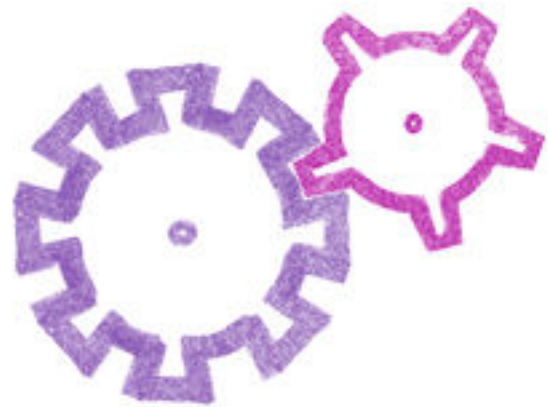


If you are planning on **doing business in Japan** knowledge of the investment environment and information on the legal, accounting and taxation framework are essential to keep you on the right track...



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Foreword

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This guide has been prepared for the assistance of those interested in doing business in Japan. It does not cover the subject exhaustively but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Japan and to obtain appropriate accounting and legal advice. This guide contains only brief notes and includes legislation in force as of September 2007.

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Country Profile

Geography and population

Geography

Japan is located in northeastern Asia between the Pacific Ocean and the Sea of Japan. The area of Japan is 377,915 square kilometers, nearly equivalent to Germany and Switzerland combined; slightly smaller than California. Japan consists of four major islands; Hokkaido, Honshu, Shikoku and Kyushu, and is surrounded by more than 6,000 smaller islands.

Many thousands of years ago these islands separated from the Asian mainland. Lying on the Pacific Ring of Fire, where the Asian and Pacific plates making up the earth's crust meet, Japan is geologically very active. There are over one hundred and sixty volcanoes in the area of which around one third are active. Mount Fuji, the highest mountain in Japan, was last active in 1707. In the past one hundred years Japan has suffered from more than twenty major earthquakes, such as the quake in Kobe in 1995 and in Niigata Prefecture in 2004. Volcanic eruptions, tsunamis and typhoons are all too familiar to the Japanese people.

Mountainous and hilly terrain account for 72.8 percent of the nation's land area. The remaining land area is made up of plateaus (11.0%), lowlands (13.8%), and inland bodies of water (2.4%). Because of this landscape, Japan's towns and cities are primarily squeezed into the coastal plateaus, with very high levels of population density.

The climate is tropical in the south and cooler in the north. Humidity is high in the western regions of the main islands, with heavy rainstorms. On the Pacific coast the weather is less extreme. Winter snowfalls are heavy in the north.

Population

In October 2005, Japan had a total population of 127,767,994 with a population growth rate of 0.02 percent. Its population density measured 336 persons per square kilometer, ranking fourth among countries with a population of 10 million or more. In 2006, Japan's total fertility rate was 1.32, partly attributable to the rise in the average age at which women bear their first child, which rose from 25.6 in 1970 to 29.1 in 2005.

Political and legal system

The Diet

Japan is a parliamentary monarchy governed by a Prime Minister and his cabinet. The Emperor lost most of his official power after WWII. The bicameral parliament is called the Diet and is composed of the upper House of Councillors (Sangi-in) and the lower House of Representatives (Shugi-in).

The House of Representatives can be dissolved anytime by the Prime Minister, in which case general election is called. Notwithstanding, the House of Councillors cannot be dissolved.

The House of Representatives holds most of the decision making power. The party which achieves a majority in the House of Representatives can nominate the Prime Minister (usually the party president), who in turn will form the cabinet, generally almost exclusively out of Diet members.

Political parties

Contrary to the UK or USA, Japanese political parties - since their creation in the late 19th century - tend to change constantly, undergoing splitting of factions, renaming and regrouping, causing utter confusion for the public. The Liberal Democratic Party (LDP or "Jiminto") is the only stable party of the last 4 decades. It has been in power since its foundation in 1958, keeping undisrupted majority control of parliament, although it required an alliance with the Komeito Party after the economic slump of the 1990's, in order to keep its control.

At the moment, the second most popular party is the newly founded Minshuto or Democratic Party of Japan (DPJ). It defeated the LDP by a single seat at the last Upper House election on 29 July 2007,.

Other parties include: the Japanese Communist Party, which maintains a constant 3% to 5% of the seats in the Diet, the Japanese Socialist Party which has almost completely disintegrated after internal dissension, the Liberal Party, and the Social Democratic Party.

Election system

The legal age for voting is 20, while the minimum age to stand for election is 25 for the lower house and 30 for the upper house. There are 242 Councillors elected for 6-year terms, and 480 Representatives elected for 4-year terms.

Both chambers are elected by a combination of proportional representation and prefectural constituencies. 96 Councillors and 180 Representatives are elected by proportional representation, and the rest by district (47 prefectures for the Councillors, 300 single-seat electoral districts for the Representatives).

Legal system

Japan's legal system has a US-style Supreme Court appointed by the cabinet. The Supreme Court presides over a legal system of lesser courts divided into four arms: High Courts, District Courts, Family Courts and Summary Courts.

Language

Japanese is the official language. Some English is spoken and understood in major cities. The Japanese writing system is very complicated and consists of three different character sets: KANJI (several thousands of Chinese characters), HIRAGANA and KATAKANA (two syllabaries of 46 characters each; together called KANA). Japanese text can be written in two ways: in the same way as Western text is written, i.e. horizontally from left to right to left, or in the traditional Japanese way, vertically from top to bottom and flowing right to left.

Dates are written YY/MM/DD. A full stop (period) is used for the decimal point, and long numbers are written with a comma (999,999,999).

Business hours/time zone

Normal business hours are 9:00 am to 5:00 ? 6:00 pm from Monday to Friday. Banks are generally open from 9:00 am to 3:00 pm from Monday to Friday. Post offices are open from 9:00 am to 5:00 pm from Monday to Friday. Some control post offices are open seven days a week.

All of Japan is in the same time zone, nine hours ahead of Greenwich Mean Time (GMT +9). No Daylight Saving Time is practiced in Japan.

Public holidays

There are 15 public holidays in Japan. If a holiday falls on Sunday, the following day is treated as a holiday. When there is a single day between two national holidays, the middle day is also taken as a holiday. During the whole or part of the second week of August, many offices and shops close (Summer Vacation). Government and other public offices as well as many companies are closed from December 29 to January 3 (New Year Holidays).

Economy

The Japanese economy had been in deflation since the late 1990s. The consumer price index has declined year-on-year for four consecutive years from the autumn of 1999 until 2003. 0.4 percent in 2000, 0.8 percent in 2001, 0.9 percent in 2002 and 0.3 percent in 2003. It is the first time that the Japanese economy had experienced such a long lasting decline in prices since the end of WWII. One cause of this deflation lied in structural factors on the supply side. Imports of low-priced textiles and consumer durable goods had been increasing at a rapid pace since 1999, and China's share of imports, among others, continues to rise. Furthermore, products that Japanese companies have produced in China and other Asian countries for importing to Japan are pushing down the prices of finished products. Weak demand from consumers and financial factors also contributed to Japan's sustained deflation.

The Japanese economy passed through a tough in January 2002 before moving into recovery. However, the world economy subsequently slowed due to the situation in Iraq, causing growth in exports from Japan to fall off and the Japanese economy to slump again at the end of 2002.

However, from the summer of 2003 onwards, corporate profits and investments in plant and equipment began to show slight improvement, and stock prices also began to recover. As of 2006 Japan's economic recovery is continuing, supported by domestic private-sector demand. The recovery trends are, however, varied among regions and types of businesses. The business conditions for small-and medium-sized businesses still remain harsh.

As of June 2007, economic improvement in the corporate sector has spread to the household sector, and personal consumption is rising slowly.

Economic growth

The real economic growth rate of Japan recorded an annual average of 4.5% from the 1970s through to the 1980s, a period of stable economic growth. In contrast, the growth rate during the 1990s remained around 1.7%. Since the beginning of the 1990s, the Japanese economy has suffered from the long and serious depression. The Japanese government reported that the economic growth rate in real terms for 1998 was -2.8 %. This negative growth rate was the first in 24 years, since the first oil shock in 1974, and its level was the worst on record in the postwar period.

According to an announcement by the Cabinet office in September 2007, Japan's gross domestic product(GDP) rose 0.6% in real terms in the April-Jun 2007 and 2.6% on an annualized basis.

The economy also achieved 3% growth in the fiscal year ended March 31, 2006. The average real GDP growth rate from 1990 to 2000 is 1.5%.

Employment Levels

The Japanese employment system played a key role in Japan's high economic growth after World War II. The system, which has helped build a society that is both stable and vigorous, was supported by 3 pillars: lifetime employment, seniority-based wages, and enterprise-based unionism. Salaries are determined mainly on the basis of duration of employment, generally going up along with age up to the forties to mid-fifties, and declining after the mid-fifties. However, since the 1990's there has been a trend to reconsider this type of salary system and to introduce a new system, which places emphasis on an employee's performance in determining the appropriate salary.

Japan's unemployment rate in 2006 was 4.1%, an improvement on the 5.4% peak in 2002.

Living standards

The standard of living in Japan is good. Wages are generally significantly higher than in other countries, although the cost of living is also higher.

Cost of living

The cost of living in Japan, especially in the major cities of Tokyo and Osaka, is high compared to other industrial countries. The cost of living in Tokyo is about the same as New York City or Hong Kong. However, outside of central Tokyo, prices of housing, food, and consumables are not greatly different from other industrial countries. It is sometimes surprising how inexpensive Japan can be.

Owning a car: This is expensive in Japan due to mandatory bi-annual inspections ("Shaken"). Cars themselves, however, can be inexpensive, with many smaller new cars available for under one million JPY(US\$9,100). Gasoline is more expensive than in North America, but cheaper than in most of Central Europe. A litre of regular gasoline is around JPY145. (about US\$1.20).

Transportation: Public transport is quicker, easier, and of course much cheaper than owning a car. You can ride on most private train lines and subways for between JPY 110 to 160 for a distance of 2 or 3 stations. There are trains and buses just about everywhere. It is customary for Japanese companies to pay for their employees' commuting costs - usually up to a maximum of between JPY25,000 to JPY40,000 per month. Taxis are relatively expensive after 11pm, as a surcharge is applied.

Housing: Japan appears to lag far behind other industrial countries in comfortable housing, especially in terms of environmental amenities and space. Generally speaking, owning a house or apartment in a metropolitan area is extremely high. Many Japanese companies pay all or part of their employees' housing rent. In Japan, the proportion of owner-occupied houses is high, especially among older people (about 80%), but the per capita area of housing is still smaller than that of the U.S. and most European countries.

Food: The cost of Japanese-style local food is generally not expensive. Local supermarkets and discount shops everywhere sell food from various countries at reasonable prices. Eating out for lunch in Japan has to be one of the best deals. You can eat a hot meal at almost any decent restaurant for around JPY1,000 (\$9.10). Dinner prices vary depending on what kind of food you eat.

Business Entities

There are a number of entities available to the foreign investor doing business in Japan. Naturally the nature of the investor's activities in Japan largely determine the entity chosen. The most common entities used include:

- Representative Office
- Japan Branch Office
- Corporate-type entity, such as:
 - KABUSHIKI KAISHA (“K.K.”: a limited stock company)
 - GODOU KAISHA (“G.K.”: a limited liability company)
- Partnership-type arrangements, such as:
 - Nini Kumiai (partnership)
 - Tokumei Kumiai (silent partnership)

Representative Office of a foreign company

Foreign companies looking to expand into Japan may initially conduct market research and other “non-commercial transactions” through an unregistered Representative Office. A Representative Office is not required to comply with government reporting or corporate registration requirements, except where the foreign company is a financial institution.

As the Representative office is not carrying on sale-type activities in Japan, and therefore not generating any income through its activities, it need not file a tax return. However, the employees of the Representative office will be liable for Japanese income taxation if they receive compensation for the rendering of personal services in Japan.

As a Representative Office is unable to engage in customer negotiations, or solicit sales, and the individual representative is held jointly and severally liable with the foreign company for any transactions, claims, or other liabilities in Japan, the entity is used primarily on a temporary basis by foreign companies that intend to establish a registered branch office or Japanese subsidiary in the near future.

Japan Branch Office

Foreign companies looking to do more than marketing or other Representative Office type activities may incorporate a branch office, as a branch office is generally able to perform sales activities without restriction. As a branch office is regarded as being the same entity as its foreign head office

from a Japanese legal and tax viewpoint its Japan source income will be subject to Japanese taxation (the effective tax rate being 42%).

While a branch is subject to Japanese corporate tax, there are some potential benefits in using a branch as opposed to a corporate entity such as a K.K. or G.K. These, along with some disadvantages are discussed in more detail in on page 10.

Establishment

The establishment of a branch requires the appointment of a representative who is a resident of Japan (no nationality requirement), and registration as a foreign company under the Corporate Law, before it can commence its business activities.

Indirect Branch Structure

Under legislation enacted in 2005, a foreign company that has its main office in Japan, or has as its main activity the carrying on of business in Japan, may not engage in commercial transactions on a continuous basis in Japan. Consequently the typical indirect branch structure historically used by foreign companies when setting up a branch in Japan may not be recognized under Japanese law.

Subsidiary Corporate Entities

There are four types of incorporated companies available under Japan's Commercial Code:

- Kabushiki Kaisha (joint stock corporation);
- Godo Kaisha (limited liability corporation);
- Gomei Kaisha (partnership corporation); and
- Goshi Kaisha (limited partnership corporation).

Kabushiki Kaisha

The most common form of corporate entity used in Japan by foreign investors is the KABISHUKI KAISHA ("K.K."). The K.K. is a limited stock corporation, meaning its shareholders are protected from liability claims made by third parties (up to their capital contribution). Prior to April 1, 2006 the minimum capital requirement was JPY10,000,000, however this was repealed under Japan's new Corporation Law.

The K.K. has a higher level of prestige in Japan than other corporate forms and further, under Japanese law, certain regulated activities (such as pharmaceutical, securities, or telecommunications) in some cases may only be performed by a K.K.

Formation

The formation of a KK requires at least one director, who must be a Japanese resident, and at least one shareholder (who can also be the director). Articles of incorporation and other registration documents are prepared and filed with the Legal Affairs Bureau. Once the registration has been processed, the K.K. may open a bank account, execute contracts, and engage in other activities as a legal entity. Capital contributions made by shareholders may be in the form of either assets or cash. Non-cash contributions for a KK require a court supervised appraisal unless one of the following applies: (i) the number of shares issued to persons who make a non-cash contribution is not more than 10% of the value of the outstanding shares, (ii) The value of the non cash contribution is JPY 5M or less, (iii) the non cash contribution is in the form of marketable securities, (iv) a qualified persons such as lawyer, CPA or licensed Tax Accountant issues an appraisal report.. Or

contributions, such as credit, are not acceptable contributions for a KK. It typically takes about four weeks to set up K.K.

Internal Structure

Japan's new Corporation Law outlines the requirements for establishing a KK, which has created a number of categories of KK, based on whether it is large or small, open or closed, listed or non-listed. The corporate governance and management structure for KKs will vary depending on whether or not the KK is open or closed, and large or small.

All KKs need at least one director who is a resident of Japan. In cases where three or more directors are appointed, a board of directors and a statutory auditor needs to be appointed.

Statutory Filings

Once the KK has been organised in accordance with the relevant corporation law requirements, the following reports need to be filed:

- Tax filing report to the relevant district tax office, and the relevant metropolitan or prefecture tax office
- Social Insurance report to the Social Insurance Office, the Labour Standards Inspection Office, and the Employment Security Bureau.

A report must also be submitted to the Minister of Finance and other Ministers having jurisdiction over the company's business activities through the Bank of Japan.

Subject to a shareholders' resolution, the KK is allowed to pay dividends at any time during the year or any number of times as long as a KK has distributable profits. However, the K.K. is not allowed to pay dividends in the case where its net assets total JPY 3M or less.

Godo Kaisha

A GODO KAISHA (G.K.) is a corporate entity loosely based on the U.S. LLC in that the liability of the investors in the G.K. is limited to their capital contribution. However, unlike U.S. LLC for US tax purposes, it is not a pass through entity for Japanese tax purposes.

Formation

Unlike the K.K. (Kabushiki Kaisha) in which those who invest are known as shareholders, investors in a GK are referred to as "members"; each member signing the GK's articles of incorporation. When there are no individual members, a management person, responsible for managing the company on the the members' behalf, need to be appointed. Articles of incorporation must be prepared and filed. Once capital contributions have been made and the registration has been processed, the company may open a bank account, execute contracts, and engage in other activities as a legal entity. Capital contributions made by members may be in the form of either assets or cash (unlike KKs, non-cash contributions do not require an inspection by a court appointed inspector), however other contributions, such as credit, are not acceptable contributions for a GK. It typically takes two to three weeks to establish a G.K.

Statutory Filings

The statutory filings for the G.K. are the same as for the K.K, listed above.

Internal Structure

The legal duties of GK managers are similar to the legal duties of KK directors. GK members may sue managers in the same way that KK shareholders may sue directors on the company's behalf.

Unlike certain types of KK, a GK is not required to establish a board of directors or hold members' meetings to manage the GK's affairs. Each member is responsible for managing the affairs of and representing the GK, however there is scope for this role to be narrowed under the GK's articles.

U.S. Tax Entity Classification

Whether GK will be treated as a separately taxed (corporate) or as a pass-through entity will depend on the tax laws of the applicable jurisdiction. For U.S. tax purposes, a GK can be treated as a default corporation that can elect to be treated as a pass-through (either disregarded or as a partnership).

Partnership Companies

In addition to K.K and G.K., Japan's commercial law provides two partnership company forms, the gomei kaisha and the goshi kaisha.

Gomei Kaisha

A gomei kaisha is a company with unlimited liability members who are jointly and severally liable for the company's liabilities.

Goshi Kaisha

A goshi kaisha is generally similar to a gomei kaisha, except that there are members with both unlimited and limited liability.

Branch versus Corporate entity

Advantages of a branch relative to company are:

- There is no requirement to appoint directors and statutory auditors for a branch, however the Branch Manager must be a resident of Japan.
- No Japanese withholding income tax is applicable to the remittance of branch profits to its head office. In the case of a company, dividends remitted overseas (including liquidation dividends) are subject to Japanese withholding tax at 20% or reduced tax treaty rates.
- Additional tax on undistributed profits of a family company (see “What taxes are there on distribution?” on page 23) is not applicable to a Japan branch of a foreign company.
- Charging head office expenses to a branch is allowed as long as such expenses are related to the branch’s business.

Disadvantages of a branch relative to a company are:

- Financial statements of the foreign company as a whole in addition to financial statements of the Japan branch itself are required to be submitted to the tax office.
- Per capita inhabitant tax (see “What taxes are there on income?” on page 21) is assessed on the share capital of the head office, leading to generally higher assessments than for a Japanese subsidiary company.
- Applicability of business scale taxation is determined based on the capital amount of the head office. So, a branch with a head office with a large paid up capital will be result in an increased business scale tax.
- Company entities (in particular the KK) have greater prestige for Japanese customers, clients and other parties than a Japan branch office.

Partnerships

Partnerships in Japan are not recognized as separate legal entities for Japanese tax purposes. Therefore, partners (kumiai-in) in a partnership (Kumiai) are taxed on the basis of the profits or losses allocated to them under such an agreement.

Partnerships fall under one of two categories: the Nini Kumiai (NK) type partnership and the Tokumei Kumiai (TK) partnership. NK-type partnerships are governed by the Japanese Civil Code while TKs are governed by Japan's Commercial Code.

NK-type Partnerships

NK-type partnerships are formed by an agreement among parties (KUMIAI-IN) whereby each partner makes an investment in the partnership and carries on a business jointly with the other partners. Such partnerships typically involve arrangements where partners jointly carry on business and together own the assets (and liabilities) of the partnership. A description of the three NK type partnerships available in Japan follows.

Nin-i Kumiai (NK)

The NK is the most commonly used NK type partnership used in Japan, with all partners jointly owning the assets within the partnership and jointly and severally liable for the partnership's liabilities. Advantages to using the NK are the partnership does not require to be registered and the NK is not limited to the kind of business it can perform.

Investment Limited Partnership (Toshi Jigyo Yugen Sekinin Kumiai or ILPS)

This partnership type is provided for under the Investment LPS Act which governs ILPSs conducting investment business. The typical ILPS consists of general partners who have unlimited liability and limited partners whose liability is limited to their capital investment. General partners are responsible for managing the partnership's business. Such partnerships need to be registered with the legal affairs bureau.

Limited Liability Partnership (Yugen Sekinin Jigyo Kumiai or LLP)

The Limited Liability Partnership ("LLP") Act which came into effect in 2005, governs limited liability partnerships. The key feature of the LLP is all partners liability is limited to their capital investment. In addition, each partner is required to be active in the management of the partnership, however unlike NKs, some restrictions are placed on an LLP's activities. Two further requirements of the LLP are it needs to submit registration with the Legal Affairs Bureau and at least one of the partners must reside in Japan (either an individual or a Japanese company).

Taxation of Partners

The taxation of a partner in NK-type partnerships will depend on whether the partner is a resident or non-resident of Japan. In the case of non-residents, their tax position will change if they have a

permanent establishment in Japan. The nature of the income earned by partners will also determine how it is taxed.

Japan Resident Partners

Japan resident partners are required to declare any income/loss generated from their partnership arrangements on their Japanese tax return, regardless of whether any actual distribution is made. The nature of the income generated by the partnership's activities will generally be retained in the hands of the individual partner, and taxed accordingly. It should be noted the introduction of a number of laws since 2005 has restricted the utilization of losses generated from partnerships.

Foreign partners without a permanent establishment in Japan

Profit distributions made to a foreign partner in an NK-type arrangement will not be subject to Japanese tax if the resident partners are not deemed to be a PE of the non-resident partner. It should be noted, given the nature of the relationship between the partners in an NK-type arrangement, the risk of the tax authorities deeming the resident partners to be a permanent establishment is significant.

Foreign partners with a permanent establishment in Japan

In such cases, the foreign partner will be required to file a Japanese tax return and pay tax at the applicable marginal rate presuming the partner is an individual. Any withholding tax paid on distributions is creditable on their tax return.

Permanent Establishment

There is no clear guidance under Japanese tax law as to whether the activities of a Japan resident partner of an NK type partnership creates a permanent establishment for non-resident partners in such partnerships. As the determination of a permanent establishment is based on facts and circumstances, each case needs to be analyzed on its own merits.

Tokumei Kumiai (TK)

A TK is provided for under Japan's Commercial Code. It consists of a TK operator and one or more "silent" or TK investors. A TK is not a legal entity for Japanese tax purposes, but rather an agreement between the TK investor and the TK operator under which the TK operator agrees to operate the business on behalf of itself and the investor. The TK investor makes a contribution to the TK operator in exchange for a percentage of the TK operator's profits or losses. Critically, the TK investor must not have any control in the management of the TK operator.

Taxation of the TK Operator

The TK operator is subject to normal Japanese corporate/income tax as a taxable entity doing business in Japan, however the TK Operator is able to claim any income distributions made to the TK investor as a deductible expense. The TK operator will report net income in the case net losses are distributed.

Taxation of TK investors

The Japanese tax implications of a TK investor may vary, depending on whether the TK investor is resident of Japan, and in the case the TK investor is a non-resident of Japan (i) whether it has a PE in Japan, or (ii) the jurisdiction in which the TK investor is a resident.

Japan resident partners

The Tokumei Kumiai profit / loss allocation is treated as normal taxable income / loss of the TK investor for the particular period in which the income / loss is received. While no withholding tax

is levied on TK profit distributions to Japanese resident partners where there are less than 10 TK investors, from January 2008, 20% withholding tax will be levied on such distributions, regardless of the number of partners. Profit / loss distributions received by the investor will be aggregated with the taxpayer's other income and taxed at the applicable marginal rate. With respect to a TK arrangement in which the investment is real estate, an active individual TK investor may be able to offset losses against other income, however a passive TK investor is prohibited from doing so. An active TK investor is one who plays an active role in the business decisions of the Japan TK operator.

Foreign partners having a permanent establishment in Japan

The profit/loss allocation from the TK to a TK investor deemed to have a PE in Japan is treated as normal taxable income/loss of the TK investor for the period in which the accounting period end date of the TK operator falls. The TK investor is required to file a tax return and pay income tax at the applicable marginal rate. The distributions from a TK to foreign partners are subject to 20% withholding tax, which is creditable for the TK investors when declaring such income in their Japanese tax returns.

Foreign partners not having a permanent establishment in Japan

A TK investor who doesn't have a PE in Japan is taxed 20% withholding on the actual distributions of the TK's profit allocations. There are no further Japanese tax obligations in respect of the TK allocations and no requirements to file a tax return in Japan. It should be noted that non-resident TK partners residing in certain jurisdictions may be able to claim a tax exemption by virtue of that jurisdiction's Double Tax Agreement ("DTA") with Japan containing an "Other income" article which provides such income is only taxable in the country in which the investor resides, meaning such TK distributions are not taxed in Japan. One example is the Netherlands-Japan DTA. While Japan's DTAs with other jurisdictions such as the US and the UK also contain an "Other income" provision, protocols to these agreements give Japan the right to impose Japan domestic withholding tax rates on such income, resulting in the 20% rate being levied.

Financing

What sources of financing are there?

- (1) Issuance of shares (public or private).
- (2) Issuance of bonds and debentures (straight or with warrant) (public or private).
- (3) Borrowings from banks, shareholders and others (secured or unsecured).
- (4) Discounting of trade notes with banks and factoring companies.
- (5) Finance leasing.

How is financing raised on the Stock Exchange?

A company that publicly offers, or makes secondary distribution of, certain securities, such as bonds or capital stocks, amounting to 100 million yen or more must file a registration statement with the local Finance Bureau prior to the offer or sale. Thereafter, this company (“public company”) must file a securities report every year. The financial statements included in such registration statements and securities reports must be audited by an independent certified public accountant or an audit corporation registered in Japan.

What kinds of financing arrangements can banks provide?

- (1) Short-term and long-term loans.
- (2) Overdraft facilities.
- (3) Discounting of trade notes receivable.
- (4) Issuance of letters of credit and stand-by letters of credit.
- (5) Various export and import finance.
- (6) Guarantees and acceptances.

What financial assistance is available from the local Governments?

Local governments of prefectures and municipalities wishing to attract certain industries to certain areas may provide financial assistance for companies, which meet certain conditions.

What other Government financial assistance is available?

The Japan Bank for International Cooperation may provide loans in syndication with commercial banks for financing exports on a long-term instalment basis, imports of certain manufactured products, etc.

Finance for certain investments is available from the Development Bank of Japan, the Japan Finance Corporation for Small Business, and other Government organizations.

Loan guarantees by the Industrial Structure Improvement Fund is available for Japanese subsidiaries or branches of foreign companies that are certified “Designated Inward Investors”.

Do Government and other agencies exist specifically to advise new investors on where and how to commence operations?

The Japan External Trade Organization (JETRO) provides certain advisory services.

Are there any exchange control regulations?

The Foreign Exchange and Foreign Control Trade Law requires foreign investors to submit the subsequent report or prior notice to the Minister of Treasury and other relevant ministers through The Bank of Japan for the following, with certain exceptions:

acquisition of shares (or equities) of a Japanese non-listed company;

acquisition of shares of a Japanese listed company if the aggregated shareholding ratio of the foreign investor in that company is or becomes 10% or more, or if acquired directly (not via a security company situated in Japan) even if the ownership ratio is less than 10%;

establishment of a branch in Japan;

making a loan to a Japanese company if;

in yen: the loan exceeds 100 million yen and has a term of more than five years, or the loan exceeds 200 million yen and has a term of more than one year

in foreign currency; the loan exceeds 100 million yen.

change of the business purpose of Japanese subsidiary or branch from the non-restricted realized business to the restricted business (see What additional permissions and notifications of the decision to commence business are required? On page 10) and vice versa;

conclusion of a licensing agreement with a Japanese company or a Japanese resident individual (only in the case of the introduction of designated technology or defined in the order concerning Foreign Direct Investment into Japan).

There is no restriction on the remittance of interest, dividends, branch profits, liquidation distributions, loan principal etc. as long as the subsequent report or prior notice was submitted at the time of the initial investment.

When remitting overseas amounts of 30 million yen or more, the form “Report of Payments etc.” must be submitted to the bank performing the remittance.

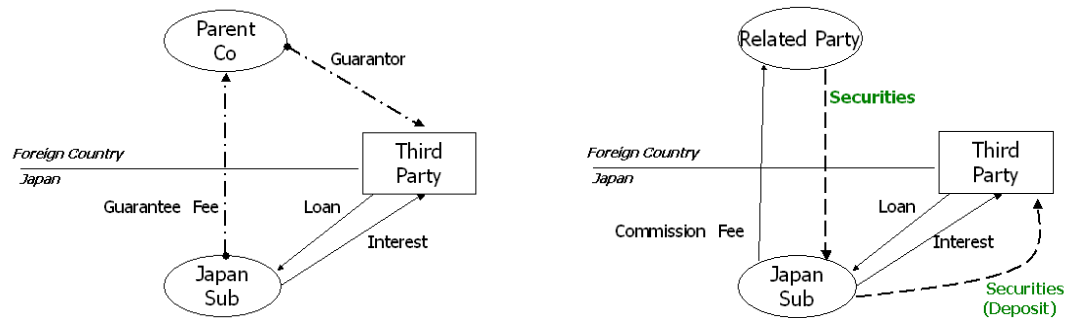
As for the required information for the subsequent report or prior notice regarding the above (1) and (3), please see List A for the case of a limited stock company, List B for the case of limited liability company and List C for the case of a Japan Branch.

Japan’s thin capitalization rules

Japan’s tax law allows corporations to treat the interest paid on debt as an expense for the purposes of calculating their taxable income. This treatment extends to debt from related foreign parties, which can be an effective means of repatriating income back to the foreign parent company. In

1992 Japan introduced its thin capitalization rules, designed to prevent taxpayers from exploiting this treatment.

Japan's thin capitalization rules apply to interest bearing loans from related foreign entities, and since April 1, 2006 loan guarantee fees and security deposit fees paid by the Japanese taxpayer to its foreign related entities.



Thin Capital Rules on Financing by non-resident parent (associated) companies

What is a foreign related entity?

For the purposes of Japan's thin capitalization rules, a foreign entity is one:

- that has a direct or indirect interest in the taxpayer of 50% or more;
- whose parent is the same as the taxpayers with the parent holding a 50% or more interest in both;
- is one that has substantial control over the taxpayer.

What is debt?

Debt is interest paid by the Japanese corporate taxpayer, including both guarantee fees paid to a foreign related party as a price for guaranteeing a loan from an unrelated third party and commission fees (i.e. rent for securities to be put as an loan deposit) paid to a related party for the borrowing of securities to be used as a loan deposit.

What is the debt to equity ratio?

The maximum amount of debt which can be obtained from a foreign related company is three times the company's equity at the time of the loan. The interest on any debt in excess of this three to one ratio is not deductible for Japanese tax purposes.

Accounting and reporting requirements applicable to companies

What business records are required to be kept under Japanese Law?

Japanese Law requires KKs to keep and maintain their books of account (general ledgers, sub-ledgers, journal etc.) and important operational and financial documents for ten years. For the GKs the period is five years.

How often must financial statements be prepared?

Japanese law requires a company to prepare financial statements for each fiscal year. The length of a fiscal year may not exceed one year. Public companies are required to prepare both interim and annual financial statements as stipulated under the Financial Instruments and Exchange Law. From April 1, 2008, listed companies will be required to disclose a summary of financial information on a quarterly basis.

How are the contents of financial statements determined?

Japanese law requires every company to prepare the following:

- Balance Sheet
- Income Statement
- The Statement of Changes in Shareholders' Equity
- Annotations for the above statements
- Business report
- Supporting schedules.

These financial statements must be prepared in accordance with Japanese Generally Accepted Accounting Principles (GAAP) and in some cases foreign accounting standards.

In addition to the above, listed companies are required to prepare cash flow statements as stipulated under the Financial Instruments and Exchange Law.

Do the financial statements have to be audited?

Japanese Company Law requires large companies to appoint an accounting auditor, which is often referred to as an external auditor, to audit their financial documents. An accounting auditor must be a certified public accountant (kaikeishi) or an audit corporation (Kansa-Hojin) registered in Japan.

Further, large companies as stated above must implement an internal audit mechanism as well as an accounting auditor which is external. Companies which elect to implement an internal audit mechanism can choose to have:

a statutory auditor (Kansa-Yaku);

a board of auditors; or

committees, which perform audit on financial documents and/or business operation.

Non-large companies have a wide range of choices with respect to governance structure, including the number of directors they may appoint.

Japan's Financial Instruments and Exchange Law requires listed companies to have their financial statements audited by a CPA or Kansa-Hojin.

Definitions

Large Company

Company whose capital stock is 500 million yen or more, or whose total amount of liabilities as of the latest balance sheet date is 20,000 billion yen or more.

Non-Large Company

Any company other than Large Companies

Listed

Any company whose shares are traded on a recognized stock exchange.

Are the books and records of an organisation open to scrutiny by anyone other than the directors and auditors?

Japanese Law provides the following;

- (1) A company must disclose to the public its balance sheet (or a summary of that in certain cases) in the Official Gazette, a daily newspaper, or on the internet.
- (2) Shareholders and creditors of a KK have the right to inspect the company's financial statements at the company's head office and branch office at any time within the company's business hours.
- (3) A shareholder who owns 3% or more of the outstanding voting shares of the company may ask to inspect the company's books and records. The company may not refuse such a request without reasonable cause.
- (4) A shareholder who owns 3% or more of the outstanding voting shares of the company may request inspection by an inspector appointed by the court concerning the affairs and financial condition of the company, based on a probable cause.
- (5) The tax authorities (and regulatory authorities in the case of regulated businesses) may examine books and records of a company.

Must the organization's accounting year end on a particular date?

No, except for banks, insurance, and other regulated companies of which accounting years are stipulated by the relevant laws.

In which language are business records required to be maintained?

Although there are no legal provisions, keeping business records in Japanese is expected. Keeping accounting records in English is accepted practice for foreign companies.

Can the accounting records be kept in a foreign currency?

No. Accounting records must be kept in Japanese yen.

Can financial statements be presented in a foreign currency?

No. Financial statements prepared on a statutory basis must be presented in Japanese yen.

Can the accounting records be kept on a computer?

Yes, if permission is obtained from the tax office to do so.

Accounting and reporting requirements applicable to branches

What accounting and reporting requirements apply to branches?

- (1) A foreign company, which has a Japan branch, must attach the financial statements of the Japan branch as well as those of the company as a whole to the Japanese corporate tax return to be filed each fiscal year.
- (2) A foreign company which conducts banking, insurance, or other regulated business must prepare financial statements for the Government in compliance with the relevant laws governing such industries. There are no accounting and reporting requirements applicable to a branch that conducts non-regulated businesses.

Are the branch's business records open to scrutiny by anyone?

- (1) A foreign company which is similar in legal terms to a KK must disclose to the public the balance sheet in the Official Gazette, a daily newspaper or on the internet after approval of the balance sheet has been given by its shareholders.
- (2) Tax authorities (and regulated authorities in the case of regulated businesses) may examine the branch's business records.

Corporate taxation

Japan tax law follows standard principles in that a taxpayer's taxable income is its gross revenues less its expenses.

What taxes are there on income?

Japanese companies are subject to corporation tax (national tax), inhabitant tax (prefectures and municipalities) and enterprise tax (prefectures).

Corporation tax

<u>Company with capital of:</u>	<u>Annual taxable income bracket</u>	<u>Applicable tax rate</u>
(A) 100 million yen or less	0 to 8 million yen	22%
	Over 8 million yen	30%
(B) Over 100 million yen	All income	30%

Inhabitant tax

Inhabitant taxes are computed as a percentage of corporation tax within the ranges shown below.

Prefecture	5.0%	to	6.0%
Municipality	12.3%	to	14.7%
Total	17.3%	to	20.7%

In addition to the above per income tax, the following per capita taxes are assessed as part of Inhabitant tax.

Sum of share capital and capital reserve	Number of employees	
	50 or less	More than 50
(Unit: million yen)	(Unit: JPY thousand)	
0 to 10	70 to 80	140 to 164
10 to 100	180 to 206	200 to 230
100 to 1,000	290 to 322	530 to 610
1,000 to 5,000	950 to 1,032	2,290 to 2,640
Over 5,000	1,210 to 1,292	3,800 to 4,400

Enterprise tax

Enterprise tax is computed as a percentage of taxable income at the following rates.

<u>Annual taxable income bracket* (Unit: JPY thousands)</u>	<u>Applicable tax rates (%)</u>
0 to 4,000	5.0 to 6.0
4,000 to 8,000	7.3 to 8.76
Over 8,000	9.6 to 11.52

* The lower rates for the lower income brackets are not applicable to companies with share capital of 10 million yen or more with places of business in three prefectures or more.

For companies with share capital of over 100 million yen, the enterprise tax will be computed as follows instead of the method above.

This taxation method is called Gaikei Hyojun Kozei (GHK) or business scale base taxation. The tax base of the GHK consists of the three different factors ? net taxable income, added value and paid in capital. The tax applies to fiscal years beginning on or after 1 April 2004.

(a) Profit-based tax:

<u>Annual taxable income bracket (Unit: JPY thousands)</u>	<u>Applicable tax rates (%)</u>
0 to 4,000	3.80 to 4.56
4,000 to 8,000	5.50 to 6.6
Over 8,000	7.20 to 8.64

(b) Value added-based tax:

The standard rate of 0.48% is imposed on the taxable base of total value added, calculated according to the following formula:

$$\text{Value added} = \text{Annual taxable income (before deduction of tax loss carry forwards)} \\ + \text{Profit distributed} *$$

* Profit distributed equals the total amount of salaries, net interest payments, and a net rent payments. Salary includes remuneration, salary, wages, bonuses, retirement allowances, as well as 75% of outsourcing fees for contract labor. If the total of the salary amount exceeds 70% of the profit distributed, the excess portion is deducted from the profit distributed.

(c) Capital-based tax:

The capital-based tax is imposed on the capital amount (the total amount of the share capital and capital reserve) at the standard tax rate of 0.2%. In the case of holding companies, the amount corresponding to the book value of the capital of the subsidiaries is deducted from the capital amount. In the case of a corporation whose capital exceeds 100 billion yen, a certain ratio applies to reduce the tax amount. In the case of a corporation whose capital exceeds 1 trillion yen, the taxable base is deemed to be 425 billion yen.

Effective tax rate

The effective tax rate for companies with capital of less than JPY 100 million and annual income of JPY 8 million or more is as follows:

	<u>Applicable tax rate (%)</u>
Corporation tax	30.00
Inhabitant tax (20.7% of corporation tax)	6.21
Enterprise tax	11.52
Total nominal rate	47.73
Effective tax rate*	42.80

The effective tax rate for companies with capital of more than JPY 100 million is as follows:

	<u>Applicable tax rate (%)</u>
Corporation tax	30.00
Inhabitant tax (20.7% of corporation tax)	6.21
Enterprise tax (profit-based tax)	8.64
Total nominal rate	44.85
Effective tax rate*	41.28

* The effective tax rates are calculated dividing the total normal rate by 1.1152 or 1.0864, taking into consideration the available deduction of enterprise tax from taxable income when paid, or in the following year irrespective of payment date.

The same tax rates apply to the taxable income of Japanese branches.

What taxes are there on distribution?

Dividends received exclusion

Dividends received by a Japanese company from another Japanese company are excluded from taxable income, provided that the investor company owns 25% or more of the shares of the company paying the dividend. If the ownership ratio is less than 25%, the percentage of dividends excluded from tax is limited to 50% of the dividends received. There are transitional measures for companies with share capital of not more than 100 million yen. The dividend exclusion is also available for a branch of a foreign company.

Withholdings on distribution

Payments of dividends by a Japanese company to foreign investors are subject to Japanese withholding income tax at 20%, or at reduced rates under tax treaties. The withholding tax rate for dividends from Japanese public companies is 7% until 31 March 2008. Repatriation of branch profits is not subject to Japanese withholding income taxes.

Additional taxes on undistributed profits of family companies

A domestic “family company”, which is a domestic company, with 50% or more of its total issued shares directly or indirectly owned by three or fewer shareholders (excluding corporate shareholders who itself is not a family company) together with their relatives, is subject to an additional surtax at the following rates on undistributed income calculated for cash accounting period in excess of a designated amount (minimum 15 million yen).

<u>Annual undistributed profit bracket (Unit: JPY '000 yen)</u>	<u>Applicable tax rate (%)</u>
0 to 30,000	10
3,000 to 100,000	15
Over 100,000	20

In addition to the above, inhabitant tax is assessed at rates shown in the previous section “What taxes are there on income?” on page 21. No additional enterprise tax is assessed.

The above surtax is suspended for family companies with share capital of JPY 100 million or less.

Own capital ratio = $\frac{\text{Own capital (including loans from affiliated parties)}}{\text{Total assets}}$

What taxes are there on net wealth?

Not applicable.

What tax incentives or privileges are there?

- (1) Special depreciation in addition to regular depreciation or tax credit is available for investments in certain energy saving equipment and other designated machinery and equipment.
- (2) A Japanese company making qualified investments in designated developing areas may deduct a provision as a reserve for overseas investment losses to the extent of 30% to 100% of the investment amount. This reserve must be changed to income after the lapse of the succeeding five-year period at the rate of 20% a year. This special treatment is available until 31 March 2008.
- (3) Corporations which have implemented a training program can claim the training credit. :

Credit is limited to the lower of either:

- 25% of the increase in training costs compared with the average training cost of the past 2 fiscal years OR
- 10% of the corporation tax liability of the current year.

What loss relief is available?

Losses incurred in business years beginning on or after 1 April 2001, may be carried forward for seven years. Losses incurred in business years before 1 April 2001 may be carried forward for five years. A tax loss may be carried back only one year for corporation tax purposes. However, this loss carry-back provision is currently suspended.

Is there double taxation relief?

- (1) Dividends received from a Japanese company are excluded from the taxable income of a recipient Japanese company. See “What taxes are there on distribution?” on page 23.
- (2) A tax credit of 10% (5% to the extent total taxable income exceeds 10 million yen) of dividends received from a Japanese company is available to a resident individual.
- (3) A Japanese company and a resident individual may either deduct foreign income taxes or claim a foreign tax credit against corporation/individual income tax and inhabitant tax. In computing

a foreign tax credit, a Japanese company may include foreign income taxes paid by its first and second tier foreign subsidiaries in respect of dividends received.

Unused foreign tax credits may be carried forward for three years. A foreign tax credit is not available for a branch of a foreign company.

What local taxes are imposed?

In addition to local income tax (inhabitant tax and enterprise tax), a company is liable to other local taxes including the following:

Prefectures

- (1) Real estate acquisition tax
- (2) Automobile tax
- (3) Automobile acquisition tax

Municipalities

- (1) Fixed assets tax
Holdings of real property and depreciable assets is subject to a 1.4% to 1.7% fixed assets tax.
- (2) Business premises tax
Holdings of business premises in excess of 1,000 square meters, or with more than 100 employees, in designated city areas is subject to business premises tax based either on floor space or amount of salaries.

What taxes are there on capital transactions?

Registration and license tax

Registration and license tax is 0.7% on share capital (minimum 150,000 yen) at the time of incorporation of a limited stock company and 0.7% for registration of an increase in share capital (minimum tax amount 30,000 yen). Registrations of ownership, leaseholds rights, real estate mortgages, industrial property and other rights, directors and statutory auditors of a company and business licenses of regulated businesses are also subject to registration and license tax.

What other taxes are payable?

There are other taxes levied on a company in addition to income taxes:

	<u>National</u>	<u>Prefectural and Municipal</u>
Taxes on property	Automobile and tonnage tax	Automobile tax Fixed assets tax City planning tax Light vehicle tax Business premises tax
Excise taxes (Taxes on consumption)	Consumption tax Liquor tax Gasoline tax Local road tax Aircraft fuel tax Petroleum tax Petroleum gas tax Tobacco tax	Local consumption tax Prefectural and municipal tobacco tax Golf course tax Light oil delivery tax Bathing tax
Taxes on transactions	Registration and licence tax Stamp duty	Real estate acquisition tax Automobile acquisition tax
Miscellaneous taxes		Mine-lot tax Hunters license tax Mineral product tax

What is the due date for corporate tax returns?

Corporate tax returns are due two months after the last day of the corporate taxpayer's fiscal year, however a month extension can be obtained from the tax authorities. Therefore, a company with a fiscal year running from 1 January to 31 December needs to file its corporate tax return on or before February 28 in the following year (March 31 if an extension has been granted).

Interim tax payments

Corporate taxpayers are required to pay an interim tax payment equal to 50% of their previous year's tax liability. This payment is due on the last day of the eight month in the new fiscal year. Therefore, a company with a fiscal year running from 1 January to 31 December needs to make its interim payment by 31 August and settle its final tax liability on 28 February (31 March if an extension has been granted) in the following year.

Consumption Tax

Japan's consumption tax is levied on (i) the legal transfer (either by sale or lease) of goods or the provision of services within Japan, or (ii) the importation of goods upon their release from a bonded area.

Consumption taxpayers

A consumption taxpayer is classified as a business enterprise. A business enterprise may be an individual or a company.

Consumption Tax Rate

Consumption tax is charged at 5%.

Non-taxable transactions

Transfers of certain designated types of property/services are non-taxable under the Consumption Tax Law.

- Sales and leases of land and rights to land
- Transfers of securities
- Financial transactions: interest of loans and savings
- Sales of postage stamps and document stamps
- Government fees
- International money orders and foreign exchange
- Medical services

Exempt Transactions

Exports and most other transactions with non-residents are typically non-taxable for Japan's consumption tax. Notable examples include:

- International transportation of passengers, freight, and international communications, including the shipment and communication occurring in Japan
- Transfer of intellectual property to non-residents
- Most services for non-residents, excluding (i) the transport or safekeeping of property in Japan, (ii) the provision of food or lodging in Japan, or (iii) services provided in Japan which are similar to (a) and (b).

Registration

The threshold for mandatory payment of consumption tax is having more than JPY 10 million in taxable sales during the base period. The base period is the fiscal year two years prior to the current fiscal year. If the amount of taxable sales in the base period is less than JPY 10 million, the taxpayer must submit a notification, in order for it to be consumption tax exempt. New companies with less than JPY 10 million in paid in capital are exempt from consumption tax for the first two fiscal years. From the second fiscal year, a capital amount of the beginning of the year would be considered for this classification. However, a new company may choose to file a consumption tax return if it anticipates a refund.

Tax periods

For individuals, the consumption tax period is the calendar year. For corporations, the tax period is the company's financial year for corporate tax purposes.

Consumption Tax returns

Final returns and payments of consumption tax are due at the end of March of the following year for individual proprietors, and within two months following the last day of the tax period for corporations.

Interim Consumption Tax payments

Depending on the amount of consumption tax in the previous period, interim consumption tax returns and payments may apply to the taxpayer:

More than JPY48,000,000	11 interim (monthly) returns and payments
Between JPY4,000,000 and JPY48,000,000	3 interim returns and payments
Between JPY480,000 and JPY4,000,000	1 interim return and payment
JPY480,000 or less	No interim return or payment

Input Tax Credits

Consumption tax can be reduced by deducting taxes on purchases against taxes on sales. The taxpayer files a tax return at the time specified above with the consumption tax reduced to reflect the refund received for taxable purchases.

Simplified System

If a taxpayer has taxable sales of JPY50,000,000 or less during its base period, the taxpayer may elect to use the simplified system to calculate the amount of creditable consumption tax by submitting a notification to the authorities.

Under this simplified system, creditable consumption tax is a percentage of the payable consumption tax with respect to taxable sales. The applicable percentage depends on the category most applicable to the taxpayer's activities:

Category 1	Wholesale	90%
Category 2	Retail	80%
Category 3	Manufacturing, etc.	70%
Category 4	Others	60%
Category 5	Service Industry	50%

Once the taxpayer elects to use the simplified method, it cannot use the regular method for the two following years.

Overseas Businesses Importing goods

Imported goods are taxed when they are released from a bonded area. The tax base on imported goods is the sum of the Cost, Insurance and Freight (CIF) price, custom duties and excise taxes. The taxpayer who withdraws the foreign good from the bonded area must pay the consumption tax before being able to receive the good.

Real Estate Transactions

The sale and leasing of land are non-taxable transactions. However, transactions involving a building or other structure will be taxable. Thus, when acquiring real estate consumption tax is levied on the value of the structure, not the land it is sitting on. Businesses purchasing real estate can claim an input tax credit in such a case.

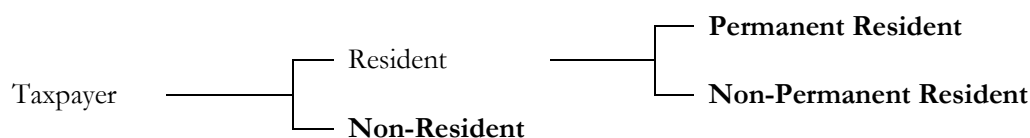
Another important real estate transaction subject to consumption tax is rental payment for commercial buildings. However, rental payment for residential buildings is not subject to consumption tax.

Individual Taxation

How an individual is taxed in Japan will depend on their tax classification, the source of their income and the nature of such income.

Individual taxpayers' classifications

Individuals are categorized as either residents or non-residents of Japan. Residents are then classified as being either non-permanent or permanent residents with the result individuals are classified as either non-resident, non-permanent resident or permanent resident, as illustrated below.



Resident

A resident is an individual whose domicile is in Japan or who has resided in Japan continuously for one year or more, and for tax purposes is further classified as being either a non-permanent resident or a permanent resident.

Non-Permanent Resident

A non-permanent resident of Japan is an individual who does not have Japanese nationality or citizenship and who has not been a resident of Japan or maintained a domicile in Japan for more than five years during the previous 10 years.

A non-permanent resident is subject to Japanese taxation on their Japan source income and any foreign source income remitted or paid into Japan.

Permanent Resident

A Permanent resident of Japan is an individual who is either a Japanese national living in Japan, or who has been a resident of Japan or maintained a domicile in Japan for more than five years during the previous 10 years.

A permanent resident is subject to Japanese taxation on their worldwide income.

Non-Resident

A non-resident is any individual who is not a resident.

Non-residents are generally subject to Japanese tax at the flat rate of 20% on their Japan source income.

For non-residents visiting Japan on a short-term basis, Japan's double tax agreements generally exempt such individuals to tax in Japan. While the provisions in each DTA are not identical, the following conditions are typical of the requirements which need to be satisfied,

- The individual is in Japan for not more than 183 days in any calendar year, fiscal year, or twelve month period;
- The individual's salary is paid by a non-resident employer; and
- None of the individual's salary is treated as a deductible expense by a permanent establishment in Japan.

Assessable Income

An individual's taxable income is defined as assessable income less deductions. Japan's tax law contains ten categories of income as listed below:

- interest income;
- dividend income;
- real estate income;
- business income;
- employment income;
- retirement income (taxed separately);
- forestry income;
- capital gains (gains realized on real property and shares are taxed separately);
- occasional income; and
- miscellaneous income.

Taxable compensation

The definition of income for Income Tax purposes includes wages, salaries, bonuses, benefits in kind and allowances if these are received as a reward for services. Shares and options received in respect of employment may also be included in the taxpayer's assessable income (see below).

Remuneration

Typically the most important element in determining an expatriate's tax liability is their employment income. Employment income commonly includes:

- basic salary;
- bonus;
- cost of living allowance;
- company housing;
- tax equalization;
- utility allowance;
- children's tuition allowance;
- share or stock options;
- home leave transportation.

In addition to the above, expatriates may continue to be covered by pension and/or profit sharing plans maintained by their head offices while they are in Japan. It should be noted that these types of benefits are typically treated as assessable income for Japanese tax purposes.

Benefits in kind

Below are the Japanese tax implications of popular benefits in kind granted to expatriates on assignment in Japan.

Company Housing

For an employee, typically 5-15% of the rent paid by their employer is included with the employee's other assessable income. For corporate officers, 50% is included with their assessable income (35% in cases where the premises are used for business purposes).

Children's Tuition Allowance

As a rule, children's school fees paid by an employer are included in the employee's assessable income. However, it may be possible for such payments to be excluded from the employee's assessable income if certain conditions are satisfied.

Moving Expenses

Reasonable moving expenses are not included as assessable income.

Home Leave Transportation

Cash provided to an employee for the purpose of returning home once a year is typically non-taxable, subject to certain conditions.

Tax Reimbursements

Payments made to cover tax liabilities are included in the employee's assessable income.

Stock Options

The tax treatment of stock options granted to employees will generally depend on whether the stock options are qualified or non-qualified.

(i) Qualified Stock Options

In order for a stock option to be treated as a qualified stock option, a number of conditions must be satisfied. The major conditions include:

- the issuing company is a K.K.
- the options are not exercised within two years of issuance
- the total exercise price is not more than JPY 12 million
- the share certificates are held by a security company or trust company

Qualified stock options are subject to Japanese tax at the time the shares are sold. The sale price less the exercise price represents a capital gain, which is taxed separately from other income at 20%.

Currently, gains made from the sale of shares in listed companies are taxed at 10% until December 31, 2008.

(ii) Non-Qualified Stock Options

Unlike qualified stock options, non-qualified stock options are taxed upon exercise and sale. At the time of exercise, the difference between the market price and the price at exercise is taxed as employment income. Second, upon sale of the share, the sale price less the market price at exercise is subject to capital gains tax at the rates given above.

Exemptions and Concessions

There are a number of benefits granted to employees which may be excluded from an individual's assessable income, including commutation allowance (the lesser of JPY100,000 or the actual commutation cost) and gifts received for long service.

Deductions against Income

A number of deductions or allowances may be made from a taxpayer's income, such as:

- deduction for accidental loss
- deduction for social insurance premiums
- allowance for a spouse
- allowance for dependants
- allowance for widow or widower
- basic allowance
- medical expenses

Foreign Tax Credit Regime

A foreign tax credit is allowed to mitigate double taxation of income when income subject to Japanese Income Tax is also subject to income taxation in another country. The Foreign tax credit is equal to the lesser of:

- (a) the amount of foreign tax paid during the taxable year; or
- (b) the amount of the foreign tax credit limitation.

$$\text{Foreign tax credit limitation} = \frac{\text{Japanese income tax for the year}}{\text{Total income taxed for year}} \times \text{Foreign-source income for year}$$

If the amount of foreign taxes paid during the taxable year exceeds the amount of the credit limitation, the excess may be carried forward three years and added to foreign taxes for credit purposes.

Taxable Income

An individual's assessable taxable income is essentially their assessable income less their claimable deductions and tax credits. An individual's taxable income is subject to tax at the following progressive rates:

Individual Tax Rates		
Taxable Income	Tax Rate	Standard Deduction
Up to JPY1,950,000	5%	JPY 0
JPY1,950,000 - JPY3,300,000	10%	JPY 97, 500
JPY3,300,000 - JPY6,950,000	20%	JPY 427,500
JPY6,950,000 - JPY9,000,000	23%	JPY 636,000
JPY9,000,000 - JPY18,000,000	33%	JPY 1,536,000
JPY18,000,000	40%	JPY 2,796,000

Inhabitant Tax Rate

Inhabitant tax is levied on an individual's taxable income at a flat 10%.

Withholding Tax

Taxpayers who receive salary income of less than JPY 20m in the fiscal year are not required to file a tax return, unless they are not paid by a Japan employer (i.e. offshore), have claimed a medical expense deduction, or their other income totals more than JPY200,000.

Due Date

Individuals must file their tax return on or before March 15th (if it falls on a holiday, then the first business day following). No extensions are granted and interest is levied on tax owing if the tax return is filed after the due date.

Compensation Structuring for Expatriates

An expatriate coming to Japan on assignment will generally enter the country as a non-permanent resident for Japanese tax purposes (unless they have resided in Japan for at least five years in the preceding 10 year period). In such cases, an offshore compensation package is an important tax-planning tool, particularly for those who work for periods on assignment outside Japan, as an outside Japan exclusion can be obtained. A salary paid from within Japan is treated as Japan source income and fully taxable in Japan, regardless of where the activities are performed.

Another potential benefit from an offshore compensation structure is there is no income tax withholding obligation in Japan. In such cases the individual is required to file an income tax return with interim tax payments being made based on the previous year's taxable income. These interim payments must be made on July 31 and November 30.

Social Insurance Programs

All residents of Japan are obliged to join the country's social insurance programs, irrespective of nationality. There are six statutory social programs for employees in Japan, separated into "Social Insurance" (health insurance, nursing care insurance, childcare allowance contribution and welfare pension insurance) and "Labour Insurance" (worker's accident compensation insurance and employment insurance). The location of the employer and the type of program will determine whether the contributions are shared by the employer and the employee or borne solely by the employer or employee.

Health Insurance

Japanese National Health Insurance provides for medical and dental care, hospitalization, medicines etc., for non-work related injuries and sickness of employees and their dependants. The premium is shared equally between the employer and the employee.

The premium for Employee's Health Insurance is 8.2% of standard regular monthly salary and bonuses and is capped at JPY 99,220 on monthly salaries of JPY 1,175,000 or more and at JPY 442,800 on annual bonuses of JPY 5,400,000 or more.

Employee's Health Insurance covers 70% of outpatient and inpatient medical expenses of employees and their dependants. This includes hospital fees, nursing care, and prescription drugs.

Nursing Care Insurance

Employees aged 40 years and older must contribute to Nursing Care Insurance.

The premium, shared equally between employer and employee, is 1.13% of monthly salary and bonuses and is capped at JPY 13,673 on monthly salaries of JPY 1,175,000 or more and at JPY 61,020 on annual bonus payments of JPY 5,400,000 or more.

Childcare Allowance Contribution

Childcare Allowance Contribution is paid by the employer only, and is currently 0.13% of salary and bonus payments made to all employees, capped at JPY 806 on monthly salaries of JPY 605,000 or more and at JPY 1,950 on bonus payments of JPY 1,500,000 or more.

Welfare Pension Insurance

Welfare Pension Insurance (Kosei Nenkin) provides pension benefits upon retirement, disability benefits, and survivor benefits in the case of death. The premium is shared equally between the employer and the employee. The premium for Welfare Pension Insurance is 15.35% of standard regular monthly salary and bonuses and is capped at JPY 95,170 on monthly salaries of JPY 605,000 or more and at JPY 230,250 on bonuses of JPY 1,500,000 or more.

In principle, a person who (a) has contributed to Welfare Pension Insurance for 25 years or more, (b) has reached 65 years of age and (c) is not employed is eligible to receive pension benefits. The benefits consist of the Old-Age Basic Pension (a fixed amount) and the Income-Related Pension. Monthly disability benefits are provided to employees who are injured from non-work related injuries or sickness after 18 months of disability (when disability benefits paid out of health insurance are terminated). Survivor pension benefits are provided to a dependent spouse or other qualified relatives in the case that the insured person dies.

Worker's Accident Compensation Insurance

The Worker's Accident Compensation Insurance provides benefits to employees who are injured or sickened due to work-related incidents while working or commuting. Employers with one or more employees must have the employees insured under Worker's Accident Compensation Insurance.

The amount of the premiums range from 0.45% to 11.8% of standard regular monthly salary and bonuses, depending on the type of work the employee is engaged in. There is no upper limit on the premium amount.

Medical expenses related to work-related accidents or illnesses are covered in full by the insurance. In the case of a permanent disability, annual or lump-sum benefits are paid based on the severity rating of the injury.

Employment Insurance

Employment Insurance provides unemployment benefits and assistance to terminated workers. All Japanese employers are required to enroll employees in the government-sponsored employment insurance program.

Both employers and employees pay employment insurance premiums, but at different rates. In most industries, premiums paid by employers are 0.9% of the employee's monthly salary and bonuses, and premiums paid by employees are 0.6% of their monthly salary and bonuses. There is no upper limit on the premium amount.

Employment Insurance provides unemployment benefits at the rate of approximately 50% of the employee's previous salary.

	Salary		Bonus	
	Employer	Employee	Employer	Employee
A. Social insurance				
Health insurance	4.1%	4.1%	4.1%	4.1%
Nursing-care insurance	0.565%	0.565%	0.565%	0.565%
Welfare pension insurance	7.675%	7.675%	7.675%	7.675%
Children Allowance	0.13%	-	0.13%	-
B. Labor insurance				
Unemployment insurance	0.9%	0.6%	0.9%	0.6%
Workers' comp	0.45%	-	0.45%	-

Other Taxes

Inheritance tax and gift tax

An heir or a donee, who was a resident in Japan as of the date of inheritance or gift is liable for inheritance tax or gift tax on all property transferred to him, irrespective of his nationality. An heir or a donee, who was a non-resident of Japan as of the date of inheritance or gift is liable for inheritance tax or gift tax only on property located in Japan transferred to him. However, if an heir or donee is a Japanese national and either the heir or donee or the deceased donor was a resident in Japan within 5 years prior to the date of inheritance or gift, the inheritance or gift of property located outside Japan is also liable for tax.

Inheritance tax is computed on the taxable value of property transferred by inheritance, after deductions including basic estate allowance (the sum of 50 million yen and 10 million yen multiplied by the number of all the heirs at law), at graduated tax rates ranging from 10% (applicable to each heir's statutory share of net assets not exceeding 10 million yen) to 50% (applicable to each heir's statutory share of net assets in excess of 300 million yen).

Gift tax is computed on the taxable value of property transferred by gift for each calendar year, after taking deductions including an annual exemption of 1,100 thousand yen, at graduated tax rates ranging from 10% (applicable to taxable gift amounts not exceeding 2 million yen) to 50% (applicable to taxable gift amounts in excess of 10 million yen).

Employment regulations and industrial relations

What kind of employment regulations exist?

Basic laws concerning employment legislation are (a) the Labor Standards Law, (b) the Labor Union Law and (c) the Labor Relations Adjustment Law. The Labor Standards Law stipulates the minimum employment conditions that employers must observe including labor contracts, wages, working hours, holidays, annual leave with pay, safety, sanitation, women and minors, accident compensation, working regulations, etc.

The Labor Union Law regulates the formation of labour unions, collective bargaining, labour agreements, etc. The Labor Relations Adjustment Law regulates restrictions and resolutions on strikes and other labor disputes.

What are customary working hours and holidays?

The Labor Standards Law stipulates that working hours must not be more than 8 hours a day and 40 hours a week. A working day from 9:00 a.m. to 5:00-6:00 p.m., with a one-hour lunch break, and a 5-day work week is common in Japan. The Labor Standards Law stipulates that an employer must give an employee at least 4 days' holiday in every 4-week period. Customary holidays are Sundays (and Saturdays in case of 5-day work week) and national holidays. In addition, annual paid holidays are given to employees based upon the company's internal working regulations or labor agreement. The minimum statutory requirement is 10 days following completion of the first six-months of service, with one day added for each of the following two years and two days added for each year thereafter of up to a total of 20 days.

Is compensation payable for redundancy?

The Labor Standards Law stipulates that when an employer discharges an employee, the employer must notify the employee of this 30 days in advance; otherwise the employer must pay the employee at least 30 days wages. Although not legally required, it is the common practice for Japanese companies to pay an employee a severance benefit when he leaves the company. The amount of the benefit is generally determined on the basis of number of years of service, current basic number of salary and whether the termination is voluntary or involuntary.

What labor organisations exist?

The Labor Standards Inspection Office supervises compliance with the Labor Standards Law. An employer with 10 or more employees is required to file the company's working regulations with the Labor Standards Inspection Office, with the opinion of the labor union or other employee representative accepting such regulations.

Are working conditions controlled?

An inspector of the Labor Standards Inspection Office may order an employer to present its books and records or inspect them at the employer's premises and question the employer or employees to investigate compliance by the employer. An employee may ask for such an investigation. Penalties including imprisonment or fines are provided for violation of the Labor Standards Law.

Are work permits required for foreign workers?

Yes. The Immigration-Control and Refugee-Recognition Law stipulates that only foreign persons who have obtained visas for (a) engaging in trade and other business or investment activities in Japan, (b) providing advanced or special technique or skills for invited organisations, (c) working as skilled laborers or (d) living permanently in Japan, may work in Japan.

Manufacturing and other trade regulations

Are manufacturing licences required?

The manufacture, sale and import of drugs requires a license from the Ministry of Health, Labor and Welfare.

Are there any controls over prices and income?

Generally no. Prices of some basic products and services, such as rice and other grains, petroleum, transportation fares, telephone and other utilities are controlled by the Government.

Is there any legislation over restrictive practices?

Anti-Trust laws prohibit private monopolies, unreasonable trading restrictions, unfair trading methods and any unreasonable restrictions on business activities by means of combination or agreement. The Fair Trade Commission supervises compliance with the law.

What other restrictions may be imposed on a company's business?

Various laws, guidance by the regulatory Government departments and various agreements including labor agreements and loan agreements may impose restrictions on a company's business.

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