income is income derived from rental of real estate (land, building) A taxpayer may deduct depreciation cost and, interest expense and fixed asset tax, etc from real estate income.

Other than above, the following income should be included.

- Interest income
- Dividend income
- Retirement income
- Capital gain from sale of shares/sale of land and buildings etc.
- Occasional income (Gift from corporation, rewards etc.)
- Forestry income
- Miscellaneous income (income which is not classified in any other income)

## Main income deductions for income tax purposes

Some deductions may be made (in a certain order) from the amounts of ordinary income. Here are main income deductions.

- Deductions for medical expenses
- Deductions for social insurance premiums
- Deductions for life insurance premiums
- Deductions for certain donations
- Deductions for a dependent spouse
- Deductions for dependents
- Basic deduction

## Final tax return

A resident taxpayer must file a final tax return for income of a calendar year between February 16 and March 15 of the following year, unless the income is below the amount of total income deductions, or unless the resident has only the employment income of JPY20 million or less which was subject to withholding taxation. If a taxpayer is required to file a final tax return, the excess of the annual tax liability over the total of prepayments of assessment income tax and withholding income tax should be paid on or before March 15 in the year following the tax year. If a taxpayer no longer a resident of Japan, the taxpayer must file the final tax return with the tax office and pay income tax before leaving Japan, in principle.

## Individual inhabitant tax

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

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

## Consumption tax and special local consumption tax

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

Basic formula for calculating the tax is as follows:

$$\text{Tax due} = (\text{total amount of consumption tax on sales}) \\ - (\text{total amount of consumption tax on purchases})$$

### Taxable transactions

- Domestic transactions

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

- Import transactions

Foreign goods received or removed from a bonded area in Japan will be subject to taxation.

### Non-taxable transactions

- Transfers and leases of land
- Transfers of securities and payments prescribed in the foreign exchange and trade law
- Leases of assets with interest
- Transfers of postage stamps and merchandise coupons
- Services rendered by the government, local governments, public corporations, and public interest corporations
- International postal services and foreign exchange services
- Medical service under social medical system and sale of assets by a social welfare organization
- School tuition, entrance fees and textbooks
- Rent of residential houses

### Tax exemption for export transactions

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

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

### Taxpayer

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

### Tax-exemption for small-scale enterprise

Where the amount of taxable sales of an enterprise in its base period (the calendar year two years prior to the current year for an individual; the business year two business years prior to the current business year for a company) is not more than JPY10 million, the enterprise will be exempt from tax on the transfer of taxable assets, etc. during the taxable period. In the case of a newly established company, sales in the first and second business year are exempt from consumption tax. However, newly established company whose capital amount is JPY10 million or more is subject to consumption tax in the first two years.

### Return and payment of consumption Tax

- Interim return and tax prepayment

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

- Final return and final payment or refund

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

## Withholding tax on payments to non-residents

A non-resident or a foreign company is subject to withholding tax at the rate of 20% on the payment of various Japanese source income. However, if a tax treaty specifies definition of income, a reduced tax rate or no tax, the tax treaty has priority to the domestic law.

## Tax treaty

Japan has conducted tax treaties within 59 countries. The purposes of tax treaties are to avoid international double taxation on the same income and to prevent tax avoidance. Generally tax treaties include the following rules:

- Definition of a resident, non-discrimination rule, source of income rule
- Permanent establishment and taxation of business income, income from international transportation
- Definition and taxation rule for dividend, interest, royalty, real estate income and capital gain
- Independent professional income, employment income and tax-exemption on short stay, professors, students, government officers, diplomats
- Mutual consultation by competent authorities, exchange of information



# Status of Residence



## Entry procedures

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

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

## Types and categories of visa and working statuses

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

### Investor/Business Manager

Activities to commence the operation of international trade or other business, to invest in international trade or other business and to operate or manage that business, or to operate (business manager acting as that business's CEO or representative) or manage (directors and head of departments, etc. under a CEO or representative) international trade or other businesses on behalf of foreign nationals(including foreign corporations) who have begun such an operation or have invested in such a business. The business in question must meet certain condition of scale. Applicants who wish to engage in business management must fulfil certain conditions concerning work status and personal history.

## Intra-company transferee

Activities on the part of personnel who are transferred to business offices in Japan for a limited period of time from business offices that are established in foreign countries by public or private organizations with head offices, branch offices, or other business offices in Japan and who engage at these business offices in the activities described in “Engineer” or “Specialist in Humanities/International Services” section of this table. Applicants must fulfil certain conditions concerning personal history and work status.

## Legal/accounting services

Activities to engage in legal or accounting business. Applicants must be attorneys or public accountants certified to perform their duties in Japan, or those with other legal qualifications recognized by Japan.

## Engineer

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

## Specialist in humanities/international services

Activities to engage in service that requires knowledge pertinent to jurisprudence, economics, sociology, or other human science fields. Activities to engage in service that requires specific ways of thought or sensitivity based on experience with foreign culture, such as interpreting, translation, copy writing, fashion design, interior design, sales, overseas business, information processing, international finance, design, or public relations and advertising based on a contract with a public or private organization in Japan. Applicants must fulfil certain conditions concerning personal history and work status.

## Skilled labor

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

## Relation between types of operation in Japan and working statuses

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

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

Representative of representative office or branch office :

‘Intra-company transferee’

Representative of corporation:

‘Investor/business manager’

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





# Protection of Intellectual and Industrial Property

## Legislation on trademark and design

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

## Japan's trademark system

### Equality for both Japanese and foreign nationals

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

## First-to-file rule

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

