



A GUIDE TO DOING BUSINESS IN JAPAN

May 2017

FOREWORD

The aim of this publication is to provide general information about the social, economic, and legal environments in Japan. Gaining a basic understanding of these environments is essential for success in doing business in Japan. All information is up to date as of April 2016. Users are advised to contact their local RSM member firm or any of the contacts listed on page 78 for further detail and updates.

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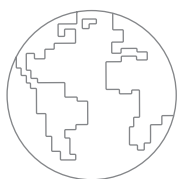
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PART I: GENERAL BUSINESS ENVIRONMENT

1. Introduction – Japan

1.1 Geography

Japan lies just off the eastern coast of the Asian continent and consists of four major islands—Hokkaido, Honshu, Shikoku, and Kyushu—as well as smaller adjacent islands. The crescent-shaped archipelago stretches from north to south.

Japan's total land area is 377,972 square kilometers. The proportion of the total land area made up by forests, farmland, and residential land is 67%, 13%, and 5%, respectively. Mountains extend along the middle of the long narrow archipelago, dividing it into two sides; one facing the Pacific and the other the Sea of Japan. Generally, rivers are short and swift flowing.

As a country located on the Pacific Ocean's "Ring of Fire", Japan has many volcanoes, both active and dormant, and regularly experiences earthquakes. Monitoring and responding to seismic activity is a major area of research and infrastructure investment.

1.2 Climate

Temperatures vary widely by region, ranging from sub-frigid to sub-tropical. The general climate, except for part of Hokkaido in the north and some of the southernmost islands, is temperate with seasonal winds. Japan has four well-defined seasons. With the exception of Hokkaido, the summers are hot and humid, preceded by a rainy season from mid-June through July, and followed by a typhoon season lasting through October. Autumn and spring are mild and quite pleasant. Winter is quite cold in some regions, with brisk winds and frequent snowfalls on the Sea of Japan side. The annual mean temperature is 23.1°C in Okinawa; 15.4°C in Tokyo; and 8.9°C in Hokkaido. Rainfall is abundant, ranging from 1,000 to 3,000 millimeters annually. Typhoons and heavy storms are not uncommon.

1.3 Natural resources

Japan is a country with few natural resources. It has virtually

no energy resources like oil, natural gas, and coal, and must rely on imports from abroad. However, the country has a near-sustainable supply of wood from its forests and a comparatively abundant supply of fresh water.

1.4 Population

Japan's total population stood at 127.1 million as of October 2015, ranking tenth in the world. Population has more than doubled since the first national census in 1920, when it was approximately 56 million. However, population growth has decreased in recent years, and the annual growth rate was -0.11% in 2015.

In 2014, Japan's population density was 336 people per square kilometer, which was one of the highest in the world.

1.5 Transportation

Roads and rail

Japan has one of the most convenient public transportation systems in the world. There is a well-developed network of roads and rail connections between all major cities. Tunnels, ferry services and bridges connect the four main islands.

Bullet trains (Shinkansen) connect major cities in Honshu, Kyushu, and Hokkaido. Subways are also important means of transportation in the urban areas, including Tokyo, Osaka, Nagoya and Sapporo. Using the trains or subways is probably the easiest way to travel. However, in the areas outside the major cities, driving a car, riding a bicycle, taking the bus or taxi or walking may be better options.

Pursuant to the Road Traffic Act, people drive on the left side of the road in Japan.

Air travel

There are 97 domestic airports in operation in Japan as of April 2016. Kansai International Airport, built on reclaimed land in Osaka Bay, opened for business in 1994. Narita (aka New Tokyo International) Airport opened in 1978. In the Chubu



region (the central region of Honshu), Chubu International Airport opened in 2005.

A new international terminal opened in Haneda Airport in October, 2010.

Marine travel

Marine transport is vital to Japanese industry, which imports raw materials and exports processed goods. Major ports are located in Yokohama and Kobe. With a long coastline, there are many small and medium sized harbors throughout Japan.

1.6 Language

The national language is Japanese. English is generally understood in the major cities and within the business community.

Business meetings in Japan usually require the use of interpreters for those who do not speak Japanese. Although most major Japanese firms have employees who are fluent in English, negotiations can be facilitated by knowledge of the Japanese language and it is still best to have an interpreter to ensure that the language differences do not become a barrier to communication.

1.7 Currency

The unit of currency is the Yen, which is usually abbreviated as ¥. There are six kinds of coins (1, 5, 10, 50, 100 and 500 yen) and four kinds of notes (1,000, 2,000, 5,000, 10,000 yen) used.

1.8 Government

The Constitution of Japan

The Constitution of Japan, formal successor to the Constitution of the Empire of Japan 1889; also known as the Meiji Constitution) is substantially influenced by the US Constitution, was promulgated on November 3, 1946 and took effect on May 3 of the following year. Consisting of 11 chapters with a total of 103 articles, it is based on the following three

principles: sovereignty of the people, pacifism, and respect for basic human rights. The Constitution defines the Emperor as the symbol of the State and of the unity of the people, and provides that the Emperor shall have no powers related to government, acting only in certain matters of State.

The Constitution of Japan provides for a democratic, fundamental separation of powers. Legislative power is vested in the Diet; executive power is vested in the Cabinet; and all judicial power is vested in the Supreme Court.

The Diet

The Diet is the highest branch of State power and the sole legislative branch of the State. The Diet is vested with powers such as initiating constitutional revision, settling the budget, approving treaties, and selecting a prime minister. Its powers clearly outweigh those of the executive branch.

The Diet consists of the House of Representatives or the Lower House (Shugiin) and the House of Councilors, or the Upper House (Sangiin), and is similar to the British parliamentary system rather than the American congressional system.

The Cabinet

The Cabinet consists of the Prime Minister and Ministers of State, and is collectively responsible to the Diet. The Prime Minister, who must be a member of the Diet, is designated by the Diet and, in practice, is always a member of the House of Representatives. The Prime Minister has the power to appoint and dismiss the Ministers of State, all of whom must be civilians and majority of whom must be members of the Diet.

The Supreme Court

The Supreme Court is the court of final resort, and its ruling sets the precedent for all final decisions in the administration of justice. It is also authorized to determine the constitutionality of any law, order, regulation, or official act and to nominate judges of lower courts.

Local Government

For local government purposes, Japan is divided into 47 areas called prefectures. There are four different types of areas having different suffixes; i.e., 1 Metropolitan (To; Tokyo-to), 2 Urban (Fu; Kyoto-fu and Osaka-fu), 1 Regional (Do; Hokkai-do) and 43 Prefectures (Ken; Kanagawa-ken, etc.). Each prefecture has its own governor (Chiji) and representative assembly. Within the prefectures, there are shi (city), machi or cho (town) and mura (village).

1.9 Olympics and other events

Japan was chosen to host the Olympics for its fourth time in the summer of 2020 and will also host the Paralympics the same year. The government is investing heavily in its success, with emphasis on improving English language signage and assistance for visitors. Japan regularly hosts important international events such as the World Expo, G8 Summits, and the World Cup.

2. Government policies affecting business

2.1 General

Government dealings with business are conducted principally through the various ministries, of which the most important ones are the Ministry of Finance (MOF) and the Ministry of Economy Trade and Industry (METI). Controls are implemented through a combination of formal legislation and accompanying regulations and less formal, but nevertheless strictly followed, administrative guidance. Most legislation is implemented by the METI, including those covering foreign trade, consumer protection, environmental matters and patents. The MOF is responsible for directing the overall economic and fiscal policies of the government, and, as a result, has much power and influence.

2.2 Restrictive practices

Anti-monopoly Act

There are three categories of activities that are prohibited by the Anti-monopoly Act. They are private monopolization, unreasonable restraint of trade, and unfair business practices. A bill to amend the Anti-monopoly Act was passed in June 2009, and regulations and guidelines clarifying the scope of the change were published for public comment in July 2009. The Fair Trade Commission in Japan (the "FTC") amended Anti-monopoly Act in January, 2010. The amendment expands the types of conduct subject to fines, increase the maximum prison terms for cartels and bid-rigging, revise the regulations regarding share acquisitions, etc.

Private Monopolization: Private monopolization is defined as such business activities, by which any entrepreneur, individually, by combination or conspiracy with any other entrepreneurs, or in any other manner, excludes or controls the business activities of other entrepreneurs, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

Unreasonable Restraint of Trade: Unreasonable restraint of trade is defined as such business activities, by which entrepreneurs by contract, agreement, or any other concerted

activities, mutually restrict or conduct their business activities in such a manner as to fix, maintain, or enhance prices; or to limit production, technology, products, facilities, or customers or suppliers, thereby causing contrary to the public interest, a substantial restraint of competition in any particular field of trade. A typical unreasonable restraint of trade is a price cartel. By a multi-party agreement, the participants of the cartel restrict one another from changing the price of certain goods, and reduce price competition in the market.

Unfair Business Practices: Unfair business practices are defined as any act coming under any one of the following paragraphs which tends to impede fair competition and which is designated by the Fair Trade Commission. (a) Unduly discriminating against other entrepreneurs; (b) Dealing at undue prices; (c) Unreasonably inducing or coercing customers of a competitor to deal with oneself; (d) Trading with another party on such conditions which will unjustly restrict the business activities of the said party; (e) Dealing with another party by unwarranted use of one's bargaining position. As stated, Fair Trade Commission is authorized to designate unfair business practices within the framework. Two types of designation have been made by the Fair Trade Commission; one being General Designations and other being Specific Designations of Unfair Business Practices.

The Fair Trade Commission (FTC): The Anti-monopoly Act, as well as some supplementary laws such as the Act to Prevent Excessive Premiums and Unreasonable Representations and the Act to Prevent Undue Delay in Payment to Subcontractors and Related Matters, is enforced by the FTC and the courts. The FTC is administratively attached to the Prime Minister, and is positioned as an extra ministerial body of the Prime Minister's Office. However, the FTC has the character of being an administrative organization under the council system, consisting of a Chairman and four Commissioners. In implementing the Anti-monopoly Law, the FTC independently performs its duties without being directed or supervised by anyone else.

Sanctions imposed on violators against the Fair Trade Commission include "cease- and-desist orders", "penalties", "criminal charges", and "civil action" which includes suspension or compensation for damages.

Patents, designs, trademarks and copyrights

For the most accurate and up-to-date information regarding laws and regulations covering patents, design rights, trademarks, and copyrights, it is advisable to seek professional guidance on the correct procedures to be taken. A summary of the most important information is as follows:

Patents: Patent may be registered after examination in accordance with the Patent Law. The term of a patent right is 20 years from the filing date of the patent application and may be extended within the limit of five years if the inventor cannot use the invention. Any person who wishes to obtain a patent is required to file an application with the Commissioner of the Patent Office.

Designs Rights (aka Design Patents): Designs may be registered after examination in accordance with the Design Law. The term of a design right is 20 years from the date of registration and may not be renewed.

Trademarks: Trademarks are registered after examination under the Trademark Law. Trademarks are protected for 10 years from the day when a created trademark was registered. Continuous use can be obtained if an application is updated. Applications for trademarks are filed with the Patent Office.

Copyrights: The term protection of copyright of novel, picture, and musical work begins with the creation of the work and lasts, in principle, 50 years following the death of the author; and cinematographic works and animation films for 70 years after the publication. The starting point for copyrights differ for works published anonymously or under a pseudonym, corporate-made works, and movie and photographic works. In these cases the copyright begins when the work is published instead of when the work was created. No procedures are required for acquiring the right.

2.3 Import and export policies

Unlike those in other countries, Japan's governmental controls over imports and exports are divided among several agencies; the Customs and Tariff Bureau, Ministry of Finance (MOF) – with respect to customs; the Trade and Economic Cooperation Bureau, Ministry of Economy, Trade and Industry (METI) – with respect to import and export controls; the Ministry of Health, Labor and Welfare and the Ministry of Agriculture, Forestry and Fishery – with respect to quarantine.

Tariff and valuation systems

Japan's tariff system is regulated mainly by the amended Customs Law of 1954 and the amended Customs Tariff Law of 1910. While the former provides for customs formalities relating to determination, payment, collection and refund of customs duty and import/export of goods, the latter stipulates the rates of customs duty, the basis for assessment of customs duty, the grounds for reduction of and exemption from customs duty and the tariff quota system. Japan's present tariff, like the Australian tariff, is based on the International Convention on Harmonized Commodity Description and Coding System (HS Convention).

Importing

Because regulation and procedures for importing commercial goods to Japan are somewhat complicated, most companies rely on professional import agents to take care of all the details. Partnering with a local distributor for at least the first few years of business is also recommended way to make sure your products can be imported smoothly. Japan has a simplified 8% tariff on imported goods valued at less than 200,000 yen.

Exporting

No tariffs are imposed on exports. While there are restrictions on certain goods that can be exported (weapons, sensitive technologies, etc.), generally the process consists of declaring

the items to a customs office and having the items inspected.

2.4 Consumer protection

There are separate legislations for consumer protection such as the Consumer Contract Act, the Act against Unjustifiable Premiums and Misleading Representations, the Act on Specified Commercial Transactions, and the Product Liability Act, as well as the Civil Code, provide general and fundamental issues on agreement. Many disputes are settled or judged under the Civil Code with the above special regulations applied to the specific case.

A cooling-off system has been adapted to protect consumers with buyer's remorse in certain sales, insurance, and services under the Act of Specified Commercial Transactions, the Insurance Business Act and the Installment Sales Act, etc.

In June 2007, the Act on Specified Commercial Transactions was passed which established a consumer class-action lawsuit system, and several courts have accepted such claims by consumer groups. The consumer group lawsuit system will be adapted to other regulations for consumer protection such as the Act against Unjustifiable Premiums and Misleading Representations and the Act on Specified Commercial Transactions.

2.5 Environmental protection

The fundamental law related to the environment of Japan is the "Environment Basic Law" enacted in 1993. Pursuant to the law, there are specific regulations such as the Wastes Disposal and Public Cleaning Act, the Soil Contamination Countermeasures Act, and the Private Sewerage System Act, and several environmental standards for protection of health and preservation of environment regarding air pollution, noise, quality of water, soil contamination, and dioxin contamination.

The Ministry of Environment adopts a prior confirmation system for compliance of environmental regulations; and anyone who undertakes business in Japan may ask the Ministry whether their business is required to make application to, or seek permission from, the Ministry.

3. Exchange controls

3.1 Business transactions

In general, there are no foreign currency exchange controls in Japan. In 1998, the Foreign Exchange and Foreign Trade Law was amended to abolish the Foreign Exchange Bank and Exchange House System. Since 1998, foreign exchange transactions do not have to go through a bank. The law has been amended several times since to respond to international requirements for transaction security for foreign remittances.

3.2 Personal transactions

Most businesses in large cities accept credit cards but cash is still the more widely used method of payment. Checks are not common but bank wire transfers are cheaper and more convenient than most countries. Most companies use bank transfers to pay for goods and services. Bank accounts can be opened by residents (i.e. Japanese and foreigners with a visa)

but not short-term visitors and non-residents.

4. Government investment incentives

4.1 General

Investment incentives are offered by the national and regional governments in selected areas and industries. These are mainly designed to encourage the relocation of business away from the congested area between Tokyo and Osaka. Financial assistance is also available for environmental conservation, and also the creation of regional employment opportunities. Incentives are available to qualifying enterprises, both Japanese and foreign. There are three categories of incentives: tax-based incentives, subsidies, and other financial incentives.

4.2 Taxation incentives

Available taxation incentives include the roll-over of capital gains by reducing the acquisition value of replacement industrial property, additional depreciation on certain fixed assets, and the exemption from, or reduction in, local taxes, such as real property acquisition tax, fixed assets tax, city planning tax and business office tax. Tax credits are also available for investment in energy-saving equipment, telecommunication equipment and for certain approved research and development expenditure.

4.3 Subsidies

A relocation subsidy is available to help finance the construction of specified welfare and environmental facilities at a new location. Small and medium sized companies are eligible for grants towards energy conservation and pollution control projects, as well as technical improvement grants. Regional employment subsidies may be given for each new individual job that is created as a result.

4.4 Other financial incentives

These are largely made up of loans at preferential rates or with delayed repayment terms from various financial institutions, such as the Development Bank of Japan and the Regional Development Corporations. A Credit Guarantee System is also available for small and medium sized enterprises.

4.5 JETRO

The Japan External Trade Organization (JETRO) is a government-related organization that works to promote mutual trade and investment between Japan and the rest of the world. The organization's goal is to promote foreign direct investment into Japan and helping small to medium size Japanese firms maximize their global export potential. JETRO offers a variety of free services for companies wishing to expand into Japan, such as temporary office space, assistance in finding local business partners, and hosting trade fairs.

5. Sources of finance

5.1 Banks

The Bank of Japan (Nippon Ginko, Nihon Ginko, Nichigin)

The Bank of Japan is Japan's central bank. The Bank's functions are essentially the same as central banks in other countries. The Bank of Japan's mission is to maintain price stability and to ensure the stability of the financial

system, thereby laying the foundations for sound economic development.

To ensure the stability of the financial system, the Bank of Japan issues banknotes as the nation's sole "issuing bank". Additionally, to achieve their goal, the Bank of Japan provides checking account calculation of settlement services, does open market operations, lends for banks as the "lender of last resort", conducts economic assessments, etc. As the "Government's Bank", the Bank of Japan also handles deposits and lending for the government, and, in accordance with various laws and ordinances, it is entrusted with national business such as treasury, government bonds, and foreign exchange.

City banks (Toshi ginko)

Currently there are three mega-bank groups, Mizuho, Sumitomo-Mitsui, and Tokyo-Mitsubishi UFJ. They operate on a large scale, with headquarters in major cities and branch networks covering the whole country. The city banks, together with their subsidiaries and affiliated companies, offer many other financial services including trade finance, foreign exchange dealing, factoring, leasing, bond issuing and dealing and corporate services.

Regional banks (Chiho ginko)

Regional banks, of which there are more than 60, are primarily based in the principal city of a prefecture and conduct the majority of their operations within that prefecture. Regional banks have strong ties with local enterprises and local government organizations. Most regional banks are small to medium in scale, and their client base usually consists of small to medium-sized enterprises.

5.2 Private financial institutions

Other sources of financing include:

1. Specialized financial institutions
 - long term financial institutions
 - institutions specializing in finance for small and medium-sized corporations
 - financial institutions for specific industries, e.g. agriculture, forestry & fishery
2. Life insurance companies
3. Nonlife insurance companies
4. Securities companies
5. Securities finance companies
6. Money market dealers.

5.3 Deposit insurance system

The deposit insurance system was established for the purpose of protecting depositors. If a financial institution fails, up to 10 million yen excluding the deposit only for the settlement is to be protected. Banks pay insurance premiums

to the Deposit Insurance Corporation, according to their deposit balance.

5.4 Stock exchanges and money markets

Stock exchanges

There are four stock exchanges (Tokyo, Nagoya, Sapporo, and Fukuoka) in Japan. After the revision of the Securities and Exchange Law in 2000, the Osaka Securities Exchange (OSE), the Tokyo Stock Exchange (TSE), and the Nagoya Stock Exchange (NSE) demutualized into stock companies in April 2001, November 2001, and April 2002, respectively. In 1999, the TSE established a new market named "Mothers," intended to provide startup businesses with access to funds at an early stage of their development and to provide investors with more diversified investment opportunities. In December 2004, JASDAQ, which was the over-the-counter market for new companies, became a stock exchange market. Therefore, the market for new companies is highly competitive.

In Japan, the securities markets may also be termed capital markets or direct money markets. There are two types: bonds (for public and corporate bonds) and stocks, each of which has a primary market and a secondary market. In Japan, indirect financing (i.e. bank loans) had been more popular than direct financing for a long time. Since 1975, however, direct financing (i.e. securities markets) has shown substantial growth, following the period where the government started issuing large volumes of bonds to the market. The ratio of direct finance is expected to increase by further development of markets and financial technologies in the future.

Bond market

The bond market has the primary (issue), secondary and futures market. There are two basic categories of bonds; one being public bonds that include both national and local government bonds, as well as government guaranteed bonds. The other type is corporate bonds that consist of bank debentures and corporate bonds.

5.5 Company and private seals

At most banks, an official seal (stamp or chop) or jitsuin, and its seal registration certificate is required for identification purpose (instead of a signature) which should be registered when an account is opened.

5.6 Bank books

Most banks in Japan give customers a bank book (tsucho) instead of issuing monthly account statements. The bank book is updated at an ATM or a service counter and is a convenient and widely accepted method of proving a bank balance with potential creditors.

5.7 Checks and wire transfers

Transferring money or making payments is mostly done through wire transfers. Checks do exist but are very rarely used even by businesses. Domestic wire transfers are far cheaper than most countries (around 400 yen per transaction) and are usually received by the other party within a few minutes.

PART II INCORPORATION AND COMPANY'S MANAGEMENT

6. Incorporation

6.1 Introduction

The Japanese law on incorporation is stipulated by the Ministry of Justice. The Companies Act was formerly a section of the Commercial Code, and became an independent act in 2005. Major revisions were also made to the contents, thus becoming the current set of regulations.

6.2 Types of business entities

Business entities in Japan can be classified into two major categories: (a) corporations (Kaisha) and (b) partnerships (Kumiai).

There are several types of corporations. The joint stock company (Kabushiki Kaisha – KK) is the dominant form of business entities with the most “reliable” impression in Japan. Also, the limited liability company (LLC), a type of corporation called Godo Kaisha (GK), was newly introduced in the Companies Act.

Partnerships can also be further classified into two categories: (a) silent partnerships or Tokumei Kumiai (TK) established under the Commercial Code and (b) general partnerships or Nin-i Kumiai established under the Civil Code. TKs are based on contractual agreements, and the terms of such agreements require its “silent” or “limited” partners to make contributions to the partnership in the form of money or other assets. As opposed to the limited partners of the TK, investors of a general partnership have unlimited liability. A limited liability partnership (LLP) law, which provides for the creation of limited liability partnerships or LLPs, was enforced on August 1, 2005. Investors of the LLPs can have limited liability and still enjoy the benefits of a true partnership (e.g. pass-through implication for tax purposes).

6.3 Types of business entities (for foreign investors)

There are four principal forms of doing business in Japan for foreign entities, and each are subject to registration (except representative offices) and other procedures stipulated by the general provisions of the Companies Act and specific rules of the Commercial Registration Law (also under the jurisdictions of the Ministry of Justice).

Representative office

A representative office is established for the purpose of preparing for the execution of business in Japan and taking care of related tasks arising thereof. Therefore, there are limitations on the activities a representative office is allowed to engage in. A representative office may engage in the following activities on behalf of its foreign entity:

- conduct market research
- collect information

A representative office may not engage in sales activities or any business transactions undertaken within Japan. If the representative office must engage in such activity, it must first be registered as a branch office of the foreign entity.





A representative office does not necessarily require registration at the time of establishment and is not subject to tax in Japan. Because a representative office cannot open bank accounts or lease real estate in its own name, agreements for such purposes must be signed by the head office of the foreign entity or by the representative at his/her individual capacity.

Branch office

The simplest way for a foreign entity to conduct business in Japan is to set up a branch office. The branch office can engage in business activities as long as its office location is secured, the representative is determined, and necessary information is registered. Note that at least one representative must have a residential address in Japan. However, because a Japanese branch office is a business location that provides services in Japan according to instructions from the foreign entity, it is ordinarily not expected to conduct independent decision making. A branch office is considered as a part of the foreign entity and does not have its own legal corporate status. Therefore, ultimately, the head office of the foreign entity will become responsible for the debts and credits of the branch office.

The activities of the operations in Japan are instrumental in defining whether an office is treated as a representative office or more beyond that. The major difference between a representative office and a branch office is that (a) the branch office may engage in business activities and (b) the branch office may open bank accounts and lease real estate in its own name.

The establishment of a branch office is classified as "inward direct investment" under the Foreign Exchange Law, and the establishment of a branch office conducting specified industries is subject to certain prior notification to the Ministry of Finance and the Ministry in charge of its industry.

Branch offices must progress through registration procedures under the Companies Act within three weeks after its determination as a branch representative, before it commences business activities.

Subsidiary company (KK, GK)

When a foreign company or investor decides to establish a subsidiary company in Japan, it must take the form of a joint-stock corporation (Kabushiki Kaisha – KK), or a limited liability company (Godo Kaisha – GK). Although other companies such as Gomei Kaisha and Goshi Kaisha are also granted corporate status under the Companies Act, they are rarely chosen in practice, for not many investors are willing to take on unlimited liability.

The similarities between KKKs and GKs are that the initial paid-in capital may be as small as one yen. The Companies Act does not require the directors or members are a resident in Japan, but, in practice, it's preferable for opening a bank account or doing business with Japanese companies that at

least one of the representative directors or representative members is a resident in Japan. The GK is a form of entity for small operating companies, and no public disclosure or reassignment of directors is required. Note that the GK is not a pass-through entity, and therefore is taxed as a normal company for Japanese tax purpose.

A subsidiary (KK or GK) is considered a separate legal entity from the parent company or investor; therefore, the foreign company or investor will bear only the liability as an equity participant of the subsidiary.

The acquisition of shares of a KK or equity interests of a GK by foreign investors such as non-residents or foreign companies is classified as "inward direct investment" under the Foreign Exchange Law. The acquisition of the shares of a KK or equity interests of a GK conducting specified industries is subject to certain prior notification to the Ministry of Finance and the Ministry in charge of its industry, and, if the prior notification is not required, the foreign investors must submit an ex-post report to the Ministry of Finance and the Ministry in charge of its industry.

Limited partnership

Another possibility of doing business is by creating a Yugen Sekinin Jigyo Kumiai, the Japanese version of a limited liability partnership (LLP). An LLP is not a corporation or legal entity, but the partnership formed only by equity participants who have limited liability. Characteristics of an LLP include the following:

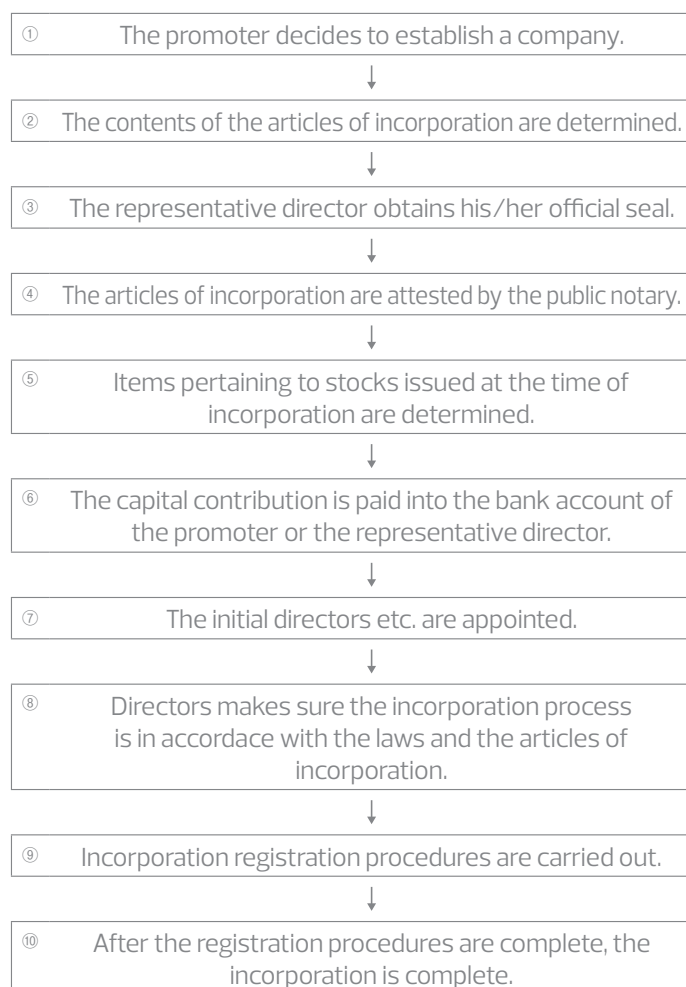
- Internal rules can be determined by agreement among the equity participants. Such rules must be registered in order to prevail when a bona-fide third party intervenes.
- Taxes are levied on profits allocated to the equity participants themselves being subject to taxation (i.e. an LLP is not subject to tax and works as a "pass-through").

6.4 Registration procedures

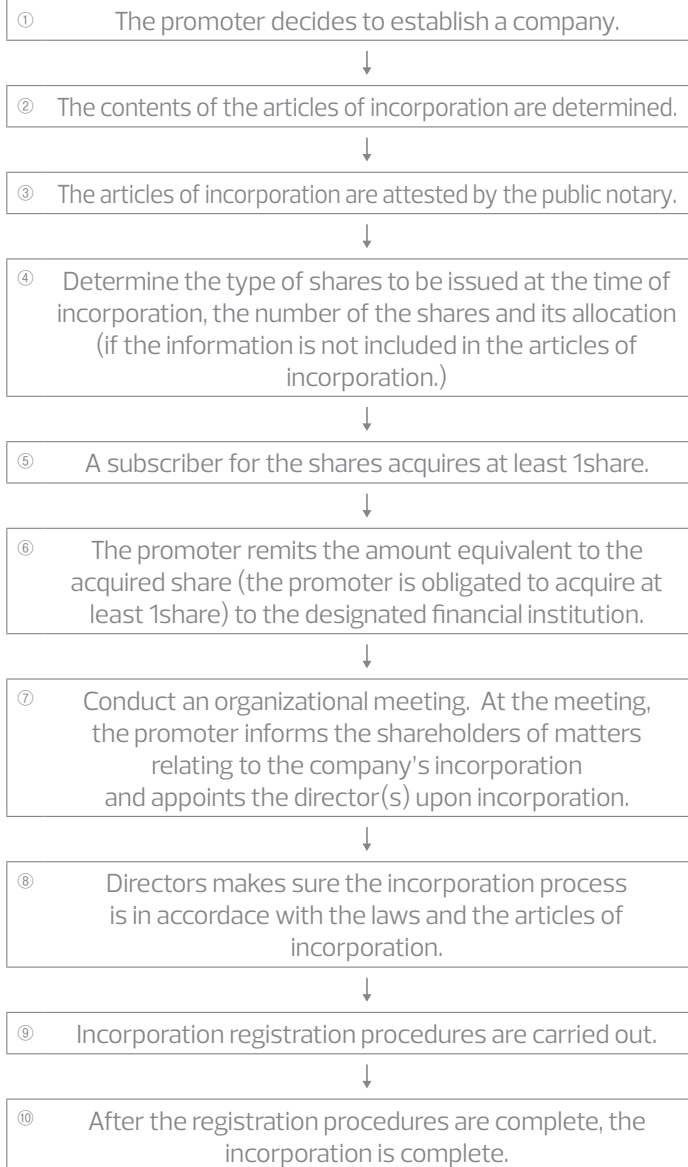
The registration procedures differ among the different types of entities. Please consult a judicial scrivener for detailed information concerning each process.

Below is a flow chart of the incorporation process of a joint stock company or Kabushiki Kaisha (KK) showing two types of incorporation; promotion and offering. Note that there are cases where appointing a person who has a residential address in Japan to certain positions (promoters, representatives, etc.) may help alleviate the complexity of the registration procedures. According to the Japanese system, a registered official seal (Jitsuin) and its registration certificate (Inkan Shomei) are necessary. It is important to think over the whole incorporation process before setting up a schedule for the commencement of business.

Promotion Establishment



Offering Establishment



6.5 Post incorporation

Annual Shareholders' Meeting

A KK must hold an annual shareholders' meeting within three months after each accounting year end where the financial statements are approved.

Disclosure

A KK is required to disclose the financial statements to public. A public gazette or a daily newspaper is often used for the purpose. Electronic public notice may also be used as an alternative. The method of the disclosure must be registered upon incorporation.

Accounting records

Companies are required to keep financial statements and accounting ledgers, vouchers, etc. for 10 years.

7. Company's management

7.1 Introduction

After the introduction of the Companies Act in May 2006, apart from partnerships, business enterprises generally consist of the more common joint stock corporation (Kabushiki Kaisha – KK). Other forms of corporate entities include the limited partnership company (Goshi Kaisha), the general partnership company (Gomei Kaisha), and the newly-introduced limited liability company (Godo Kaisha – GK) instead of the closed limited liability company (Yugen Kaisha – YK) which was absorbed into a KK.

Since a KK may be established for one yen as a minimum paid-in capital under the Companies Act and is well recognized, a KK is the most common type of company vehicle. This section is provided as a guide to be considered in incorporating and managing a KK.

There are various types of KK, from a small and closed company to a large and public company. The most common form of KK initially incorporated include: (a) a KK of which the articles of incorporation contain provisions to the effect that any acquisition of shares by transfer (with respect to all the shares issued by the company) requires approval from the shareholders' meeting or the board of directors of the KK (a "Closed KK"); and (b) the paid-in capital of the KK is less than 500 million yen and the aggregate debt of the KK is less than 20 billion yen (a "small/medium KK"). If a KK is public and/or a large company, there are special regulations under the Companies Act and the Financial Instruments and Exchange Act.

7.2 Management structure

A KK must have shareholders' meetings and one or more directors and may have (a) a board of directors, (b) statutory auditor(s), (c) a board of statutory auditors, (d) accounting auditor(s), (e) accounting advisor(s), and (f) committees, depending on the type and management structure of the KK, as prescribed by the articles of incorporation.

7.3 Director(s)

A KK must have at least one director with a term of office usually set at two years, though directors for a Closed KK can be appointed for up to 10 years if provided for in the articles of incorporation. If the board of directors is placed, three or more directors are required. Directors can be re-elected more than once. Directors must be individuals and not corporations. Although there is no specific statutory residency requirement in the Companies Act, in practice, it's preferable for doing business with Japanese companies that at least one of the representative directors is a Japanese resident. The board of directors' meeting shall be conducted by directors, who are physically present at the meeting.

7.4 Director's duties

Directors must keep good faith towards the company when they act on its behalf. Directors are in a position of trust and accordingly must act in the best interests of the company. Therefore, if they act against these duties and the company incurs any losses, they are liable for any damages and losses incurred by the company. Directors are also required to compensate third parties if the directors cause them any damages due to gross negligence or reckless action.

7.5 Board of directors and representative director

According to the shareholders' decision, a KK may have a board of directors (Torishimariyaku-kai). For public companies, a board of directors is mandatory. For a KK with a board of directors, the authority of the shareholders' meeting is limited. For a KK without a board of directors, the shareholders' meeting may resolve the matters provided for in the Companies Act, the organization, operations and administration of the KK, and any and all other matters regarding the KK, whereas for a KK with a board of directors, the shareholders' meeting may resolve only the matters provided for in the Companies Act and the articles of incorporation. The board of directors has the power to make decisions on the execution of business operations in general with the exception of such power as is stipulated by the shareholders', by law, or by the articles of incorporation, and also to supervise the execution of duties of the directors. The board of directors has, in most circumstances, very broad powers. The following items must be decided by the board of directors:

- Sale and purchase of important assets;
- Borrowing substantial amounts;
- Appointment and dismissal of a general manager and other important employees;

- Set-up, change and closure of branches and other important organizations;
- Establishment and maintenance of corporate governance; and others

The representative director represents the company and is empowered to make decisions on or execute the business on matters delegated to him/her by the board of directors.

7.6 Restrictions on directors' action

Restrictions are imposed on certain transactions of directors; transactions in competition with the company and director's action which could be construed as being in competition with the company. When a director enters into such business as is a part of his/her company's business operations, the director must report the details to the shareholders' meeting or the board of directors (if any) and ask for their approval.

When a director enters into a transaction with a competing business without prior approval, the company may claim compensation for any damages resulting directly from the action of the director or the third party. The account of profit earned by the director or the party is presumed to be the amount of damages or loss of revenues incurred by the company.

When a director purchases products or other assets of the company or sells products or other assets to the company for himself/herself or on behalf of a third party, or enters into a business relationship with the company, the director must have prior approval of the shareholders' meeting or the board of directors. The approval is also necessary when the company guarantees the liabilities of a director. A director doing business on behalf of a third party implies that the director acts as agent for that third party.

7.7 Statutory auditor(s)

For public companies or large companies which have no executive committees, a statutory auditor is mandatory. A statutory auditor (Kansayaku) is appointed by the majority of shareholders' votes as part of a company's internal organization. The statutory auditor cannot be an employee or director of the company but may be a shareholder. There is no legal requirement for the statutory auditor to hold any professional qualification or to have any accounting experience. The term of appointment is four years, and they may be re-elected.

A board of statutory auditor (Kansayaku-kai) consisting of at least three auditors may be appointed, half of which shall be external auditor(s), in the sense that they have had no specific business relationship with the company.

A statutory auditor's primary duty is to audit directors' performance of their duties, to examine the documents the directors intend to submit to the shareholders' meeting, to prepare an audit report based on the results from such examination and to provide the audit report to the annual

general shareholders' meeting. For these purposes, a statutory auditor has the power to carry out audit procedures by attending the board of directors' meeting, directing directors/managers to report on business operations, visiting subsidiaries and affiliates, making observation of assets, and reviewing administration systems. Where there are any issues, a statutory auditor may report to the board of directors. Further, a statutory auditor may request the directors to cease certain company practices which may lead to the risk of causing any damage or loss to the company. A statutory auditor has the power to act on behalf of the company, if the board of directors chooses to ignore the order.

For non-public companies, the scope of the audit may be limited to accounting according to the articles of incorporation.

7.8 Accounting auditor(s)

Accounting auditor(s) (Kaikai Kansanin) must be appointed to audit the financial statements and related documents (and internal controls) if the company is a large company, a KK with audit and supervisory committee or a KK with Nominating Committee, etc., or a listed company whose shares are transferable under the Financial Instruments and Exchange Act. Accounting auditor(s) must be qualified as certified public accountants (either individuals or corporations) and independent from the company.

7.9 Accounting advisors

The role of accounting advisors (Kaikai Sanyo) was recently introduced. Accounting advisors must be qualified tax advisers (either individuals or corporations) or certified public accountants (again either individuals or corporations). Accounting advisors prepare accounting documents jointly with the directors and executive officers. If an accounting advisor finds any fraudulent act or material facts in respect of the performance of the duties of directors which may constitute a breach of law or the articles of incorporation, the accounting advisor must report the fact to the statutory auditors (or shareholders if the company does not have statutory auditors). The roles of accounting advisors are tailored for small/medium companies. The term of appointment of accounting advisors is for two years, but it can be extended up to 10 years by the articles of incorporation in the case of a Closed KK.

7.10 Company with committees

Depending on the shareholders' decision, a KK may have committees. There are the following two types of committees:

(a) audit and supervisory committee or (b) nominating committee, audit committee and compensation committee (Nominating Committees, etc.).

The KK with an audit and supervisory committee do have not statutory auditors but an audit and supervisory committee organized by three or more directors, the majority of whom shall be outside directors. Directors who are an audit and supervisory committee members are elected separately from other directors by a shareholders' meeting. An audit and supervisory committee audits the execution of duties of directors and may state their opinions on the election or dismissal, or resignation of directors and the remunerations of directors at a shareholders' meeting.

The KK with Nominating Committees, etc. must have a nominating committee, an audit committee and a compensation committee. Each of the committees has three or more members appointed from amongst the directors. Members of each committee shall be appointed by resolution of the board of directors. A nominating committee determines the proposals for the appointment and removal of directors and accounting advisors to be submitted to a shareholders' meeting. An audit committee audits the execution of duties by executive officers, directors and accounting advisors. A compensation committee determines the remunerations for directors, executive officers and accounting advisors.

Companies with Nominating Committees, etc. do not have statutory auditors and must have at least three directors forming a board of directors, executive officers and accounting auditors.







PART III: ACCOUNTING, TAXATION & LABOR REGULATIONS

8. Accounting

8.1 Introduction

In 1949, Corporate Accounting Principles were issued by the (former) Ministry of Finance. In connection with Commercial Codes, Japanese accounting principles have been developed in several areas such as costing and consolidation accounting with practices. Japan Institute of Certified Public Accountants (JICPA) has also published guidelines in various accounting issues. Generally accepted accounting principles (GAAP) in Japan consist of these principles and practices.

Since 2001, Accounting and Reporting Standards have been issued by the Accounting Standards Board of Japan (ASBJ), which has superseded the Business Accounting Deliberation Council (BADC).

These standards provide guidelines for the preparation of financial statements and their attestations. These standards are not mandatory, but they are also reflected in the Regulations concerning terminology, forms and preparation methods of financial statements issued by the Ministry of Finance. Therefore, listed companies are required to comply with these regulations.

8.2 Fundamental accounting principles

There are seven general principles for business enterprises:

- True and fair reporting;
- Orderly system of bookkeeping;
- Distinction between capital surplus and earned surplus;
- Clear disclosure;
- Consistency;
- Prudence;
- Accordance with reliable accounting records and facts.

8.3 International convergence of accounting standards

The ASBJ agrees with the objective of international convergence to achieve high-quality accounting standards, since it is beneficial to respective capital markets around the world. To promote international convergence towards high-quality standards, the board is committed to establish closer relationships with the International Accounting Standards Board (IASB) and other accounting standard setters around the world.

Under the August 2007 Memorandum of Understanding (MoU), known as the Tokyo Agreement, the IASB and the ASBJ agreed to improve IFRS and Japanese GAAP, and to bring about their convergence. Accordingly, the ASBJ executed the purport of convergence and while almost achieving their purpose, the ASBJ has actively participated in the IASB's standard-setting process both by supporting the IASB's outreach activities in Japan and, as the current chair of the Asian-Oceania Standard-Setters Group, by gathering the views of the Asia-Oceania region on IASB projects. The ASBJ in doing so, has contributed effectively to the global accounting-setting process and ensured that the views of the ASBJ were considered by the IASB. The ASBJ now actively participates in the IASB's projects of "Agenda Consultation 2015" and "Annual Improvements to IFRSs 2014-2016 Cycle".

8.4 Public filing requirements

Public notice of financial statements

A Kabushiki Kaisha (KK) shall give public notice of its balance sheet (or, for a large company, its balance sheet and profit and loss statement) without delay after the conclusion of the annual shareholders meeting. In this regard, however, with respect to a KK whose method for the public notice is to post the notice in newspapers or the official gazette, it shall be sufficient to give public notice of a condensed balance sheet. Electronic public notice may also be used as an alternative.

Additionally, a KK which shall submit an annual securities report (see below) to the prime minister pursuant to the Financial Instruments and Exchange Act does not have to give public notice because more detailed information will be disclosed through the Electric Disclosure for Investors'

NETwork (EDINET).

Annual securities report

A listed company and/or certain companies provided in the Financial Instruments and Exchange Act are required to file annual securities reports with the finance bureau within three months (or, for a foreign company, six months) after the end of fiscal year. A listed company is also required to promptly file its copy with the stock exchange.

They are also required to file annual securities reports by using the Electric Disclosure for Investors' NETwork (EDINET) with the finance bureau.

The financial statements or consolidated financial statements included in the annual securities reports are required to be audited by independent accounting auditors.

Certain foreign companies which are required to file annual securities report in Japan may submit alternative documents disclosed in their home country and written in English, instead of the annual securities report, on the condition that the public interests or investors are protected.

Quarterly securities report

Listed companies or certain companies shall submit quarterly securities reports for each three month period, except for the fourth quarter, to the finance bureau within 45 days after the end of each quarter.

They are also required to file quarterly securities reports by the Electric Disclosure for Investors' NETwork (EDINET) with the finance bureau.

Quarterly financial statements are required to be reviewed by independent accounting auditors.

Certain foreign companies which are required to file quarterly securities reports in Japan may submit alternative documents disclosed in their home countries and written in English, instead of quarterly securities reports, on the condition that the public interests or investors are protected.

8.5 Audit requirements

Audit under the Company Act

Under the Companies Act, for companies with accounting auditors, the documents listed in the following items shall be audited by the auditors listed in each such item;

- a. The financial statements and supplementary schedules: Statutory/company auditors (Kansayaku) (or audit committee for companies with committees) and accounting auditors. Accounting auditors must be audit firms or CPAs;
- b. The business reports: Statutory/company auditors (or audit committee for companies with committees).

A company with accounting auditors means any KK which has

or is required to have accounting auditors, such as companies with committees or large companies. A large company means any KK which satisfies any of the following requirements;

- a. That the amount of the stated capital in the balance sheet as of the end of its most recent fiscal year is 500 million yen or more; or
- b. That the total sum of the amounts in the liabilities section of the balance sheet as of the end of its most recent fiscal year is 20,000 million yen or more.

Audit under the Financial Instruments and Exchange Act

Under the Financial Instruments and Exchange Act, companies which are required to file annual securities reports, financial statements and consolidated financial statements shall be audited by independent accounting auditors.

8.6 Internal control over financial reporting (J-SOX)

A listed company or other company provided in the Financial Instruments and Exchange Act shall submit internal control reports assessing the effectiveness of the internal control system and procedures. The internal control report shall be audited by the accounting auditors.

8.7 Accounting year

Companies are free to choose their fiscal year end, but most Japanese companies choose March as their year end. Branches should adopt the same year end as their head office of the foreign entity. For individuals, the calendar year is used, i.e. the end of December.

8.8 Inventories

Scope of inventories

Inventories are assets:

- held for sale in the ordinary course of business;
- in the process of production for such sales;
- in the form of raw material to be consumed in the manufacturing process; or
- in the form of office supplies to be consumed in the sales and general administration activities.

Measurement of inventories

Inventories should be measured at the acquisition cost which consists of the cost of purchases or the cost of manufactured products plus related costs necessary to place the inventories into its intended useful condition.

The total amount of the cost of goods purchased or manufactured is to be allocated between the cost of goods sold during the fiscal year and the cost of inventories at the fiscal year end.

In the process of the allocation, the following cost-flow assumptions may be chosen by the company:

- Specific identification method;
- FIFO method;
- Periodic average method;
- Moving average method;
- Retail inventory method.

Tax laws also prescribe the most recent purchase price method as standard for the tax purpose, which will be automatically applied unless another method is registered.

The value of inventories at the fiscal year end is also influenced by the system of accounting for inventories (the perpetual inventory system or the periodic inventory system) which determines the amount of inventory at the fiscal year end.

At balance sheet date, if the future realizable net (selling) value of the inventories is lower than the acquisition cost, the inventories shall be measured at the net (selling) value. The net selling value is computed as follows:

Net (selling value) = Selling price – estimated additional manufacturing costs – estimated direct selling costs

8.9 Tangible Assets

Scope of tangible assets

Tangible assets are as follows:

- Buildings and annexed structures;
- Structures;
- Machinery;
- Equipment;
- Cars;
- Lands;
- Lease assets;
- Construction in process.

These assets are held for use in the production or supply of goods and services or for administrative purposes, and are expected to be used for more than one fiscal year.

Depending on their characteristics, tangible assets are generally divided into two categories:

- Depreciable assets, such as buildings and machinery;
- Non-depreciable assets, such as land.

Measurement of acquisition cost

Tangible assets should be measured at the acquisition cost which consists of the cost of purchases or the cost of manufactured products plus related costs necessary to place the tangible assets into its intended useful condition in the same way as for inventories.

Measurement of subsequent cost

Subsequent costs are costs incurred after the date of acquisition, exchange or construction, and they are classified into two categories:

- capital expenditures – expenditures that provide future benefits, such as the significant improvements to the engine to an existing car;
- revenue expenditures – expenditures that do not result in a significant increase in future service potential, such as normal repair and maintenance costs.

Capital expenditures should be capitalized as part of the cost of the assets, and revenue expenditures should be charged to expenses when incurred.

The company should regard the expenditure as a capital expenditure, if the expenditure is a cost that:

- extends the assets' estimated useful lives;
- increases the quantity of services provided by the assets; or
- substantially improves the quality of services provided by the assets; or
- substantially reduces the previously assessed operating costs.

Depreciation

Accounting principles require that the acquisition costs of tangible assets should be allocated to each accounting period over their useful lives by using such depreciation methods as:

- Straight line method – a method in which the depreciation expense is to be computed evenly over their useful lives
- Declining balance method – a method in which the depreciation expense is to be computed by multiplying an un-depreciated amount at the beginning of the fiscal year by a certain rate
- Sum-of-the-year's-digits method – a method in which the computed depreciation expense is to be decreased gradually, in the way of arithmetical series
- Units of production method – a method in which depreciation expense is to be computed in proportion to the degree of production or services provided.

8.10 Leases

Classification of leases

Lease transactions are classified into two categories:

- finance lease transactions; and
- operating lease transactions.

A finance lease is defined as a lease in which:

- a. the contract cannot be cancelled effectively by either party, based on a specific term in the contract; and
- b. substantially all of the economic benefits and costs of ownership of an asset are transferred to the lessee.

In the determination of the above (b), the following criteria are adopted:

- a criterion based on present value – the present value of lease payments is about 90% or more of the estimated cash price of the lease asset; and
- a criterion based on economical useful life – the lease term is about 75% or more of the useful life of the lease asset.

A lease which is not classified as a finance lease is regarded as an operating lease. Furthermore, a finance lease is classified into two categories:

- finance lease with ownership transfer;
- finance lease without ownership transfer.

A financial lease which includes one or more of the following factor(s) is regarded as a finance lease with ownership transfer:

- transfer of the ownership of the lease asset;
- finance lease with a bargain purchase option;
- finance lease of a custom-made lease asset.

Lease is rather a new accounting area and applies to the companies for which statutory audit applies. Most small/medium companies do not recognize finance leases in practice.

8.11 Intangible Assets

Intangible asset are generally defined as non-monetary assets without physical substance. Intangible assets are expected to provide services or benefits during more than one accounting period, as in the case of tangible assets. The most common identifiable intangibles are patents, copyrights, trademarks, brand names, franchises, licenses and software development costs. Unidentifiable intangible assets are called goodwill. Goodwill is subject to amortization over 20 years or less using the straight-line method under Japanese GAAP.

Accounting for software related costs

Software is defined as programs which give orders to make a computer perform functionally. Contents are treated separately from software in principle. However, contents separately related to software are regarded as an integral part of the software.

Accounting methods for software development costs vary according to the following categories

Software for the purpose of R&D

Development costs are to be charged to R&D expense.

Build-to-order software

Development costs are treated as well as costs of contract construction.

Software for market sales

Development costs of the product master should be capitalized excluding costs which are regarded as R&D expenses and incurred for functional maintenance of the product master.

Software for internal use

When it is regarded as probable that the software will create future profits by increasing revenues or decreasing expenses, costs for the software are capitalized as intangible assets. If not, the costs are charged to expenses.

Amortization for capitalized software

Software for market sales

In principle, the capitalized software costs are to be amortized to expenses by the method based on the expected sales quantity or the expected sales profits. Note that the annual amortization expense be greater than the amount computed based on the expected sales quantity or the expected sales profits method or the amount equally allocated for the remaining period.

Software for internal use

For software intended for internal use, the method of amortization assumed as the most reasonable in the light of actual usage should be employed. In general, the straight-line method is regarded as reasonable. As for the useful life, it should be a period available for use of software which is less than five years unless there are reasonable grounds why it is necessary to be more than five years. A review of the useful life should be performed every fiscal year.

8.12 Impairment loss

Companies subject to statutory audit must take impairment loss into account.

In brief, the basic procedures of accounting for impairment loss on fixed assets typically such as land, building, machineries and goodwill are as follows:

- Group fixed assets by identifiable cash flows;
- Determine whether or not there is any indication of impairment;
- Determine whether or not to recognize an impairment loss on the asset; and
- Measure the amount of impairment loss;
- Account for the impairment loss on the income statement.

Grouping of assets

Impairment loss is required to be recognized and measured on the relevant asset or asset group. An asset group means a minimum group of assets that generate cash flows independently from other asset or asset groups.

Indication of impairment

If one or more of the following occur at the end of the fiscal year, there is an indication of impairment:

- continuous deficit in the results or cash flows from the operating activity;
- discontinued operations or reorganization;
- significant deterioration of the business environment;
- drastic decline of the market price.

Recognition of impairment loss

When any indication of impairment exists, the company should examine whether or not to recognize an impairment loss for the assets or asset group by comparing the following amounts:

- the undiscounted future cash flow;
- the carrying amount.

If the undiscounted future cash flow is less than the carrying amount, impairment loss should be recognized.

Measurement of impairment loss

When an impairment loss is recognized, the carrying amount of the asset should be reduced to the recoverable amount.

8.13 Foreign currency transactions

Foreign currency transactions are transactions denominated in a foreign currency.

In principle, foreign currency transactions should be translated into Japanese yen at the rate on the date of transaction.

At the end of the fiscal year, in principle, foreign currency monetary assets and liabilities should be translated into Japanese yen at the rate on the balance sheet date.

Translation of foreign currency financial statements

Translation of financial statements of foreign branches

In translating the financial statements of foreign branches, they should conform to the translation standards used for foreign currency items at the head office as follows:

- Revenue and expense items are translated at the rates of the dates on which those items were recognized in the accounts (except for items such as depreciation)
- Balance sheet items such as monetary items are translated at the closing rate
- Other balance sheet items are translated at the rate on the date of which the items are recognized in the accounts.

Translation of financial statements of foreign subsidiaries

In translating the financial statements of foreign subsidiaries, they should apply the following translation standards:

- Revenue and expense items are translated into Japanese yen at the average rate over the period. However, they may also be translated at the closing rate
- Assets and liabilities are translated at the closing rate
- Items attributed to capital in acquisition by a parent company are translated at the rate of the transaction date
- Differences derived from the above are recognized as translation adjustment in net assets.

8.14 Treasury stock

Treasury stocks are the company's own capital stocks that have been issued and subsequently reacquired. Treasury stocks are to be presented as a reduction in the amount of the stockholder's equity in net assets.

Accounting for treasury stock

Acquisition

When treasury stocks are acquired for cash consideration, the acquisition is to be recognized on the day when the consideration is paid. When treasury stocks are acquired for consideration other than cash, the acquisition is to be

recognized on the day when it is delivered.

Disposal

The disposal of treasury stocks in accordance with the procedures for new stock issuance is to be recognized on the due date of payment. Any gain on the disposal of treasury stocks is to be credited to other capital surplus, while any loss on the disposal of treasury stocks is to be charged to other capital surplus. If the balance of other capital surplus is less than the loss on the disposal of treasury stocks, other earned surplus is to be deducted.

Retirement

When treasury stocks are retired, the carrying amount of the treasury stocks is deducted from other capital surplus at the completion of the retirement procedures. When this accounting treatment results in a debit balance of other capital surplus, the amount of other capital surplus is to be zero with a decrease of other earned surplus.

Additional costs relating to the acquisition, disposal and retirement of treasury stocks are to be accounted for in the income statement as non-operating expense.

8.15 Revenue recognition

Realization principal

In principle, revenues should be recognized in the income statement only when they are:

- earned; and
- realized or realizable.

Revenue is deemed to be earned when the company has substantially accomplished what it must do, to be entitled to the benefits represented by the revenues.

Revenue is realized when goods and services are exchanged for cash or claims to cash. Revenue is realizable when assets received in exchange are easy to be converted to cash.

Consignment sales

Sales revenue is recognized on the date when the goods of the consignor are sold by a consignee. Accordingly, if it is certain that the goods or services have been sold by the receipt of invoices before the balance sheet date, the revenue should be recognized in the current period.

Sales on trial

Sales revenue is recognized when customers express their intention to purchase goods or services.

Advance sales

Sales revenue is recognized only when goods or services are transferred, and advanced money received before goods or services are transferred should be accounted for as a liability and should be deferred to the next fiscal year.

Installment sales

Sales revenue is recognized on the date when goods or services are delivered. However, as payment is required and collected over a relatively long period of time, it results in additional costs such as collection fees and after-service costs, as well as a high risk of bad debt. Therefore, allowance for such expenses should be set up with special consideration. In order to recognize revenue discreetly, sales revenue may be recognized when cash is or should be collected.

Construction contracts

Sales revenues and costs related to construction contracts are to be recognized by the following methods;

- Percentage-of-completion method, by which sales revenues and costs are to be accounted for in proportion to the percentage of completion;
- Completed-contract method, by which sales revenues and costs are to be accounted for at the time of completion and delivery.

In case that a certainty of accomplishment corresponding to a part of progress exists, the percentage-of-completion method should be applied.

8.16 Research and development (R&D) costs

Research means designed investigation or seeking for the purpose of discovering new knowledge. Development means to bring research accomplishments or other knowledge into shape as schedules or designs for new products, services, production methods or significant improvement of existing products.

R&D costs are to be accounted for in the income statement as expenses, as incurred.

8.17 Deferred tax

Deferred tax accounting is required to achieve a reasonable matching between net income before income taxes and income taxes by the relevant allocation of the amount of income taxes, when there is a difference between the amounts of the assets and liabilities for financial statements and amounts of assets and liabilities for tax purpose.

Temporary differences

Temporary differences are defined as differences between amounts of assets and liabilities for financial statements and amounts of assets and liabilities for tax purpose. Temporary differences are classified into the following categories:

Future deductible temporary difference, such as:

- excess reserve for bad debt;
- excess depreciation of depreciable assets; or
- valuation loss on inventories, not deductible for tax purpose.

Future taxable temporary difference, such as:

- difference derived from the reduced value entry for tax purposes by the reserve method.

Permanent differences

Permanent differences are not subject to deferred tax accounting, because such differences do not cause any effects on the taxable income calculation in the subsequent fiscal years.

Effective tax rate for corporations

Effective tax rate applied in the calculation of deferred tax assets or liabilities is calculated as follows:

$$\text{Effective tax rate} = \frac{\text{Corporate tax rate} \times (1 + \text{inhabitant tax rate}) + \text{business tax rate}}{1 + \text{business tax rate}}$$

8.18 Comprehensive income

Comprehensive income is the change in net assets of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. This includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Not only the stockholders of the company but also the owner of the subscription warrant that the company publishes and the minority stockholders of consolidated financial statements are treated as owners.

Other comprehensive income (OCI) is the amount which is not included in net income and minority interests (losses) of comprehensive income. OCI is the difference between comprehensive income and net income in non-consolidated financial statements as well as the difference between comprehensive income and the net income before minority stockholders profit and loss adjustment in consolidated financial statements. Both the amounts related to a parent company stockholder and the amount related to minority stockholders are included in the OCI of consolidated financial statements.

8.19 Accounting changes and correction of errors

An accounting change can be characterized as the change of accounting policy, way of presentation and line items, and accounting estimates. "Correction of errors" is not however, classified as an accounting change.

The change of accounting policy, way of presentation and line items, and correction of errors are classified as retroactive restatement or adjustments.

9. Corporate Taxation

9.1 Taxable entities

Types of corporation and the scope for taxation

Corporations are subject to corporation tax, and are required to file tax returns. For the purposes of the tax, there are various types of corporations, each of which is subject to corporation tax in its own way.

Corporations are classified as either domestic corporations (resident corporations) or foreign corporations for corporation tax purposes. Domestic corporations are those that have a head or main office located in Japan, and foreign corporations are all corporations other than domestic corporations. For corporation tax purposes, corporations include public corporations, public interest corporations, cooperatives, ordinary corporations and non-juridical organizations.

The scope of taxable income according to the type of corporation is as follows.

Type of corporation		Tax on ordinary income
Domestic corporation	Ordinary corporations(*)	Taxable
	Cooperatives	
	Public interest corporations	Taxable only on income from profit-making businesses
	Non-juridical organizations	
	Public corporations	Non-taxable
Foreign corporation	Ordinary corporations(*)	Taxable on income related to PE and on certain income from sources in Japan
	Non-juridical organizations	Taxable only on income from profit-making businesses

(*) applied to most of foreign investors or corporations

Foreign corporations having a Permanent Establishment ("PE")

For Japanese tax purposes, generally foreign corporations (corporations whose head offices are not located in Japan) are classified into the following four categories, according to whether the corporation has a permanent establishment, and if it has, the type of such a permanent establishment.

- Foreign corporations which possess branches, factories and other fixed places in which business is being conducted inside Japan.
- Foreign corporations (excluding foreign corporations falling under item (a)) which operate inside Japan for over one year on construction, installation, assembly and other works or providing supervision services for such works.
- Foreign corporations (excluding foreign corporations falling under item (a, b)) which have inside Japan persons who are entitled to conclude contracts for the sake of themselves.
- Foreign corporations not falling into the above categories. ("without PE")

Also, refer to tax treaties where its definitions are clarified or placed differently, if applicable.

As from April 1, 2016, foreign corporations which have a PE are taxable on income related to the PE in Japan regardless of whether the income of sources is incurred in Japan or not. The change happens in connection with the harmonization of the Authorized OECD Approach (AoA).

Principle of taxation on actual beneficiary

Where a person to whom the revenue from assets or business seems to be legally imputed is merely nominal, that is, the person does not enjoy the revenue, but a corporation other than the said person is enjoying the revenue, the revenue shall be considered as being attributable to the corporation which enjoys the revenue, and corporate income tax rules shall apply to such corporations.

9.2 Tax rate

The corporate tax rate on ordinary income is as follows:

Type of corporation		Classification of Taxable Income	Tax rates
Ordinary corporations	Corporations with more than 100 million yen of capital or contribution to capital	Ordinary income	23.4%(*1)
	Other corporations (*3)	the portion of the income which is equal to or less than 8 million yen per year	19%(*2)
		the portion of the income which is in excess of 8 million yen per year	23.4%(*1)

(*1) This rate is applied for the fiscal years starting as from April 1, 2016, and reduced to 23.2% for the fiscal years starting as from April 2018.

(*2) In accordance with the Special Taxation Measures Law, the reduced tax rate at 15% is applied for the fiscal years starting from April 2012 through to March 31, 2017, instead.

(*3) If the holding company which has 100% of the issued shares directly or indirectly in the corporation has the paid-in capital of 500 million yen or more, even if the corporations have 100 million yen or less of capital or contribution to capital, the reduced rate is not applicable.

Due to the introduction of local corporate tax for the fiscal years starting from October 1, 2014 which tax rate is 10.3% since April 2017, the practical corporation tax rates for the above periods will generally be as follows:

Type of corporation		Classification of Taxable Income	Tax rates
Ordinary corporations	Corporations with more than 100 million yen of capital or contribution to capital	Ordinary income	25.81%
	Other corporations	the portion of the income which is equal to or less than 8 million yen per year	20.96% (16.55%)
		the portion of the income which is in excess of 8 million yen per year	25.81%

In addition to the corporate income taxes, local business (enterprise) tax and inhabitant taxes will also be levied on corporations. Although the tax rate and taxable income for the business tax varies according to the type of business, most of the taxable income comprises the annual income. Also, there are inhabitant taxes that are levied according to the size of the company (i.e. the number of branches, the number of employees and the amount of capital), even when there is no income. Refer to Chapter 11.2 and 11.3 in detail.

9.3 Place of tax payment

A corporation is required to file returns and other supplemental documents to the Tax Office in their jurisdiction. The place of tax payment of a domestic corporation is the place where its head or main office is located. However, if that place is considered inappropriate from the condition of the corporation's business or estate, the tax authority may designate another place as its place of tax payment.

In the case of a foreign corporation, generally, the place of tax payment is where the corporation's main permanent establishment or estate in Japan is located.

9.4 Income subject to tax

Resident companies

The computation of the net income follows generally accepted accounting principles (GAAP) in Japan. In practice, however, where detailed rules are placed in Corporate Tax Laws (e.g., depreciation, entertainment, etc.), companies tend to follow the tax treatments as far as those may be accepted under Japanese GAAP ("Tax accounting").

Corporate tax shall be computed on the net income which must be approved in the Annual Shareholders' Meeting, on which adjustments shall be made for tax purpose. Thus, it is important to understand the interrelation between the provisions under GAAP and Corporate Tax Laws.

The tax base for ordinary income tax is the taxable income after the tax adjustments for each fiscal year. As for corporations, capital gains are included as part of taxable income, however, transactions that are capital in nature is not included.

Non-resident companies

Foreign (non-resident) companies are not subject to corporate income tax in Japan unless they have a permanent establishment in Japan. If a corporation has a permanent establishment in Japan, however, the corporation is subject to tax on so much of its industrial or commercial profits that are attributable to the permanent establishment. When and if foreign companies that have no permanent establishment have certain income such as dividend, interest and royalty, the foreign companies are taxed by way of withholding tax although applicable tax treaty may be available.

9.5 Calculation of taxable income

There are some special treatments in Corporate Tax Laws to which should be paid attention.

Depreciation

Depreciable assets

The Corporation 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 corporate tax purposes.

Depreciable tangible assets include all kinds of tangible fixed assets, excluding land, etc. For example, buildings, structures, machinery and equipment, vessels, airplanes, vehicles, tools, etc. are depreciable. Depreciable intangible assets are stipulated in laws and regulations. They include intangible property such as goodwill, patents, trademarks, and mining rights.

Recognition of depreciable assets

A fixed asset is an asset that can be used for business purposes for one or more years. However, if the amount is less than 100,000 yen, it can be charged directly as an expense as long as the company makes such an accounting treatment in the accounting book.

For the assets amounting to 100,000 yen or more and less than 200,000 yen, a special depreciation (three years' straight line method) is available for tax purposes. For small/medium companies which are registered under the blue form tax return, another special deduction is available with the assets of less than 300,000 yen under certain conditions. These should be reflected in the accounting books to take the tax benefits.

Method of depreciation

Depreciation is generally calculated by the following method. However, there are exceptions which can be made with the consent of the tax authority.

- a. Straight line method
- b. Declining balance method
- c. Units of production method
- d. Straight line (lease period) method

Selection of a depreciation method

A corporation may choose one method for each group of its depreciable assets or for each office, shop, factory, etc., from among the depreciation methods outlined as above. If not chosen, declining balance method is applied as standard for tax except buildings and accompanying facilities, constructions and intangible assets for which straight line method must be applied.

Useful lives

The useful life of various kinds of depreciable assets, tangible or intangible, are legally determined by the Regulations issued by the Ministry of Finance for this purposes. Since the Useful Lives Tables prescribe is very detailed, companies often follow the Regulations for accounting purpose. The useful life of secondhand assets may be estimated reasonably by the corporation or referred to certain formulas provided by Law.

Difference between accounting and tax for depreciation

If the depreciation for accounting exceeds the limit allowed for tax purposes, the excess part is deemed not to be recorded for tax purposes. The excess part of the depreciation for accounting over the deductible limit for tax purposes may be deducted in subsequent business years within the deductible limit.

Entertainment expenses

Entertainment expenses for tax purposes are narrowly defined. They include expenses for entertaining guests, receiving guests, unspecified expenses for guests, and other expenses which are spent for guests such as gifts or similar items.

In general, the total amount of the entertainment expenses incurred shall be excluded from the deductible expenses for tax purposes. However, of the total amount of entertainment expenses, the expenses for foods and drinks (except those

spent wholly for directors or employees) are deductible up to 50% for the fiscal years starting between April 1, 2014 and March 31, 2018. Also, for the small/medium corporations whose paid-in capital at the fiscal year-end is 100 million yen or less, or which is not 100% owned by the large company whose paid-in capital is 500 million or more, entertainment expenses may be deductible up to 8 million yen as an option.

Directors' salaries and bonuses

In principle, directors' salaries and bonuses are not deductible for tax purposes, whatever name is used. However, if the salaries are paid regularly (i.e., monthly or every two weeks) as a fixed amount, they may be deducted. However, the portion of directors' salaries that are deemed to be unreasonably high, should be excluded from deductible expenses.

Retirement allowances for directors are deductible at the time when the payment is made upon retirement, unless the amount is unreasonable high.

9.6 Tax credits

Tax credit on withholding tax

Where a domestic corporation is, in each accounting period, to receive interest, dividend, compensation benefit, profit, gain, distribution of profit, or reward as stated in the Income Tax Act, the amount of income tax withheld for such items shall be credited against the amount of corporation tax on the taxable income for the fiscal year. This shall apply only when there is a detailed statement in the final return as to the amount to be credited, as well as its computation. In this case, the amount to be credited shall be limited to the amount stated as the amount to be credited.

In general terms, the provisions shall also be applied in the case (a) where foreign corporations receive, for each fiscal year, payment of domestic source income as stated in the respective items on which the income tax is imposed pursuant to the Income Tax Act, and (b) where foreign corporations are also required to file corporate tax returns on their domestic source income, in accordance with the classification of foreign corporations.

Foreign tax credits

Where a domestic corporation is, in each fiscal year, to pay foreign corporation tax on income from foreign branches or foreign withholding income tax on interest, dividend, royalty, etc., the amount of the foreign corporation tax or withholding tax, within the limit of the amount computed pursuant to the following formula, shall be credited against the amount of corporation tax of the fiscal year (excluding fixed amounts calculated as the portion of the income tax with a high rate). Where the amount of foreign income tax is within the amount of creditable limit, the difference may be carried forward for three years.

amount of creditable limit	=	amount of tax arising from the world wide income	×	foreign source income during the fiscal year world-wide income during the fiscal year
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Exemption of foreign dividends

Dividends of a foreign company ("foreign dividends") received by a domestic company will be deductible from the taxable income when calculating the income for each year, up to 95% of the amount of the dividends, in principle. However, the companies subject to this regulation shall not be allowed to include the amount of foreign tax paid in the deductible expenses when calculating the income in each fiscal year.

"Foreign companies" are defined as the companies of which 25% of the issued stocks are owned by a Japanese company for six consecutive months before the date the dividends are declared. However, please note that there may be cases where the tax treaty overrides this condition, if applicable.

Other tax credits

There are some tax credits or deductions for development and research, acquisition of certain assets and increasing salary or number of employee under particular conditions.

9.7 Tax return filing and payment

Resident companies

A corporation is required to file an annual tax return within two months after the end of its business year, whether or not it has a positive income for the fiscal year. The business year must be within one year for the tax purposes.

The taxable income and amount of corporate tax to be included in the annual tax return should be calculated based on information in the financial statements.

An annual tax return must be accompanied by the corporation's balance sheet, profit and loss statement, and any other documents describing adjusted items necessary for calculating its taxable income and the corporation tax due in the tax returns. Shareholding structure and related parties' information must also be disclosed.

Special treatment for annual tax return

If a corporation cannot file their annual tax return because the accounting auditor has not finalized the audit or for other

unavoidable reasons, in general, the time limit for the annual tax return may be postponed for one month with the prior approval of the Tax Authority.

Non-resident companies

Foreign corporations must file tax returns and make payments in the same manner as a domestic corporation.

9.8 Blue form tax return

Requirements of the blue form tax return

A corporation may file a blue form tax return in the same manner as an individual taxpayer, with the approval of the Tax Office. To be eligible to file a blue form tax return, the corporation must keep journals, general ledgers and other necessary books, and record all transactions affecting assets, liabilities and capital in the books clearly and in a good order.

The corporation must also settle accounts on the basis of the records, prepare balance sheets, profit and loss statements and other statements, and keep almost all books and documents for seven years.

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

Privileges of the blue form tax return

Privileges granted to corporations who can file a blue form tax return include the following:

- Carried-over net losses for nine years, which are incurred from fiscal years for which a blue form tax return is filed, can be deducted as expenses in subsequent fiscal years for a nine year period. (It changes to ten years from fiscal year beginning from April 1, 2018 or later.)
- Most of the special depreciation allowances and the special tax credits provided for in the Special Taxation Measures Law only apply to companies who are able to file a blue form tax return.
- Additional depreciation for acquisition assets.
- Tax credit for acquisition of certain assets etc.

9.9 Loss carry forward and carry back (relief of losses)

A corporation that files a blue form tax return may generally carry forward losses for nine years (or ten years after the fiscal years starting from April 2018) following the loss year. The utilization of loss carried forward is limited gradually (65% for the fiscal year starting after April 2015, 60% for the fiscal year starting after April 2016, 55% after the fiscal year starting from April 2017, or 50% after the fiscal years onward starting from April 2018) of the total taxable income for the current year, except for the small/medium corporations. In order to receive the benefit of this regulation, the company must

continue to file tax returns every year after filing the blue form tax return for the loss year.

The regulation that allowed a corporation that files a blue form tax return to carry back the loss incurred in the subsequent fiscal year has been terminated until March 31, 2018. The small/medium corporations are an exception and may still use this rule.

9.10 International aspects

Anti-tax haven (CFC) rules

Where shares are held by Japanese corporations or individual investors in a so-called tax haven country, under Japanese domestic tax law, some of those investors may be subject to tax in Japan on an appropriate portion of the current retained earnings of the subsidiaries in the tax haven country ("tax haven subsidiary").

A "tax haven subsidiary" for these purposes is a company:

- a. With more than 50% of which is directly or indirectly owned by the Japanese company, Japanese resident individuals or non-resident individuals having a special relationship with the Japanese company or the Japanese resident individual, and
- b. which either has:
 - its main or head office in a country which does not impose tax on income; or
 - an income tax burden of (effective tax rate) less than 20%

The tax haven subsidiaries include a (direct) subsidiary, a subsidiary's subsidiary and a subsidiary of subsidiary's subsidiary.

The proportionate share of the total income of the tax haven subsidiary is treated as part of the Japanese shareholder's taxable income and is subject to normal corporate or income taxes in Japan, unless all of the following conditions are met:

- i. business purpose test
- ii. substance test
- iii. administration and control test
- iv. unrelated party test or country of location test

Certain income such as dividends, interests, royalties, etc., are still subject to tax in Japan on an appropriate portion, in principle, even though the above conditions are all met while tax credits may be available.

Transfer pricing taxation

The transfer pricing taxation is set out under the Special Taxation Measures Law for the purpose of preventing tax avoidance by companies through transactions with their related overseas companies.

Transactions subject to transfer pricing legislation

The sale and purchase of assets, rendering of services and any other transactions with related overseas companies which do not meet the arm's-length concept are subject to the transfer pricing legislation. Under this legislation, the tax authority may recalculate for tax purposes, the income derived from the transactions based on the following arm's-length pricing methods:

- a. comparable uncontrolled price method;
- b. resale price method;
- c. cost-plus method; or
- d. profit split method;
- e. transactional net margin method;
- f. a reasonable alternative method.

Transaction with related overseas companies conducted through unrelated companies could also be subject to this legislation.

Related overseas companies

A related overseas company for these purposes is a foreign company which has any of the following specific relationships with a domestic company:

- a. Shareholding relationship with 50% or more directly or indirectly in issued shares
- b. Substantial control relationship
- c. Combination of shareholding relationship and substantial control relationship

Thin capitalization

The thin capitalization rule was introduced in 1992. This rule states that interest is partly excluded from a corporation's deductible expenses when the corporation has borrowed money exceeding three times the amount of its capital from its leading shareholder.

A "foreign leading shareholder" means a non-resident or a foreign corporation which can control the corporation in question by owning 50% or more directly or indirectly of the issued shares or keeping a special connection with the corporation.

The non-deductible amount of interest is calculated as follows:

Total amount of interest paid to foreign leading shareholder in the fiscal year	X	(X) – Share of the foreign leading shareholders ×3
		Average amount of interest bearing debt in the fiscal year(X)

A third party loan with foreign related parties' guarantee shall be included in the debt and interests on the loan and the guarantee fees shall be included in the interests.

Earning Stripping Rules

This rule was introduced in 2013. The earnings stripping rules will limit the deductibility of the net interest expenses with the related parties in excess of 50% of the adjusted taxable income. Any non-deductible portion may be carried forward for seven fiscal years and deducted in a fiscal year in which net interest expenses with the related parties do not exceed 50% of the adjusted taxable income. The adjusted taxable income is calculated as below.

Taxable income

+ net interest expenses with the related parties

+ depreciation and amortization

+ dividend income which is subject to tax exemption

+/- bad debt expenses and other extraordinary income/losses

Adjusted taxable income

Reporting requirements

Transfer pricing documentation

Based on the recommendation of BEPS project Action 13 (Guidance on Transfer Pricing Documentation and Country-by-Country Reporting) by OECD, new transfer pricing (TP) documentation requirements have been introduced in the 2016 tax reform.

1. Notification for Ultimate Parent Entity *1,2
2. Country-by-Country report (English only) *1,3
3. Master File *1,3
4. Local File *4

The documents show the details of affiliated companies (e.g. amount of revenue, profit and employee), corporation's structure, outlines of intangible assets, and evidence of determination for TP.

*1 A MNE group with total consolidated revenue of 100 billion yen or more

*2 First deadline: the end of the day of the fiscal year starting after Apr.1, 2016

*3 First deadline: the day after one year from the end of the day of the fiscal year starting Apr.1, 2016

*4 A corporation with the following transaction in the fiscal year
a. Transaction of 5,000 million yen or more with the foreign

related party

b. Transaction of intangibles of 300 million yen or more with the foreign related party

Even if a corporation does not meet the threshold above a, b, the corporation is subject to the transfer price taxation, therefore, the tax authority may request the Local File or similar information upon tax inspection.

Statement of foreign affiliated company

Corporations which have transactions with foreign affiliated companies are required to attach the statement which indicates the details of foreign affiliated companies (e.g. address, name, paid in capital, amount of sales, profit and particular transactions) in the corporate tax returns.

Shareholding structure diagram

Corporations which have wholly owning parent companies, wholly owned subsidiaries and fellow subsidiary companies are required to attach the shareholding structure diagram which indicates some details (e.g. organization chart, shareholding pertaining to company, address, paid in capital and closing month) in the corporate tax returns.

Tax treaty

Treatment under the tax treaty

As of June 1, 2016, Japan has concluded 65 tax treaties with 96 countries or counties, and expands a broad tax treaty network. The table below contains the withholding rates under the tax treaties, which apply to the items which are of high interest for foreign investors; dividends, interests and royalties.

In the case that a tax treaty concluded by Japan includes stipulations regarding domestic source income which may differ from domestic tax laws, the domestic source income of the corporation subject to such treaty shall, in principle, abide by the treaty.

Rate: as of July 2016

Treaty Partners	Dividends	Interests *3	Royalties
Armenia	15	0/10	0/10 *4
Arab Emirates	5/10 *5	0/10	10
Australia	0/5/10/15 *6	0/10	5
Austria	10/20 *7	10	10
Azerbaijan	15	0/10	0/10 *4
Bangladesh	10/15 *8	0/10	10
Belarus	15	0/10	0/10 *4
Belgium	5/10/15 *9	10	10
Brazil	12.5	0/12.5	12.5/15/25 *10
Brunei	5/10 *5	0/10	10
Bulgaria	10/15 *8	0/10	10
Canada	5/10/15 *11	0/10	10
China	10	0/10	10

Czech Republic	10/15 ^{*8}	0/10	0/10 ^{*12}
Denmark	10/15 ^{*13}	10	10
Egypt	15/20 ^{*14}	–	15
Fiji	–	–	10
Finland	10/15 ^{*8}	10	10
France	0/5/10 ^{*15}	0/10	0
Georgia	15	0/10	0/10 ^{*4}
Germany ^{*1}	10/15 ^{*16}	0/10 ^{*17}	10
Hong Kong	5/10 ^{*5}	0/10	5
Hungary	10	0/10	0/10 ^{*12}
India	10	0/10	10
Indonesia	10/15 ^{*13}	0/10	10
Ireland	0/10/15 ^{*18}	10	10
Israel	5/15 ^{*8}	0/10	10
Italy	10/15 ^{*8}	10	10
Kazakhstan	5/15 ^{*19}	0/10	10
Korea	5/15 ^{*8}	0/10	10
Kyrgyzstan	15	0/10	0/10 ^{*4}
Kuwait	5/10 ^{*5}	0/10	10
Luxembourg	5/15 ^{*8}	0/10	10
Malaysia	0/5/15 ^{*20}	0/10	10
Mexico	0/5/15 ^{*20}	0/10/15 ^{*21}	10
Moldova	15	0/10	0/10 ^{*4}
Netherlands	0/5/10 ^{*22}	0/10	0
New Zealand	0/15 ^{*23}	0/10	5
Norway	5/15 ^{*8}	0/10	10
Oman	5/10 ^{*5}	0/10	10
Pakistan	5/7.5/10 ^{*24}	0/10	10
Philippines	10/15 ^{*25}	0/10	10/15 ^{*26}
Poland	10	0/10	0/10 ^{*12}
Portuguese	5/10 ^{*27}	0/5/10 ^{*28}	5
Qatar	5/10 ^{*5}	0/10	5
Romania	10	0/10	10/15 ^{*29}
Russia	15	0/10	0/10 ^{*4}
Saudi Arabia	5/10 ^{*30}	0/10	5/10 ^{*31}
Singapore	0/5/15 ^{*32}	0/10	10
Slovakia	10/15 ^{*8}	0/10	0/10 ^{*12}
South Africa	5/15 ^{*8}	0/10	10
Spain	10/15 ^{*33}	10	10
Sri Lanka	6/20 ^{*34}	–	0/10.21 ^{*35}
Sweden	0/10 ^{*36}	0/10 ^{*37}	0
Switzerland	0/5/10 ^{*38}	0/10	0
Tajikistan	15	0/10	0/10 ^{*4}
Thailand	15/20 ^{*39}	0/10/25 ^{*40}	15
Turkey	10/15/20 ^{*41}	0/10/15 ^{*42}	10
Turkmenistan	15	0/10	0/10 ^{*4}
Ukraine	15	0/10	0/10 ^{*4}

United Kingdom	0/10 ^{*43}	0/10 ^{*37}	0
United States ^{*2}	0/5/10 ^{*44}	0/10	0
Uzbekistan	15	0/10	0/10 ^{*4}
Vietnam	10	0/10	10
Zambia	0	0/10	10

Notes

^{*1} New tax treaty awaits to come into effect (the rates above are still effective in July 2016)

^{*2} New protocol awaits to come into effect (the rates above are applied before introducing the new treaty)

^{*3} Exempt for government etc. (applying almost all tax treaties)

^{*4} Exempt for literary, artistic, scientific etc.

^{*5} Lower rate for 6 months, 10% or more shareholdings, directly or indirectly, corporation (excluding dividend which is deductible from Japanese taxable income)

^{*6} Exempt for 12 months, 80% or more shareholdings, directly, corporation, other conditions; 5% for 10% or more shareholdings, directly, corporation; 10% for other; 10% or 15% for particular dividend which is deductible from Japanese taxable income

^{*7} Lower rate for 12 months, more than 50% shareholdings, corporation

^{*8} Lower rate for 6 months, 25% or more shareholdings, corporation

^{*9} 10% for in Japan, 6 months, 25% or more shareholdings, corporation; 5% for in Belgium, 6 months, 25% or more shareholdings, corporation; 15% for other

^{*10} 25% for trade mark; 15% for film or tape for cinematograph, radio, television; 12.5% for other

^{*11} 5% for 6 month, 25% or more shareholdings, corporation (10% for particular type); 15% for other

^{*12} 10% for industrial royalty; Exempt for cultural royalty

^{*13} Lower rate for 12 months, 25% or more shareholdings, corporation

^{*14} 20% for particular dividend to individual

^{*15} 5% for 6 month, 10% or more shareholdings, directly or indirectly, corporation (exempt for particular type); 10% for other

^{*16} Lower rate for only in Japan, 12 months, 25% or more shareholdings, directly or indirectly, corporation

^{*17} Exempt for particular bond

^{*18} Exempt if paid by a company in Ireland; 10% for in Japan, 6 months, 25% or more shareholdings, corporation; 15% for other

^{*19} Lower rate for 6 months, 10% or more shareholdings, directly or indirectly, corporation (excluding dividend which is deductible from taxable income)

^{*20} 5% for 6 months, 25% or more shareholdings, corporation

(exempt for particular type); 15% for other

- *21 Exempt for government etc.; 10% for bank or insurance company etc.; 15% for other
- *22 5% for 6 months, 10% or more shareholdings, directly or indirectly, corporation (exempt for particular type); 10% for other
- *23 Exempt for 6 months, 10% or more shareholdings, directly or indirectly, corporation, other conditions
- *24 5% for 6 months, 50% or more shareholdings, directly, corporation; 7.5% for 6 months, 25% or more shareholdings, directly, corporation; 10% for other (dividend which is deductible from Japanese taxable income is also 10%)
- *25 Lower rate for 6 month, 10% or more shareholdings, directly, corporation
- *26 15% for film or tape for cinematograph, radio, television (10% for particular royalty); 10% for other
- *27 Lower rate for 12 month, 10% or more shareholdings, directly, corporation (excluding dividend which is deductible from taxable income)
- *28 Exempt for government etc.; 5% for particular bank.; 10% for other
- *29 10% for cultural royalty; 15% for industrial royalty
- *30 Lower rate for 183 days, 10% or more shareholdings, directly or indirectly, corporation (excluding dividend which is deductible from Japanese taxable income)
- *31 Lower rate for industrial, commercial or scientific equipment
- *32 5% for 6 months, 25% or more shareholdings, corporation (exempt for particular type); 15% for other
- *33 Lower rate for 6 months, 25% or more shareholdings, directly, corporation
- *34 Exempt or 6% or 20% which depend on condition
- *35 Exempt for copyright, cinematograph film, etc.
- *36 Lower rate for 6 months, 10% or more shareholdings, directly or indirectly, corporation (excluding particular partnership)
- *37 Exempt basically (10% for some kind of interest)
- *38 5% for 6 months, 10% or more shareholdings, directly or indirectly, corporation Exempt for 6 months, 50% or more shareholdings, directly or indirectly, corporation 10% for other (dividend which is deductible from taxable income is also 10%)
- *39 15% for 6 months, 25% or more shareholdings, corporation engaged in an industrial undertaking 20% for 6 months, 25% or more shareholdings, corporation, in other cases
- *40 Exempt for government etc.; 10% for financial institution or insurance company; 25% for other
- *41 10% for 6 months, 25% or more shareholdings, corporation; 15% for other; 15% or 20% for in case of Turkey, depending on Turkish tax rate
- *42 Exempt for government etc.; 10% for bank or insurance

company; 15% for other

- *43 Exempt for 6 months, 10% or more shareholdings, directly or indirectly, corporation (excluding dividend which is deductible from Japanese taxable income); Exempt for particular pension fund or pension scheme; 10% for other
- *44 Exempt for 12 months, more than 50% shareholdings, directly or indirectly, corporation, other conditions 5% for 10% or more shareholdings, directly or indirectly, corporation 10% for other (dividend which is deductible from Japanese taxable income is also 10%)

10. Taxation of Individuals

10.1 Taxpayers

Classification of individual taxpayers

Individual residents in Japan are subject to both the national income tax and the local inhabitant tax.

For tax purposes, individuals are classified as "resident" and "non-resident", and "resident" is further classified as "permanent resident" and "non-permanent resident" under the Individual Income Tax Law. The scope of the taxable income and taxable method for individuals differs depending on their classification into the above categories.

Classification	Period for having domicile and residence		Japanese nationality	No Japanese nationality
Having domicile(*)	More than 5 years within the last 10 years		Permanent resident	Permanent resident
	5 years or less within the last 10 years		Permanent resident	Non-permanent resident
No domicile	Having residence	More than 5 years within the last 10 years	Permanent resident	Permanent resident
		one year or more – 5 years or less within the last 10 years	Permanent resident	Non-permanent resident
		Less than one year	Non-resident	Non-resident
	No residence	–	Non-resident	

(*) main resident place of the individual for living

Income subject to tax

Permanent residents are residents other than non-permanent residents. Permanent residents are subject to income tax on their worldwide income.

Non-permanent residents are subject to tax on income sourced in Japan as well as any non-Japan sourced income that is paid in or remitted into Japan.

Non-residents are persons who do not satisfy the conditions for residents. Non-residents are subject to tax only on income sourced in Japan. They are taxed at a flat rate of 20% (in addition, the special reconstruction tax regime was introduced due to the North Japan earthquake in 2011, the tax rate is 2.1% of national income tax until 2037) of the compensation for their personal services rendered in Japan. Under certain circumstances, treaty benefits may reduce the Japanese tax burden. Non-residents are not subject to local inhabitant tax.

As from January 2017, non-residents which have a PE in Japan are taxable on income related to the PE as well as certain income non-related to the PE regardless of whether the income of source is incurred in Japan or not. The change happens in connection with the harmonization of the Authorized OECD Approach (AoA).

10.2 Taxable income

Filing and payment

Individual income tax comprises of self-assessed income tax and withholding income tax.

a. Withholding income tax

Please refer to Chapter 11.8.

b. Self-assessed income tax

Residents must submit an income tax return for income earned each calendar year, except in some cases (when the total income does not exceed the total deductions, and those who receive salary income from only one location not exceeding 20 million yen or who have other income of 200,000 yen or less, etc.) and must pay the tax payable between February 16 and March 15 of the following year.

Classification of income

An individual's taxable income is defined as the assessable income less allowable deductions. Assessable income for these purposes consists of the following:

- a. interest income;
- b. dividend income;
- c. real estate income;
- d. business income;
- e. employment income;
- f. retirement income;
- g. timber income;
- h. capital gains;
- i. occasional income; and
- j. miscellaneous income

Tax rates

The following tax rates and deductions are applied to the net of taxable ordinary income minus allowable deductions and personal reliefs in respect of individuals who are classified as permanent or non-permanent resident taxpayers.

(Unit: Yen)

Taxable income		Tax rate applicable to taxable income band	Deduction
Over	But not over		
–	1,950,000	5%	–
1,950,000	3,300,000	10%	97,500
3,300,000	6,950,000	20%	427,500
6,950,000	9,000,000	23%	636,000
9,000,000	18,000,000	33%	1,536,000
18,000,000	40,000,000	40%	2,796,000
40,000,000		45%	4,796,000

Capital gains of certain assets such as lands, buildings, stock shares, bonds and beneficiary rights are taxed at a flat rate of 15% or 30% (apart from the special reconstruction tax on national income tax) according to the kind of income and holding periods.

Employment income for non-residents

Non-residents are subject to the national income tax on their Japan-sourced income but not subject to the local inhabitant tax.

When employees are classified as non-resident and when they temporarily work in foreign countries, regardless of whether the salary is paid in Japan or outside Japan, the salary income corresponding to the work in the foreign countries shall not be subject to national income tax in Japan.

Directors are subject to the national tax income even for the work in the foreign countries as well as the work in Japan.

Onshore payment

Generally speaking, when an employee is classified as a non-resident, the salary income corresponding to their work in Japan shall be subject to 20% (plus the special reconstruction tax at 2.1%) as withholding tax.

Offshore payment

If the salary income received by a non-resident is sourced in Japan and if the salary is paid outside Japan, the salary payer will not be obliged to withhold individual income tax. Instead, the employees are required to file their tax returns in the form of a quasi-final tax return on an annual basis and shall pay Japanese income tax at the rate of 20% (plus the special reconstruction tax at 2.1%) on the salary income sourced in Japan by March 15 in the following year.

Please note that, if a tax treaty specifies the definition of income, a reduced tax rate or no tax, the tax treaty has priority over the domestic law.

Exit tax

Exit tax regime has been implemented since July 1, 2015. When certain residents who have share stocks valued at 100 million yen or more depart from Japan, capital gains of the stocks are recognized as deemed taxable income and taxed at the applicable tax rates (plus the special reconstruction tax at 2.1%) even if the gains are unrealized.

10.3 Deductions and credits

Deductions and exemptions

In computing taxable income, an individual is entitled to certain allowances and deductions for national income tax purposes. A resident tax payer is entitled to a basic personal deduction, exemptions for a dependent spouse, children aged at 16 or older, etc. Special exemptions also exist for the disabled. Similar exemptions and deductions are available for the purposes of the local inhabitant tax.

Social insurance premiums paid to the Japanese Government or similar are fully deductible, and life insurance premiums paid to insurance companies may be deducted up to 40,000 yen. Taxpayers may also deduct earthquake insurance premiums of up to 50,000 yen.

Medical expenses and contributions to charities qualified by the Minister of Finance are partially deductible. For the latter, the first 2,000 yen in qualifying 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 2 million yen after deducting the lower of 5% of gross taxable income or 100,000 yen.

Foreign tax credit

Foreign income taxes paid by residents may be credited against their Japanese tax. The principle is the same as for the corporation tax.

Reporting requirements

Statement of exercise for stock options

Corporations which exercise stock options are required to submit the report which provides names and addresses of the exercisers, numbers of shares, paid amounts and other to the Tax Office by January 31 of the following calendar year.

Statement of economic benefits given by foreign parent companies

Corporations whose directors or employees are given economic benefits (e.g. SO, RSU, ESPP) by foreign affiliated company (e.g. parent companies) are required to submit a report which provides name and address of the parent

company, names and addresses of the directors or employees, amounts of economic benefits and other to the Tax Office by March 31 of the following calendar year.

Statement of property in overseas

Certain residents who have the properties totaling over 50 million JPY in overseas as of December 31 are required to submit the report which indicates the details of the properties in the Tax Office by March 15 of the following calendar year.

Statement of property and debt

Individuals who meet all of the following conditions are required to submit a report which includes the details of properties and debts to the Tax Office by March 15 of the following calendar year.

- Filings of income tax returns are mandatory,
- Taxable income over 20 million yen, and
- Properties totalling over 300 million yen or particular securities over 100 million yen as of December 31

11. Indirect and Other Taxes

11.1 Consumption tax

Introduction

Generally speaking, the Japanese consumption tax system may be comparable to the European value added tax (VAT) system. The Japanese consumption tax liability vis-à-vis the tax authorities arises only to taxable enterprises, and the consumption tax liability due by a taxpayer is basically calculated at the output consumption tax minus the input consumption tax. The Japanese consumption tax rate is currently a flat rate of 8% (6.3% for national and 1.7% for local tax). The tax rate has been forecasted to increase to 10% (7.8% for national and 2.2% for local tax) in the future, while a reduced tax rate will be introduced at 8% (6.24% for national and 1.76% for local tax) for certain foods and newspapers.

Registration (taxable entity/entrepreneur)

Under the Consumption Tax Law, it depends on the taxable income amount in the two previous fiscal year ("basic year") or the first 6 months of previous year ("specific period") whether the company or entrepreneur is obliged to register with the consumption tax. The threshold is 10 million yen, although all businesses are still entitled to be registered on a voluntary basis. Once the business decides to register with the consumption tax voluntarily, however, it cannot be changed for two years.

When a new company is incorporated and its initial paid-in capital is 10 million yen or more, or the paid-in capital is 10 million yen or more at the beginning of the fiscal year, they are subject to the consumption tax registration in the fiscal year if there is no basic year or specific period. Besides, even if the company which is incorporated on or after April 1, 2014 has paid-in capital of less than 10 million yen, as far as the company is owned more than 50% by the holding company whose taxable sale is more than 500 million yen in the basic

year, the new company is required to be registered with consumption tax.

The consumption taxpayer is a seller, a lesser of the assets or a service provider. Therefore, not only Japanese enterprises but also foreign enterprises can be a consumption tax payer, if the transaction takes place in Japan, except for certain exempted transactions.

Calculation

Broadly speaking, the output consumption tax is a consumption tax charged to and received from a consumer or enterprise in exchange for the transfer of assets, leasing of assets or provision of services in Japan. Input consumption tax is, on the contrary, a consumption tax charged by and paid to an enterprise in exchange for the transfer of assets, leasing of assets or provision of services in Japan. If the output consumption tax exceeds the (deductible) input consumption tax, the excess is generally payable to the tax authority, while if the (deductible) input consumption tax exceeds the output consumption tax, the excess is generally refunded. Very detailed and complex rules exist which stipulate as to the calculation of consumption tax liability.

Electronic cross-border services (reverse charge mechanism)

The provisions of electronic services from overseas have new regimes since October 1, 2015 and apply to the two categories; business-to-business (B2B) and business-to-customer (B2C). As for the provision of B2B electronic services such as digital content distribution, distribution or use of software, advertising via internet, etc., so-called a "reverse charge mechanism" has been introduced where the Japanese business who receives the electronic services from foreign business is required to realize the output tax by themselves and may take a credit against the input tax according to the taxable ratio, in principle. The foreign business is obliged to notify to the Japanese business as the B2B electronic service provider.

As for foreign businesses who provide B2C services to customers or businesses in Japan, the foreign businesses are liable to declare and pay the output tax even if there is no permanent establishment. However, as far as the foreign businesses are voluntarily registered as the B2C service providers at the National Tax Agency, then the customers may take a credit.

As for services related to entertainment and sports provided by foreign businesses, the Japanese businesses receiving the services in Japan are liable to declare the tax through the reverse charge mechanism.

Bookkeeping system

Japan does not only rely on invoicing when no consumption tax identification number is available, but bookkeeping is crucial to identify consumption tax on each transaction. Each transaction should be categorized into; taxable, non-taxable, exempt or out of scope. Import (input) consumption

tax should also be identified and recorded at its actual amount. All businesses which are registered for consumption tax should keep accounting records to cope with the Consumption Tax Laws.

Filing and payment

Unless a special (and very rare) application is made, in the case of a corporation, the fiscal period for consumption tax purposes coincides with the fiscal year for corporate income tax purposes. The consumption tax returns should be filed with the tax authorities within two months after the end of the relevant fiscal period (no extension available). Any consumption tax liability shown in the consumption tax return should be paid by the same deadline as that of the consumption tax returns filing. A consumption tax refund, if any, is made only after the filing of the consumption tax returns, and it generally takes a few months from the filing of the consumption tax returns before the refund is made.

Interim consumption tax payments may be required semi-annually, quarterly or monthly, depending on the amount of the consumption tax liability for the immediately preceding fiscal period.

11.2 Inhabitant tax

Corporate inhabitant tax

Corporations pay corporate inhabitant tax to prefectures and municipalities on their taxable income. If the corporation is located in the 23 wards of Tokyo, the local tax returns must be filed only with the Bureau of Taxation of Tokyo. In other cases, the tax returns must be filed with both of the prefectures and municipalities.

Tax rate:

1. Per income levy: For the 23 wards of Tokyo, a rate of 12.9% is applied on the national corporation tax amount (for the corporation whose paid-in capital is more than 100 million yen, or the corporation tax amount is more than 10 million yen, 16.3% is applied). If the corporation has no corporation tax for the business year, no income-based tax is levied.
2. Per capita levy: The amounts of per capita levy in a business year are fixed amounts. The standard tax rate varies according to the capital amounts and the number of employees. In the case of a company whose capital is 10 million yen and number of employees is not more than 50, the per capita tax is 70,000 yen (depending on the municipality). The per capita levy will solely depend on the head office's capital and the maximum per capita tax is 3,800,000 yen. Even a company with a deficit is subject to a per capita levy.

Many tax rate renewals have occurred almost every year.

Individual inhabitant tax

Payers of employment income are required to submit a report on the employment income, subjected to withholding income tax for the preceding year, in respect of directors and employees as of 1st of January of the current year, to the appropriate offices of the municipalities in which the officers and employees resided as of that date.

The municipal offices are to assess inhabitant tax to be collected from the directors and employees in 12 equal installments, from June of the current year to May of the following year. The payers of the directors' and employees' salaries are then required to deduct from monthly salaries the amount of each installment and pay it to the municipalities.

11.3 Business tax

Business tax is levied on all corporations by the prefectures. The tax is based on income, and a corporation in deficit is not levied unless it is subject to size-based corporate tax. Business tax is deductible for corporate tax purpose.

Tax rate:

For taxable income of not more than 4 million yen	3.65% (*3.4%)
For taxable income of more than 4 million yen and not more than 8 million yen	5.465% (*5.1%)
For taxable income of more than 8 million yen	7.18% (*6.7%)

*For Tokyo, these tax rates are applied to the corporation whose paid-in capital is 100 million yen or less, and taxable income is 25 million yen or less.

For the fiscal years starting from April 1, 2017 onward, the following rates will be used.

For taxable income of not more than 4 million yen	5.25% (5.0%)
For taxable income of more than 4 million yen and not more than 8 million yen	7.665% (7.3%)
For taxable income of more than 8 million yen	10.08% (9.6%)

The tax rates above are the maximum rates and the actual rate depends on each prefecture.

Size-based corporation tax:

Tax payers are corporations (including foreign companies) with paid-in capital of more than 100 million yen. It is based on not only income but also capital and added value (i.e., salaries, rent, and interest). The rate is shown below.

Size-based corporate tax rate (Tokyo):

Per income according to the amount of income	0.395–0.88% (*1.995–3.78%)
Per capital	0.525%
Per value added	1.26%

*For the fiscal years starting from April 1, 2017 onward, the above rates in blanket will be used.

Special local corporate tax:

Special local corporate tax has been imposed for the fiscal years starting on or after October 1, 2008. Tax revenue from the special local corporate tax has been relocated by the national government to local governments, in order to decrease the gap in tax revenue between urban and rural areas. The business tax rates before the reduction are almost the same as the sum of the reduced business tax and the special local corporate tax. This is a temporary measure until an overhaul of the tax system is implemented at a future date and is announced to be abolished for the periods starting on and after April 1, 2017.

Special local corporate tax rate:

Tax base	Paid-in capital of 100 million yen or less	Paid-in capital in excess of 100 million yen
Taxable income × Standard rate of business tax	43.2%	67.4%

11.4 Registration 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 tax rates vary according to the value of the property.

11.5 Stamp duty

Stamp duty is imposed on certain taxable documents such as deeds and contracts. The levy is either based on the value involved or a flat rate. The maximum stamp duty liability is generally 600,000 yen per document.

11.6 Annual property tax or depreciable asset tax

Generally, the annual property tax ("Kotei-shisan-zei") and the depreciable assets tax ("Shokyakushisanzei") are payable on land, buildings, ships, aircraft or other kinds of depreciable

assets by its registered owner as of January 1 of each year. Property tax is levied by one or more local governmental bodies within the territory of which the property in question is located or based. "Registered owner" means the person registered as the owner of the property in the registration book maintained by a national juridical office or local governmental bodies. Depreciable assets are not subject to registration. However, depreciable assets tax is levied on the owner whether it has a permanent establishment or not.

Regarding depreciable assets tax, the owner must report his depreciable assets to the local governmental bodies in January every year. Other than the depreciable assets such as land and buildings, the local governmental bodies calculate the tax amount and inform it to the owners. The annual property tax rate is 1.4%.

When an owner has land worth less than 300,000 yen, buildings less than 200,000 yen, or depreciable assets amounting to less than 1,500,000 yen within a territory, property tax shall be exempted.

11.7 Inheritance and gift tax

Inheritance tax

Inheritance tax is levied on the heirs and legatees who acquire property by inheritance or bequest. An individual domiciled in Japan is subject to tax on all properties, regardless of the location. An individual not domiciled in Japan is, in principal, taxed only on the property located in Japan at the time of the decedent's death as long as the decedent is not domiciled in Japan. However, a Japanese national not domiciled in Japan is subject to inheritance tax on all inherited properties, regardless of the location.

The basic estate allowance is 30 million yen plus 6 million yen per legal heir. Spouses are entitled to a higher allowance, which depends on the estate and the spouses' share.

The rates rise in bands from 10% on the first 10 million yen to 55% on the excess over 600 million yen.

Gift tax

Gift tax is levied on individuals receiving gifts from other individuals. A donee domiciled in Japan is taxable on all gifts of property, regardless of their location. A donee not domiciled in Japan is, in principle, taxable only on gifts of the property located in Japan at the time of the gift as long as the donor is not domiciled in Japan. However, a donee who is a Japanese national not domiciled in Japan is subject to tax on all gifts of property, regardless of the location.

An annual exemption of 1,100,000 yen applies.

11.8 Withholding tax

Withholding at source

In contrast to self-assessed income tax, which is levied on the income of individuals or corporations, withholding income tax is assessed against payments made either by an individual or a corporation. Income subject to withholding income tax

is determined in accordance with the tax classification of the recipient of that income: whether an individual is a resident or non-resident, whether a corporation is domestic or foreign, and furthermore, if the corporation has a permanent establishment within Japan.

Payment of withholding tax

Individuals or corporations whose income is subject to withholding tax owe the tax withheld at source. The payer is obliged to pay the tax on behalf of the payee no later than the 10th day of the month following the month in which the income was paid, in principle. On the other hand, generally speaking, when a payment is made from out of Japan and a payer with a domicile or business office in Japan pays the income to a non-resident individual or a foreign corporation in another country, the withholding tax may be paid by the last day of the month following in which the income was paid.

Resident individuals and domestic corporations (as recipients)

The incomes which make up the taxable income for residents are quite similar for resident individuals and domestic corporations; the only main difference being that income such as salaries are specifically related to an individual.

Resident individuals

Payments made in Japan of the following income to residents are subject to withholding at source:

1. Interests on bonds and saving deposits, etc.
2. Dividends
3. Salaries, wages, bonuses and similar compensation
4. Retirement allowances
5. Certain compensation, fees, etc., to persons other than employees
6. Others

Domestic corporations

When a domestic corporation shall receive the following income within Japan, the withholding tax is levied:

1. Interests on bonds and savings deposits etc.
2. Dividends
3. Distribution of profit to a domestic silent partner under a TK (Tokumei Kumiai) contracts
4. Others

Non-resident individuals and foreign corporations (as recipients)

Non-resident individuals and foreign corporations are subject to withholding tax at the rate of 10–20% (the special reconstruction tax regime was introduced due to the North

Japan earthquake in 2011, the tax rate shall be increased by 2.1% until 2037) on the payment of various Japanese source incomes. However, if a tax treaty is applicable, the tax treaty has priority over the domestic law, resulting in a reduced tax rate or no tax.

Non-resident individuals

Generally, payments made in Japan on the following income to non-resident individuals are subject to withholding at source (the special reconstruction tax regime was applied to non-residents in addition):

1. Interest

Interest derived from a loan whose proceeds are utilized for business conducted in Japan is subject to a withholding tax at 20%.

2. Dividends

Dividends from Japanese corporations paid to non-residents are subject to withholding tax at a rate of 20%.

3. Royalties

Royalties received from those who operate business in Japan are subject to the basic withholding tax rate of 20%.

The following are income items which are subject to withholding tax and the rates under the domestic law:

	Person having PE in Japan		Person without PE in Japan	Withholding
	Person having an office, etc., in Japan	Person continuously engaged in construction or assembly in Japan over one year or doing business through a designated agent in Japan		
Business income			Exempt	N/A
Income from the management,ownership of assets				N/A
Income from transfer of land,etc.				10%
Other domestic sourced income				N/A
Consideration for personal service business				20%
Rent on real property				20%
Interests (*1)		Domestic-sourced (*2)	Separate withholding taxation	15%
Dividends				20%
Interest on loans				20%
Royalties				20%
Prices for advertising promotions				20%
Annuity payments				20%
Benefit compensation for periodical deposits				15%
Distribution of profit based on the silent partnership agreement				20%
Salary,other fees,pension,retirement benefit,etc.				20%

*1 applied to interest on deposit, etc.

*2 subject to self-assessed income tax

Foreign corporations

When foreign corporations are the payees, withholding tax must be deducted from the payment according to the following classifications.

a. Foreign corporations with a permanent establishment within Japan

The income of foreign corporation with a permanent establishment within Japan which is subject to Japanese withholding tax consists mainly of the following incomes:

- Interest from domestic bonds and savings deposits placed in Japan
- Dividends received from domestic corporations
- Royalties received from those who operate business in Japan, including compensation for transfers of industrial property and copyrights
- Remuneration for the transfer of real estate located in Japan
- Compensation for personal services conducted in

Japan

- Rent from real estate located in Japan
- Income arising from a Kumiai partnership
- Allocation of profit according to a TK contract
- Others

b. Foreign corporations without a permanent establishment within Japan

The incomes are the same as those for foreign corporations with a permanent establishment within Japan, except for income arising from a Kumiai partnership, etc.

Tax Rates Under Tax Treaties

Interests, Dividends, Royalties

Japanese withholding income tax will ordinarily be imposed on the payments of interests, dividends and royalties in a similar way for non-resident individuals and foreign companies. The normal withholding rate is 20% plus the special reconstruction tax 2.1% of Japanese income tax in general, however, reduced tax rates may be available under Japan's tax treaties for

foreign investors and companies not having a permanent establishment in Japan. In order to obtain the reduction (or exemption) of the Japanese withholding tax under the tax treaty, the recipient should, before the date of payment, submit an application form for the relief from the Japanese income tax to the chief of the relevant district Tax Office through the payer of the income.

Tax rates

The rates of withholding tax under the respective tax treaties are set out in Chapter 9.10. Note that these are only general rates and that different rates or exemptions may apply in specific cases. Tax treaties are continually being updated, so that it is recommended to check the latest treaty each time.

Reporting requirements

Corporations or entrepreneurs that pay salary, retirement fee or others are required to file certain reports to the Tax Office by January 31 of the following calendar year. In addition to including the names and addresses of payer and payees, amounts of transactions and withholding tax, the report should include the following:

1. Statement of salary
2. Statement of retirement fee
3. Statement of professional fee
4. Statement of rent fee for real estate
5. Statement of interest for non-resident
6. Statement of royalty for non-resident

12. Labor Regulations

12.1 Introduction

In Japan, the laws concerning the welfare of employees are set forth by the Ministry of Health, Labor and Welfare. Some of the laws which protect the rights of employees are represented by Labor Standards Act, Worker's Accident Compensation Insurance Law, Welfare Pension Law, National Health Insurance Law, National Pension Act, and Employment Insurance Act.

12.2 Rules of employment

Entities continuously employing 10 employees or more are required to draw up rules of employment and submit those rules of employment to the local Labor Standards Inspection Office. Once submitted, the rules of employment have the same legal force as labor contracts as long as the contents meet the standards of the Labor Standards Act. Rules of employment are regulations within the workplace which describe the working conditions such as working hours and wages as well as the regulations that the employees must follow while they are on duty. Although it is not mandatory for the entities with fewer than 10 workers to create such rules, they are encouraged to do so. Below are some examples of information which must be included in the rules of

employment.

Working hours

Time at which work begins and at which work ends, rest periods, days off, and leave.

Wages

Methods for determination, computation and payment of wages, the dates for closing accounts for wages and for payment of wages.

Resignations or dismissals

Retirement conditions (including grounds for dismissal).

12.3 Procedures in recruitment

There are many recruitment agencies which offer various services according to employers' needs. Private employment agencies often act as a matching agent, providing free career counseling to job seekers and charging recruitment fees to companies on a contingency basis. The government version of this service is known as "Hello Work," which is free of charge for both candidates and companies. Other types of services include web portals and magazines where companies can post recruiting advertisements on the Internet, and database search services where the companies can conduct a proactive search for the type of candidate they are looking for.

At the time of recruitment, employers may decide the number and types of workers as they wish. However, there are certain restrictions provided under law such as the Law on Securing of Equal Opportunity and Treatment between Men and Women in Employment, and companies may not restrict the gender of the candidates when creating job advertisements (with exceptions for specific positions). In addition, the Employment Measures Act prohibits employers from setting a limit in age when recruiting employees.

12.4 Cost of recruitment

The cost of employment varies according to the type of service used. For example, "Hello Work" services are free of charge, whereas private recruiting agencies charge fees of approximately 30% of the candidates' first year salary when the recruitment succeeds (i.e. when the employer gives an offer to the candidate and the candidate accepts such offer). The timing for the fee incurred also varies according to the type of the service since web portals, recruiting magazines and executive search services require an initial fee whereas recruiting agencies usually charge on a contingency basis.

12.5 Labor contract

Companies enter into labor contracts with each worker. The employer must notify the employees of the following working conditions in writing, on or by the date of their employment. Below are the examples of the information which must be included in such working contract.

- Term of labor contract,
- Workplace and work engaged in,
- Starting time and closing time, labor in excess of working hours, rest periods, days off, and leave,
- Methods of determination, calculation, and payment of wages, and
- Retirement conditions (including grounds for dismissal).

In most cases, the labor contract for a permanent employee will not stipulate a term of contract, and the fact that no such term exists should be stated explicitly in the contract. When the contract does stipulate a term of contract, it must not be longer than three years, with some exceptions.

12.6 Working conditions

Generally, working conditions are stipulated in both the rules of employment and the labor contracts. Some examples are as follows.

Probation period

Employers are allowed to set a probation period, generally lasting for approximately three or six months, before officially hiring an employee. The purpose of the probation period is to see if the employee is able to carry out the task they are responsible for. If the employer decides not to fully employ the employee after such a probation period, they are required to provide valid reasons and fulfill strict criteria.

Paid leave

Employers must grant 10 days of paid leave after an employee has worked for six consecutive months after their recruitment, provided that they have been present for 80% or more of the scheduled work days. Subsequent to the first six months and immediately following the first year of employment, the number of days of paid leave per year increases by an additional one day at the end of each of the next two years, and by an additional two days at the end of each of the subsequent years up to and including the sixth year, providing the employee's attendance is 80% or more of the total working days, up to a maximum of 20 days per year. The rights to annual paid leave expire two years after having been awarded.

Basically, paid leave must be taken as calculated in terms of days. However, employees are allowed to take paid leave as calculated on the basis of hours up to the number of hours equivalent to five days per year as long as a written agreement has been made either with a labor union organized by a majority of the workers at the workplace (where such a labor union has been organized) or with a person representing a majority of the workers (where such labor union has not

been organized).

Other leave

In addition to the annual paid leave of 10 days or more, companies in Japan often grant leave for the birth of a child, death of a family member, etc. Such leave includes maternity leave, childcare leave, family care leave, leave of absence to nurse a child, etc.

Wage system

Employers must pay wages directly to employees on a specified date each month (it is permissible to have more than one pay day per month). Employers are allowed to remit wages into a bank account specified by the employee where the employee has agreed to that method of payment, and may also deduct social insurance premiums, taxes and similar expenses from wages. The minimum wage is determined according to the region and industry.

Working hours, rest periods, days off

The maximum number of labor hours stipulated by the Labor Standards Law ("statutory working hours") is eight hours per day (i.e., 40 hours per week, excluding rest periods). There are some exceptions according to the type of business, such as eight hours per day and 44 hours per week maximum in the case of employees of employers in the retail and service sectors with less than 10 regular employees.

The stipulated rest period hours change according to the total work hours. For example, if an employee works for six hours, the employer must give the employee at least a 45-minute break. If an employee works for more than eight hours, the employer must give such employee at least a one hour break. Regarding days off, an employer must give employees at least one day off per week or four days off in any four week period (statutory days off). Sundays and public holidays do not necessarily have to be days off as long as it has been agreed upon between the employer and employee.

Overtime payment (and modified work hours)

When the employer has entered into a written agreement either with a labor union organized by a majority of the workers at the workplace (where such labor union has been organized) or with a person representing a majority of the workers (where such labor union has not been organized) and has notified the local Labor Standards Inspection Office, the employer may extend the statutory working hours or have workers work on statutory days off in accordance with the provisions of the agreement.

When an employee works for more than the statutory working hours, the employer must provide on overtime payment. The rate is usually 125% of the hourly wage. The rate further increases when the employee works during days off or late at night after 22:00.

Type of Overtime	Rate of increase
Work in excess of statutory working hours	25%
Work in excess of statutory working hours and more than 60 hours per month	50%
Work on statutory days off	35%
Work late at night (from PM 10:00 to AM 5:00)	25%
Work late at night in excess of statutory working hours	50%
Work late at night in excess of statutory working hours and more than 60 hours per month	75%
Work late at night on statutory days off	60%

However, small to medium-sized companies will be subject to special treatment if certain criteria are fulfilled.

It is possible to grant paid leave to employees instead of the additional 25% increase of salary for overtime work hours more than 60 hours per month. For example, if an employee works overtime for 76 hours, the hourly rates for the overtime exceeding 60 hours (i.e., 16 hours) must be raised by 150%. However, it is also possible to raise the hourly wages of those hours by only 125% and grant paid leave for the remaining portion at the regular hourly rate which would equal four hours (i.e., 25% of 16 hours).

Exceptions for managers and supervisors

Certain managers or supervisors are exempt from the usual regulations concerning working hours, rest periods and days off (except for regulations on work after 22:00). Such managers or supervisors mean persons who are responsible for management or supervision or persons who handle confidential administrative work and are closely involved in management.

Retirement allowance

Although it is not mandatory, most companies in Japan have some kind of retirement allowance system. When an employee leaves a company, the employer will make the payment according to factors such as how long the employee worked for the company and why they are leaving.

Resignations and dismissals

When an employee entering into a labor contract without definite term wishes to terminate the labor contract, the employee can do so by notifying the employer two weeks prior to the date of resignation. Even where the company sets their own rules regarding the timing of when the employee must notify the employer in advance, it will be ineffective if the stated period is unreasonable.

On the other hand, employers cannot dismiss the employee unless the dismissal has objectively reasonable grounds and is considered to be appropriate in general societal terms.

12.7 Welfare and social security

Employers are obligated to provide the following insurance to their employees (excluding part-time workers):

- Workers' Accident Compensation Insurance
- Employment Insurance
- Health Insurance and Nursing care Insurance
- Employees' Pension Insurance

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