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Japan TAX Guide

APO-Tax Corporation

Corporate Tax Summary

Domestic corporations in Japan are subject to taxation on their worldwide income.

Taxation of foreign corporations depends on their presence and activities in Japan. If a foreign corporation has registered a branch in Japan, it is subject to taxation on domestically sourced income, as the branch is regarded as a permanent establishment (PE). If a branch has not been registered, the corporation is not subject to tax unless it earns Japanese-source income, such as interest on loans, property rental, or personal services performed in Japan.

When a Japanese subsidiary of a foreign corporation pays dividends or royalties to its foreign parent corporation, a withholding tax of 20.42% applies. If a tax treaty exists between Japan and the parent company's home country, the rate may be reduced to between 5% and 15%—or even exempted—provided the company files the Application Form for Income Tax Convention before payment. Japan has international tax treaties with many countries.

To prevent international tax avoidance, Japan has implemented various types of taxation. These include:

Transfer Price Taxation
If transactions between a Japanese corporation and a foreign affiliate are not conducted at an arm's-length price, and the resulting profit recorded in Japan is lower than it would have been under arm's-length conditions, the profit may be reassessed and taxed at an arm's-length price. A company is required to prepare and retain transfer pricing documentation if the total value of transactions with foreign affiliates exceeds ¥5 billion.

Anti-Tax Haven Rule
If a Japanese company establishes a designated tax haven subsidiary in a low-tax jurisdiction, the income of the subsidiary must be included in the income of the Japanese company.

Thin Capitalization Rule
Interest paid by a Japanese subsidiary on debt to its foreign parent company is not deductible to the extent the average balance of such debt exceeds three times the foreign parent's equity in the net assets of the

Japanese subsidiary.

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

Under Japanese tax law, certain expenses, such as depreciation, must be recorded in the financial statements to be deductible. Expenses that are not recorded are not allowed as tax deductions.

Corporate taxable income is calculated by adjusting the accounting net income that is approved at the General Shareholders Meeting (GSM). The GSM should be held within three months after the end of the fiscal year.

However, corporate tax must be estimated and paid within two months after the fiscal year-end, even if the GSM has not yet been held and thus the accounting income has not been approved. Filing of the corporate tax return may be extended by one month if an extension request is submitted.

If the tax due is not paid or the tax return is not filed by the deadline, delinquent taxes and penalties are imposed. It is quite challenging for foreign companies to meet these deadlines, as accounting income is often not finalized within such a short period.

Basis of Taxation

Taxable income of ordinary corporations in Japan is subject to both national corporate income tax and local taxes, including inhabitant tax and enterprise tax. Corporate income tax is calculated by applying the applicable tax rate to taxable income (taxable revenue minus taxable expenses), and then subtracting any allowable deductions.

The standard corporate tax rate is 23.2%. However, for small and medium-sized enterprises with stated capital of less than ¥100 million, the first ¥8 million of annual income is subject to a reduced rate of 15%.

Under the 2025 tax reform, an additional 4% tax—referred to as the “defense enhancement tax”—will be imposed on corporate income tax for fiscal years starting on or after April 1, 2026.

Local taxes include the inhabitant tax, which consists of a corporate levy and a per capita levy. In Tokyo, the inhabitant tax is levied at a rate of 10.4% on national corporate tax, while the enterprise tax is imposed at a rate of 7.48% on taxable income.

In addition, corporations with capital exceeding ¥100 million are subject to size-based corporate taxation.

The financial statements approved at the GSM must be attached to the corporate tax returns, but no statutory independent audit is required on the financial statements unless the company meets certain size thresholds.

Accounting books and records must be prepared in Japanese yen by the double-entry bookkeeping method. There is no requirement to use Japanese language or Japanese GAAP. Records may be prepared using other accounting standards, such as IFRS or other GAAP variants. Accounting books and records should be maintained at the headquarters in Japan for 10 years.

Certain expenses, such as depreciation, are tax deductible only if they are recorded in the accounting books. Entertainment expenses are not fully deductible for large corporations but may be partially deductible for small corporations. Bonuses paid to directors on an ad hoc basis are not deductible. Accrued expenses—such as bonuses, unused vacation, retirement allowances, and similar items—are not tax deductible.

Local tax returns for inhabitant tax and enterprise tax are filed together with the corporate income tax return. The per capita portion of the inhabitant tax is levied based on the amount of stated capital, regardless of taxable income. Accrued enterprise tax is not deductible from taxable income in the current year, but becomes deductible in the following year when the tax return is filed. As a result, the effective tax rate for ordinary corporations (in Tokyo) is approximately 34.59% (35.43% after the defense tax increase goes into effect).

If a company chooses to file under the blue tax return system, it becomes eligible for various tax benefits. The application must be submitted by the earlier of the end of the first fiscal year or within three months from the date of incorporation.

Net operating loss may be carried forward for up to 10 years, provided the company maintains blue tax return status. In certain cases, carry-back of net operating losses is allowed for blue tax return filers.

Revenue recognized for accounting purposes is generally subject to corporate tax, with the exception of dividends received. Dividends from a foreign subsidiary are also tax exempt to some extent.

Individual Tax Summary

A permanent resident is taxed on worldwide income at a progressive tax rate from 5% to 45%. Similar to corporate taxation, individuals filing under the blue tax return system are eligible for various tax benefits.

Certain types of income—such as interest, dividends, salary, retirement benefits, and professional fees for lawyers and accountants—are subject to withholding tax. Commutation allowance, commonly paid together with salary, is partially tax exempt.

Individual tax is calculated on a calendar-year basis, and tax returns should be filed from February 16 to March 15 each year. If the taxpayer is in a tax refund position, the return may be filed before February 16.

Payroll income tax is withheld monthly from salaries according to tax rate tables. Employers are required to remit the withheld tax to the tax office by the 10th of the following month.

Although tax is withheld each month, the final annual tax liability is determined based on the total taxable income for the year. The difference between the total tax withheld and the final tax due is adjusted in the December payroll through the year-end tax adjustment, which is mandatory for employers.

However, if an employee's total income exceeds ¥20 million, the employee must file an individual tax return. The employer must also report annual withholding tax information to the tax office by January 31.

In addition to income tax withholding, payroll deductions include 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 and is based on income earned in the previous calendar year.

The municipal office calculates the Individual Inhabitant Tax and issues a statement to the company by May 31. The company is then required to withhold the tax in equal installments over 12 months, from June to May of the following year. Withheld inhabitant tax must be paid to the municipal office by the 10th of the following month.

There are four types of social insurance in Japan: Health Insurance and Welfare Pension Insurance (referred to as "Social Insurance" in the narrow sense) and Employment Insurance and Worker's Accident Compensation Insurance (collectively referred to as "Labor Insurance").

Premiums for Health Insurance, Welfare Pension Insurance, and Employment Insurance are shared nearly equally between employer and employee. However, premiums for Worker's Accident Insurance are paid entirely by the employer. Annual statutory reporting for these social insurances is required every July.

Under Japan's Social Security Agreements, employees who work outside their home country for periods not expected to exceed five years are subject only to the social security system of their home country, not that 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 10 years. A non-permanent resident is taxed only on their Japanese-source income and foreign-source income paid in Japan or remitted into Japan. Japanese-source income includes salaries, wages, and other compensation for services attributable to work performed in Japan (i.e., workdays outside Japan are excluded).

A non-resident is defined as an individual who has resided—or intends to reside—in Japan for less than one year as of the current date. Non-residents are taxed on their Japanese-source income, which is subject to a flat rate of 20.42%. If the total stay in Japan is 183 days or less, a tax treaty exemption may apply.

Consumption Tax Summary

Japan's consumption tax (JCT), a value-added (VAT) equivalent, was introduced in April 1989. It is classified as an indirect tax and applies to most domestic transactions and imports of foreign goods. Exceptions include financial and capital transactions, as well as medical, welfare, and educational services. The standard JCT rate is 10%. A reduced rate of 8% is applied for daily necessities, such as food, beverages, and subscriptions to periodical newspapers.

JCT also applies to electronic commerce, including the delivery of e-books, music, advertisements, and cloud services provided by companies outside Japan.

Transfers of goods or provision of services conducted by a company in Japan are exempt from the consumption tax.

A company must file a JCT return if its taxable sales during the base period—the fiscal year preceding the two fiscal years prior to the current one—exceed ¥10 million. Newly established companies are generally not required to file a JCT return unless their capital is ¥10 million or more at the time of incorporation.

Even without a PE in Japan, foreign entities are subject to JCT if they conduct domestic sales transactions.

Starting October 1, 2024, a foreign corporation with share capital of ¥10 million or more at the beginning of its fiscal year is required to file a JCT return upon its first sale of goods in Japan. In contrast, a foreign corporation with capital under ¥10 million is exempt—although there are numerous exemptions.

If the amount of JCT paid on taxable purchases (including import consumption tax) exceeds the JCT collected on taxable sales, the entity may submit a JCT return to claim a refund.

The JCT return must be filed and paid within two months after the end of the fiscal year. However, if a one-month filing extension for the corporate tax return has been granted, the JCT return deadline can also be extended for one month, provided a separate extension request is submitted.

Consumption Tax Qualified Invoice System

On October 1, 2023, Japan fundamentally reformed the JCT system with the introduction of the consumption tax qualified invoice system. This reform marks a shift toward becoming a VAT-style system similar to those used in Europe, in the following three ways:

1. **Consumption Tax ID Number**
   Business entities wishing to become a JCT invoice issuer must register with the authorized tax office and obtain a consumption tax ID number. Only entities that are eligible for consumption tax can be registered as JCT invoice issuers.

   If a consumption tax-exempt entity wishes to become a JCT invoice issuer, it must first apply to become consumption tax-eligible. Once registered as a JCT invoice issuer, an entity generally cannot revert to tax-exempt status, even if its taxable sales during the base period fall below ¥10 million.

2. **JCT Invoice Requirements**
   Only a registered JCT invoice issuer may issue qualified invoices, which must include:

   - Supplier’s name and consumption tax ID number
   - Date of transaction
   - Transaction details (with separate indication of items subject to the reduced tax rate)
   - Transaction amount at each applicable tax rate
   - Consumption tax amount at each applicable tax rate
   - Customer’s name

3. **Input Consumption Tax Credit Eligibility for Buyers**
   Starting October 1, 2023, entities that are not registered as JCT invoice issuers are not permitted to issues invoices that include consumption tax. If such an invoice is issued, the buyer cannot claim the input consumption tax credit based on that invoice. However, there will be a transition period to allow partial input consumption tax credit during a six-year period from October 1, 2023, to September 30, 2029.

   As under the previous system, buyers must retain proper accounting records and the relevant JCT invoice in order to claim the input consumption tax credit.

Electronic Book Preservation Act

Following a two-year transitional period, the Electronic Book Preservation Act came into force on January 1, 2024. Businesses must preserve the electronic stored information (ESI) for income tax and corporate tax purposes in accordance with the following conditions:

1. **Prevent Unauthorized Corrections or Deletions**
   Businesses must establish written administrative rules to prevent unauthorized corrections or deletions of ESI.

2. **Maintain Appropriate Equipment**
   Businesses must maintain appropriate equipment, such as displays and printers, to ensure the prompt, neat, and clear output of ESI at all times.

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

   Alternative 1: Create a spreadsheet using software such as Microsoft Excel to show:

   (i) the date of transaction
   (ii) the transaction amount
   (iii) the name of customers/vendors

   Alternative 2: Save transaction data files using a systematic file name convention that identifies the above information. The files should be stored in a designated folder to optimize search functionality.

   It is crucial that electronic transaction data can be downloaded at any time upon request by tax auditors.

Other Taxes Payable

Fixed Asset Tax, Business Office Tax, and Stamp Tax are other common taxes imposed on companies in Japan.

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

Business Office Tax is levied on companies located in major cities such as Tokyo and Osaka. If a company in such cities exceeds certain thresholds for office size (measured in square meters) and number of employees, a Business Office Tax return must be filed with the municipal tax office within two months after the fiscal year-end.

Stamp Tax is paid by affixing and canceling a stamp on the taxable documents, including various contractual agreements, promissory notes, and articles of incorporation, as listed in the Stamp Duty Act.