April 2024

Japan TAX Guide

APO-Tax Corporation

Corporate Tax Summary

Domestic Corporations in Japan are subject to income earned all over the world.

Foreign Corporations which have registered a branch in Japan are subject to domestic sourced income as a branch is regarded as a Permanent Establishment (PE). Foreign Corporations which have not registered a branch (a representative office) are not taxed in Japan, unless they receive specified kinds of income such as interest on loans, rent of real property, and income from personal services performed in Japan.

When a Japanese subsidiary of a foreign corporation pays dividends, royalties to its foreign parent corporation, a withholding tax is imposed at 20.42%. If an international tax treaty exists between the countries, the withholding tax rate can be reduced to 5% to 15% or be exempted, subject to that filing of the application for the tax treaty is made before payment. Japan has international tax treaties with many foreign countries.

There are various kinds of taxation in Japan to prevent international tax avoidance.

Transfer Price Taxation: If transactions between foreign affiliates are not made at the arms-length price and the lower profit is recorded in Japan, the profit of the transaction is reassessed at the arms-length price and taxed. A company is required to prepare and keep the documentation opf the transfer price policies if the transaction value is more than 5 billion Yen.

Anti-Tax Heaven Rule: If a Japanese company establishes a designated tax heaven subsidiary in a lower tax burden country, the income of a designated tax heaven subsidiary must be included in the income of that Japanese company.

Thin Capitalization Rule: Interest paid by a Japanese subsidiary on debt to the foreign parent company is disallowed to the extent the average balance of debt on which the interest is paid is more than 3 times the equity of the foreign parent in net assets of the Japanese subsidiary.

Earnings Stripping Rule: This rule limits the amount of allowable deductions for net interest paid by a Japanese subsidiary on debt to the foreign parent company under certain conditions.

Under the Japanese tax rule, certain expenses such as depreciation must be booked in order to be deducted as a tax expense. If these are not booked, they are not allowed for tax purposes.

Corporate taxable income is calculated through the tax adjustment process to the accounting net income resolved at the General Shareholders Meeting (GSM). GSM should be held within 3 months after the fiscal year end. However, corporate tax due must be estimated and paid within 2 months after the fiscal year end even if the accounting net income is not resolved at the GSM. Accordingly, filing of the corporate income tax return can be extended one month by filing an extension request. If the tax due is not paid and/or the tax returns are not filed by the due date, delinquent taxes and penalties are imposed. It is quite challenging for foreign companies to meet these deadlines as the accounting income would not be fixed within a relatively short period.

Basis of Taxation

Corporate income tax is calculated as taxable income (taxable revenue minus taxable expense) times tax rate minus tax deductions. If a company chooses to file as a blue tax return enterprise, it becomes eligible for various tax privileges. The due date for the application is the earlier of the first fiscal year end or the day after 3 months from the date of incorporation.

The financial statements resolved at GSM should be attached to the corporate tax returns, but no independent audit is required on the financial statements. Accounting books and records should be prepared in Japanese yen by the double entry bookkeeping method, but there is no Japanese language requirement nor Japanese GAAP requirement. They can be prepared by other GAAP, IFRS, etc. Accounting books and records should be maintained at the headquarters in Japan for 10 years.

Certain expenses, such as depreciation, are tax deductible only when they are recorded in the accounting book. Entertainment expenses are not fully tax deductible for large corporations but can be deductible to some extent for small corporations. Director’s bonus paid on an ad-hoc basis is not tax deductible. Accrued expenses, such as accrued bonus, unused vacation, retirement remuneration and other expenses, are not tax deductible.

Local tax returns, such as inhabitant tax and enterprise tax, are filed together with the corporate income tax return. Inhabitant tax per capita is levied based on the amount of capital, regardless of taxable income. Accrued enterprise tax is not deductible from taxable income in the current year, but deductible when the tax return is actually filed the following year.

Net operating loss can be carried forward over the next 10 years subject to blue tax return filing status. Under certain circumstances, carry back of net operating loss is allowed for blue tax return enterprises.

Revenues for accounting purposes are generally taxed except for dividends received. Dividends from a foreign subsidiary are also tax exempt to some extent.

Individual Tax summary

A permanent resident is taxed on the worldwide income at a progressive tax rate from 5% to 45%. Same as corporate income tax, blue tax return filing status provides various tax privileges. Certain income, such as interest, dividends, payroll, retirement remuneration and professional fees for lawyers and accountants, are subject to withholding tax. Commutation allowance commonly paid together with payroll is exempt from tax to some extent. Individual tax is calculated on a calendar year basis and the tax return should be filed from February 16 to March 15 every year. In the case of a tax refund position, the tax return can be filed before February 16.

Payroll income tax is withheld monthly from salaries according to tax rate tables. An employer is obliged to pay the withholding tax to the tax office by the 10th of the following month. Even if the tax is withheld on a monthly basis, the annual tax due should be computed based on annual taxable income. The balance between the withholding tax paid throughout the year and final tax amount due is adjusted in the December salary every year. This procedure, called year-end tax adjustment, is obligatory for employers. However, if an employee's total income exceeds ￥20 million, the employee must file an individual tax return. Employer should report annual withholding tax information to the tax office by every January 31.

Payroll deduction items other than withholding tax are individual inhabitant tax and social insurance premiums. Individual inhabitant tax is imposed on a resident who has a domicile in Japan as of January 1. It is levied on the income earned in the previous year. The municipal office calculates the individual inhabitant tax and issues a statement to the company no later than May 31 of that year. The company is required to withhold the individual inhabitant tax over 12 months from June to May of the following year. The payment of the withholding inhabitant tax must be made by the 10th of the following month.

There are four types of social insurance in Japan. These are health insurance and welfare pension insurance (social insurances in narrow terms), and employment insurance and worker's accident compensation insurance (referred to as labor insurances). Both employer and employee bear the premiums of social insurance (narrow terms) and employment insurance nearly equally. Premiums of worker's accident insurance are paid by the employer only. Annual statutory reporting of these social insurances is required every July.

Japan's Social Security Agreement provides that employees covered by the Agreement, who work outside of their home country for periods that are not expected to exceed 5 years, are subject only to the social security systems in the home country, not those of the country of employment.

A non-permanent resident is defined as a person who has maintained a domicile or residence in Japan for five years or less during the past ten years. A non-permanent resident is taxed only on his/her Japanese source income and foreign source income paid in Japan or remitted into Japan. Japanese source income includes salaries, wages and other compensation for personnel services attributable to a period of service

in Japan (i.e., exclusion of work days outside of Japan).

A non-resident is defined as an individual who has resided or intended to reside in Japan for less than one year up to the current date. A non-resident is taxed on his/her Japanese source income only at the flat rate of 20.42%. If the total number of days in Japan is 183 days or less, a tax treaty exemption could be taken.

Consumption Tax Summary

Japanese consumption tax ("JCT", a VAT equivalent tax) was introduced in April 1989. It is categorized as an indirect tax in which almost every domestic transaction and every transaction for the import of foreign goods, with the exception of financial transactions, capital transactions, medical services, welfare services and educational services, is subject to taxation at the rate of 10%. Reduced tax rate of 8% is applied for daily necessities such as food, drink and periodical newspaper subscription.

JCT is also applied to electronic commerce such as delivery of an electronic book, music, advertisements, or cloud services that an overseas company performs outside of Japan. Transfers of goods or provision of services, etc., conducted by a company in Japan which qualifies as export transaction are exempt from the consumption tax.

If the consumption tax sales during the base period (the fiscal year before the two fiscal years prior the current year) exceed 10 million yen, a consumption tax declaration is required, but there is no need to file a tax return for the taxable period when there is no consumption tax payable.

On the other hand, if the amount of consumption tax on taxable purchases (including consumption tax on import) is greater than the amount of consumption tax on taxable sales, business entities can submit a consumption tax return for a refund.

The consumption tax return must be filed and paid within two months after the end of the fiscal year principally. However, when business entities file one month extension request of the corporate tax returns, the due date of the consumption return can also be extended for one month subject to filing of another extension request.

Consumption Tax Qualified Invoice System

On October 1, 2023, Japan fundamentally reformed the JCT with introduction of the consumption tax qualified invoice system. This tax reform serves as a turning point on the way to becoming a VAT system similar to those in Europe in the following three ways:

1. Consumption tax ID number
   Business entities wishing to become a "JCT invoice issuer" must be registered with the authorised tax office to obtain a consumption tax ID number. Only a consumption tax-eligible entity can become a JCT invoice issuer.

   If a consumption tax non-eligible entity such as a consumption tax-exempt entity wishes to become

a JCT invoice issuer, it must first file an application to become a consumption tax-eligible entity. Once an entity becomes a JCT invoice issuer, it principally cannot revert to being a consumption tax-exempt entity, even if its taxable sales for the base period fall to JPY 10 million or less.

2. JCT invoice
   Only a JCT invoice issuer can issue a JCT invoice, which must contain:
   - Name and tax ID number
   - Date of transaction
   - Transaction detail (with separate indication of items subject to the reduced tax rate)
   - Transaction amount at the applicable tax rate
   - Consumption tax amount at the applicable tax rate
   - Customer name

3. Eligibility of consumption tax credit at customers/buyers
   From 1 October 2023, a consumption tax non-eligible entity will not be allowed to issue an invoice with consumption tax. In addition, if the entity issues an invoice with consumption tax, the customers/buyers will be unable to claim the input consumption tax credit. However, there will be a transitional period to allow partial input consumption tax credit during a six-year period from October 1, 2023 to September 30, 2029.

   Just as with the present consumption tax system, in order to claim the input consumption tax credits, the customers/buyers should keep proper accounting books with the necessary information and retain the JCT invoice.

Electronic Book Preservation Act

After a two years' transitional period from the enactment, the Electric Book Preservation Act has come into force on January 1, 2024. Businesses must preserve the electronic stored information (ESI) in accordance with the Act for income and corporate tax purposes in the following manner.

1. Prevent any unauthorized corrections and/or deletions
   Businesses should prepare written administrative rules to prevent any unauthorized corrections and/or deletions of the ESI.

2. Appropriate equipment
   Businesses should be equipped with appropriate equipment to keep displays and printers in use and ensure the prompt, neat and clear output of ESI at all times.

3. Enable a search function for the ESI
   If there is no system to preserve the ESI, the following alternatives may be used to ensure that there is a search function.

   Alternative 1: Prepare a list using spreadsheet software such as excel to show (i) the date of transaction, (ii) the transaction amount and (iii) the name of customers/vendors

Alternative 2: Prepare the transaction data files using systematic file names to identify the above information (i), (ii) and (iii). The data files must be kept in the designated folder to optimize search functionality.

It is crucial that the electric transaction data can be downloaded at any time upon request by tax auditors from the revenue authorities.

Other Tax Payable

Fixed Asset Tax, Business Office Tax and Stamp Tax are other popular taxes for a company in Japan.

A company is required to file a depreciable asset report, which summarizes depreciable assets held as of January 1 every year, to the municipal tax office by every January 31.
The municipal tax office calculates the Fixed Asset Tax and issues a statement to the company.

Business Office Tax is levied on companies located in big cities such as Tokyo and Osaka. If a company in such big cities qualifies for a certain threshold of size of office space (square meter) and number of employees, the Business Office Tax return should be filed to the municipal tax office within 2 months after the fiscal year end.

Stamp Tax is paid by affixing and cancelling a stamp on the taxable documents (various contractual agreements, promissory notes, articles of incorporation, etc.) which are listed in the Stamp Duty Act.