International Tax

Japan Highlights

In Plain English

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Investment basics:

Currency – Japanese Yen (JPY) **Foreign exchange control –** There are no controls, but some reporting requirements apply.

Accounting principles/financial statements – Japanese GAAP. Financial statements must be prepared annually.

Principal business entities – These are the joint stock company, limited liability company, partnership, and branch of a foreign corporation.

Corporate taxation:

Rates	
Corporate Income Tax Rate	23.2% (30%-34% including local taxes)
Branch Rate	23.2% (30%-34% including local taxes)
Capital Gains Tax Rate	23.2% (30%-34% including local taxes)

Residence – A company that has its principal or main office in Japan is considered to be resident. Local management is not required.

Basis – A resident corporation is taxed on worldwide income; a foreign corporation generally is taxed only on certain Japanese-source income. However, if a foreign corporation has a permanent establishment (PE) in Japan, any income attributable to the PE (branch) is taxable in the same way as a subsidiary.

Taxable income – The taxable income of a corporation in each accounting period is the excess of gross taxable revenue over total deductible business expenses. No gain or loss generally is recognized for certain assets transferred between 100% subsidiaries.

Rate – The national standard corporation tax rate of 23.2% applies to ordinary corporations with share capital exceeding JPY 100 million.

Companies also must pay local inhabitants tax, which varies with the location and size of the firm. The inhabitants tax, charged by both prefectures and municipalities, comprises the corporation tax levy (levied as a percentage of national corporation tax), and a per capita levy (determined based on capital and the number of employees).

The local enterprise tax, another tax imposed by the prefectures, has three components: (i) progressive standard rates of up to 3.6% of taxable profits (note that the standard rate of income-based enterprise tax was lowered for fiscal years beginning on or after 1 October 2019, and a new, special enterprise tax was introduced, but the revision has little impact on the effective enterprise tax rate); (ii) 1.2% of a “value- added” factor; and (iii) 0.5% of share capital and capital surplus.

The effective tax rate for corporations (inclusive of the local inhabitants and enterprise taxes), based on the maximum rates applicable in Tokyo to a company whose paid-in capital is over JPY 100 million, is approximately 30%.

The corporate tax rate for a branch is the same as for a subsidiary.

Surtax – A 2.1% surtax applies on the withholding tax for certain Japanese-source income, as discussed below under "Withholding tax."

Alternative minimum tax – There is no alternative minimum tax.

Taxation of dividends – Dividends received by a resident corporation from another resident corporation are excluded from taxable income for corporation tax purposes if the recipient holds 100% of the dividend- paying corporation for a certain period. If a corporation owns more than 33.3% of the shares in a dividend- paying corporation for at least six months before the date the right to receive a dividend is determined, the dividend (less the dividend-receiving resident corporation's interest expense allocated to the dividend) is excluded from taxable income. If a corporation holds 33.3% or less of the shares but more than 5% of shares or holds more than 33.3% of the shares but for less than six months before the dividend determination, 50% of the dividend is excluded from taxable income. If a corporation owns 5% or less of the shares, 20% of the dividend is excluded from taxable income. A foreign dividend exemption system exempts 95% of dividends received by a Japanese company from its qualifying shareholdings of 25% or more in foreign companies that have been held for at least six months before the dividend determination date. However, foreign dividends that are deductible in the source country are excluded from the exemption, and the full amounts of the dividends are included in taxable income.

Capital gains – Capital gains are taxable as ordinary income; capital losses generally are deductible.

Losses – Only 50% of a company's taxable income may be offset by net operating losses (NOLs). A small or medium-sized enterprise (SME) with share capital of no more than JPY 100 million is exempt from the NOL restriction, unless the SME is owned by a large corporation. NOL carryforwards may be further restricted in certain situations, including a change of ownership of more than 50% in connection with a discontinuance of an old business and commencement of a new business.

The NOL carryforward period is 10 years for NOLs incurred during fiscal years starting on or after 1 April 2018. SMEs may carry back losses for one year.

Foreign tax relief – Foreign tax paid may be credited against Japanese tax, subject to certain limitations. An indirect foreign tax credit (deemed paid foreign tax credit) generally is unavailable.

Participation exemption – There is no participation exemption in respect of capital gains, but there is a 95% foreign dividend exemption (see above under "Taxation of dividends").

Holding company regime – There is no holding company regime. **Incentives –** Various tax credits are available, including an R&D credit. Tax incentives are available for

increasing wages and salaries for fiscal years that start between 1 April 2018 and 31 March 2021.

The R&D credit and certain other tax incentives are not available to large corporations that do not satisfy certain conditions for fiscal years that start between 1 April 2018 and 31 March 2021.

Compliance for corporations:

Tax year – A corporation selects its fiscal year when it begins operations in Japan. The accounting period must not exceed 12 months. A branch's tax year generally is the same as the tax year of its head office.

Consolidated returns – A Japanese domestic parent corporation and its 100%-owned domestic subsidiaries may elect to file a consolidated tax return for national tax purposes only, i.e., local taxation is calculated on a stand-alone basis. Once a group has been approved to enter into the consolidated tax regime, in principle, the group cannot voluntarily revoke this status.

Consolidated taxable income is calculated for the consolidated group as a single tax unit by aggregating the separate taxable income of each subsidiary in the group and applying necessary adjustments. The consolidated tax liability is calculated based on consolidated taxable income multiplied by the applicable tax rate, adjusted for various tax credits. The group's consolidated tax liability is allocated to the individual corporations in the group based on the taxable income or loss of each corporation.

In principle, when forming/joining the consolidated group existing subsidiaries are subject to the mark-to- market rule and forfeiture of their existing NOLs. There are some exceptions whereby mark-to-market would not apply and a separate return limitation year rule (under which a subsidiary's NOLs incurred before joining the group can be carried forward and offset only against its own taxable income) would be available for subsidiaries held for more than five years and subsidiaries that meet certain requirements.

Filing and payment – A corporation or a branch must file a final tax return and pay its final taxes due within two months after the close of its fiscal year. Taxes must be prepaid within two months from the end of the sixth month of the tax year, in an amount equal to either: (i) 50% of the tax payable on the previous year's earnings; or (ii) the actual tax liability for the first six months.

Companies may file either a "blue" or a "white" return. The blue return carries a wide range of privileges, such as deductions, including tax loss carryforwards and accelerated depreciation. To use this form, companies must apply before the beginning of the applicable tax year (or, for a newly formed company, before the end of the first year), and must meet certain requirements in relation to their accounting systems and recordkeeping.

Penalties – Various penalties are imposed on taxpayers that underreport their total tax due and that fail to timely submit tax payments and tax returns. Penalties are not deductible for Japanese tax purposes.

Rulings – Japan has a limited advance ruling system. Written rulings generally are available to the public, and the availability of a ruling is subject to certain restrictions (e.g., no hypothetical cases).

Individual taxation:

Rates

National Income Tax Rate	Taxable Income	Rate
	Up to JPY 1,950,000	5% (5.105% including surtax)
	JPY 1,950,001 – JPY 3,300,000	10% (10.21% including surtax)
	JPY 3,300,001 – JPY 6,950,000	20% (20.42% including surtax)
	JPY 6,950,001 – JPY 9,000,000	23% (23.483% including surtax)
	JPY 9,000,001 – JPY 18,000,000	33% (33.693% including surtax)
	JPY 18,000,001 – JPY 40,000,000	40% (40.84% including surtax)
	Over JPY 40,000,000	45% (45.945% including surtax)
Local Inhabitants Tax Rate		10% (plus per capita levy of JPY 4,000 and JPY 1,000 surtax)
Capital Gains Tax Rate		15%/30% (20.315%/39.63% including national surtax and local inhabitants tax)

Residence – Permanent residents are taxed on their worldwide income. Nonpermanent residents are taxed on their Japanese-source income and on foreign-source income paid in or remitted into Japan. As from 2017, nonpermanent residents also are taxable on capital gains from the sale of non-listed shares and shares acquired while resident in Japan. Nonresidents are taxed on their Japanese-source income.

Basis – An individual who is domiciled or who has a residence in Japan for one year or more is a resident. A non-Japanese national who has spent five years or less in Japan in the preceding 10-year period is regarded as a nonpermanent resident.

Taxable income – Most income, including employment income and investment income, is taxable. Specified deductions, allowances, and credits are available to reduce tax.

Rates – Progressive rates up to 55% (combined national and local inhabitants tax) apply. A surtax of 2.1% applies to national tax due, to help pay for recovery following the 2011 earthquake.

Capital gains – National income tax applies at 15% on gains of individuals from the sale of shares. Long- term gains of individuals from the sale of real property are subject to national income tax at 15%, and short-term gains at 30%. A surtax of 2.1% applies to the national tax due on capital gains, to help pay for recovery following the 2011 earthquake. In addition, local inhabitants tax at 5% applies on gains from the sale of shares, and long-term gains from the sale of real property. Short-term gains from the sale of real property are subject to local inhabitants tax at 9%.

Deductions and allowances – Subject to certain restrictions, deductions are granted for social insurance premiums paid under Japanese government plans, life insurance premiums, earthquake insurance premiums, charitable contributions, qualified medical expenses, etc. Personal deductions are allowed for the individual, a dependent spouse (but only by individuals who income is less than JPY 10 million), and children aged 16 or older. Exemptions exist for the disabled and the elderly.

Foreign tax relief – Foreign taxes paid may be credited against the Japanese tax liability, subject to certain limitations.

Compliance for individuals:

Tax year – Calendar year

Filing status – Joint filing is not permitted. Additionally, the tax rates are uniform and are not dependent on marital or other status.

Filing and payment – Tax on employment income and investment income generally is withheld at source. Self-employment business income is calculated in a similar manner as for corporations and must be self- reported.

Penalties – Japan imposes various penalties on taxpayers who underreport their total tax due and who fail to timely submit tax payments and tax returns. Penalties are not deductible for Japanese tax purposes.

Rulings – Japan has a limited advance ruling system. Written rulings generally are available to the public, and the availability of a ruling is subject to certain restrictions (e.g., no hypothetical cases).

Withholding tax:

Rates				
Type Of Payment	Residents		Nonresidents	
	Company	Individual	Company	Individual
Dividends	20% (20.42% including surtax)	20% (20.42% including surtax)	15%/20% (15.315%/20.42% including surtax)	20% (20.42% including surtax)
Interest	20% (20.42% including surtax)	20% (20.42% including surtax)	15%/20% (15.315%/20.42% including surtax)	20% (20.42% including surtax)
Royalties	20% (20.42% including surtax)	Progressive rates up to 20% (20.42% including surtax)	20% (20.42% including surtax)	20% (20.42% including surtax)
Fees for Technical Services	20% (20.42% including surtax)	Progressive rates up to 20% (20.42% including surtax)	20% (20.42% including surtax)	20% (20.42% including surtax)

Dividends – A 20% withholding tax normally is levied on dividends paid to residents and to nonresidents, unless the rate is reduced under a tax treaty. The rate is 15% for dividends paid by a listed company to a nonresident. A 2.1% surtax increases the effective domestic rates to 20.42% and 15.315%.

Interest – Interest on loans paid to residents and to nonresidents generally is subject to a 20% withholding tax. The rate on interest paid to a nonresident company on deposits and bonds is 15%. A 2.1% surtax increases the effective domestic rates to 20.42% and 15.315%. The rate may be reduced under a tax treaty.

Royalties – Royalties paid to residents and to nonresidents are subject to a 20% withholding tax, unless the rate is reduced under a tax treaty. (A lower withholding rate based on a progressive scale may apply for resident individuals.) A 2.1% surtax increases the effective domestic rate to 20.42%.

Technical service fees – A 20% withholding tax generally is levied on Japanese-source service fees paid to residents and to nonresidents, unless exempt under a tax treaty. (A lower withholding rate based on a progressive scale may apply for resident individuals.) A 2.1% surtax increases the effective domestic rate to 20.42%.

Branch remittance tax – Japan does not impose a branch remittance tax.

Anti-avoidance rules:

Transfer pricing – The prices of goods and services exchanged between internationally affiliated entities must be consistent with the arm's length principle. Internationally affiliated entities are defined, among others, as those with a relationship consisting of a direct or indirect foreign shareholding of 50% or more, or a "control in substance" relationship. The burden is on the taxpayer to demonstrate that the pricing is reasonable. Failure to do so may give rise to a transfer pricing adjustment, at the discretion of the tax authorities. Advance pricing agreements on the reasonableness of the taxpayer's methodology and results may be obtained from the tax authorities. (See also "Disclosure requirements.")

Japanese transfer pricing documentation rules follow the OECD's three-tiered approach to documentation (i.e., country-by-country (CbC) reporting, master file, and local file). The master file and "Notification for Ultimate Parent Entity" must be submitted annually for groups with prior year revenue equal to or greater than JPY 100 billion. Local file contemporaneous documentation requirements apply for intercompany transactions equal to or greater than JPY 5 billion, or equal to or greater than JPY 300 million for intangible related transactions. Local files must be submitted to an examiner at the latest within 45 days of a request, although the actual deadline to respond to a request is set by the examiner and may be less. Where the contemporaneous documentation thresholds are not met, local files must be submitted to an examiner at the latest within 60 days of a request, although the actual deadline to respond to a request is set by the examiner and may be less.

New hard to value intangibles (HTVI) rules apply for income years beginning on or after 1 April 2020. The HTVI rules allow the Japanese tax authorities to consider after the fact (ex-post) outcomes to make adjustments to the pricing of transactions involving HTVIs (as defined in the new rules).

As from income years beginning on or after 1 April 2020, the discounted cash flow method is formally allowed as a pricing method, and the statute of limitations relating to transfer pricing is extended from six to seven years.

Interest deduction limitations

Thin capitalization

Japan's thin capitalization rules primarily restrict the deductibility of interest payable (including certain guarantee fees) by a Japanese corporation or a foreign corporation liable to pay corporation tax in Japan to its foreign controlling shareholder (or certain third parties), if the interest is not subject to Japanese tax in the hands of the recipient. A foreign controlling shareholder is defined as a foreign corporation or nonresident individual that: (i) directly or indirectly owns 50% or more of the total outstanding shares of the Japanese corporation (i.e., a parent-subsidiary relationship); (ii) is a foreign corporation in which 50% or more of the total outstanding shares are directly or indirectly owned by the same shareholder that directly or indirectly owns 50% or more of the shares of the relevant Japanese entity (i.e., a brother-sister relationship); or (iii) otherwise exercises control over the Japanese entity. This rule also applies to situations involving certain third parties, including situations where: (i) a third party provides a loan to the Japanese entity that is funded by a back-to-back loan arrangement with the foreign controlling shareholder; (ii) a third party provides a loan to the Japanese entity that is guaranteed by a foreign controlling shareholder; or (iii) a third party provides a loan to the Japanese entity based on arrangements involving bonds and certain repo transactions.

There is a debt-to-equity safe harbor ratio of 3:1 (2:1 for certain repo transactions). This effectively means that there will be a restriction only if the debt from the foreign controlling shareholder (or specified third party) exceeds three times the amount of net equity the shareholder/third party owns, and the total debt exceeds three times the equity. In such a situation, interest expense calculated on the excess debt is nondeductible for Japanese corporate income tax purposes. If the taxpayer can demonstrate the existence of comparable Japanese corporations that have a higher debt-to-equity ratio, that higher ratio may be used.

Earning stripping rules

Where net interest payments (i.e., the amount after deducting interest income from interest expense) exceed 20% of adjusted taxable income in a fiscal year, the excess portion is nondeductible. "Adjusted taxable income" is taxable income without applying certain provisions, excluding certain items (i.e., exempt dividends), and adding back withholding tax deducted from corporate tax and certain other expenses. De minimis exceptions to the application of the earnings stripping rules exist for: (i) net interest payments to related parties not exceeding JPY 20 million; or (ii) aggregate interest payments of a Japanese group (domestic companies with a common Japanese parent holding greater than 50% direct or indirect control) that are not more than 20% of the group's adjusted income. Where both the earning stripping and the thin capitalization rules are applicable, the larger of the two potential disallowances will apply. To the extent the application of the above rules gives rise to nondeductible interest, such interest expense may be carried forward and deducted (within the limitation) against taxable income arising during the following seven fiscal years. The above rules apply for fiscal years beginning on or after 1 April 2020, with similar rules applying for fiscal years beginning prior to that date.

Hybrids – While Japan has a foreign dividend exemption system that exempts 95% of dividends received by a Japanese company from certain qualifying shareholdings (see "Taxation of dividends," above), foreign dividends that are deductible in the source country are fully or partially excluded from the exemption in line with BEPS action 2. Similar concepts also exist for the calculation of a controlled foreign company's (CFC's) taxable profits (see also "Controlled foreign companies," below).

Economic substance requirements – Japan has no prescribed economic substance requirements. However, if a transaction lacks substance or business purpose, general anti-avoidance rules may apply. For more detail, see the "General anti-avoidance rule" section, below.

Controlled foreign companies – A Japanese company that (together with associated persons) holds 10% or more of the outstanding shares of a CFC generally is taxed on its pro rata share of the CFC's taxable profits.

A CFC may include any non-Japanese company that has an effective tax rate of less than 20% and (for fiscal years of CFCs starting on or after 1 April 2018) any "paper," "cash box", or "black-listed" company that has an effective tax rate of less than 30%, where the company is more than 50% "controlled," directly or indirectly, by Japanese shareholders. A CFC is considered controlled by Japanese shareholders where Japanese shareholders directly or indirectly own more than 50% of the outstanding shares. For fiscal years of CFCs starting on or after 1 April 2018, the definition of controlled is expanded to include companies controlled in substance, regardless of the number of shares owned.

The CFC rules may be waived for a foreign company with an effective tax rate of less than 20% where it has fixed facilities engaged in business in the foreign country and conducts business activities in that country. Even if a CFC satisfies these conditions, certain passive income is subject to tax in the hands of the Japanese parent company. The inclusion of taxable profits from paper, cash box and black-listed CFCs cannot be waived.

Disclosure requirements – Disclosure requirements apply to the 10%-or-more shareholders of CFCs. Transactions with foreign related parties should be disclosed (on Form 17(4)) and submitted with the tax return.

Exit tax – Individual income tax generally is imposed on unrealized capital gains on certain financial assets at the time of a resident individual's departure from Japan, if the total value of the individual's eligible assets is JPY 100 million or more, and the individual has lived in Japan for more than five years in the last 10 years before departure. There is no exit tax for corporate income tax purposes.

General anti-avoidance rule – General anti-avoidance rules may apply in certain situations to family corporations, reorganizing corporations or their shareholders, members of a tax consolidated group, and foreign corporations with a permanent establishment in Japan.

Other – Broadly applicable anti-avoidance rules are in place.

Consumption tax:

Rates	
Standard Rate	10% (national tax 7.8% and local tax 2.2% combined)
Reduced Rate	0%/8% (national tax 6.24% and local tax 1.76% combined)

Taxable transactions – Japanese consumption tax, similar to a European-style VAT, is levied on the supply of goods and services in Japan; the sale or lease of certain assets in Japan; the import of goods; and certain digital services provided in Japan by nonresidents.

Rates – The current combined national and local rate is 10% (8% for certain items) for taxable transactions, and 0% in certain circumstances (e.g., export transactions).

The reduced rate of 8% applies to food and beverages (excluding alcoholic drinks and dining out), and certain newspapers issued more than twice a week (i.e., those based on subscriptions). Consumption tax rate-qualified invoices are required, and from 1 October 2023, an EU VAT-type invoice will be required.

Registration – An existing company may elect to be a consumption taxpayer if taxable sales for consumption tax purposes do not exceed JPY 10 million in the "base period" (two years before the current year, or the first six months of the prior year), subject to certain other conditions. In principle, a new company with share capital of less than JPY 10 million should be automatically exempt from filing consumption tax returns until taxable sales exceed JPY 10 million in the base period, or a timely consumption taxpayer election is filed. The election is binding for a minimum of two taxable years. Other than this election, no registration procedures exist under the current consumption tax system A new consumption tax system will be introduced as from 1 October 2023, and only companies that are registered with the Japanese tax office as a qualified invoice issuer business will be able to issue qualified invoices. Relevant registrations will be available beginning 1 October 2021 by filing an application form with the Japanese tax office.

Filing and payment – A company must file a consumption tax return and remit the applicable tax to the tax authorities if the company is a consumption taxpayer (see under "Registration," above). The frequency of remittances depends on the total consumption tax collected. The amount of creditable input consumption tax generally depends on total sales, the taxable sales ratio and the method used. Other thresholds/tests also may be applicable.

Other taxes on corporations and individuals:

Unless otherwise stated, the taxes in this section apply both to companies and individuals and are imposed at the national level.

Social security – The employer must withhold the employee's contribution and make its own contributions to social security tax, which has several components. The highest combined employer portion is approximately 16.63%. The highest combined employee's portion is approximately 15.69%.

Payroll tax – The employer must withhold national and local income tax and social security contributions at source.

Capital duty – Capital duty is included in the local inhabitants tax (per capita levy) and the factor-based local enterprise tax includes a levy on capital, that applies only to companies, not to individuals.

Real property tax – The municipal fixed assets levy is assessed at an annual rate of 1.4%. A prefectural real estate acquisitions tax of 3%-4% (temporarily, 1.5%-2%) of the assessed value applies at the time land or buildings are acquired, and a real estate registration tax is imposed on the assessed value of real property at rates ranging from 0.4% to 2%, depending on the type of transfer.

Transfer tax – The transfer of certain assets is subject to stamp duty on contracts executed in Japan.

Stamp duty – Stamp duty of JPY 200 to JPY 600,000 is imposed on the execution of taxable documents.

Capital acquisitions tax – See “Real property tax,” above.

Net wealth/net worth tax – There is no net wealth or net worth tax.

Inheritance/gift tax – Beneficiaries, not deceased persons or donors, are subject to inheritance/gift tax at progressive rates of 10% to 55%. The scope of inheritance/gift tax depends on the domicile of the deceased/donor, the domicile of the beneficiary, nationality of the beneficiary, and the location of the property. A beneficiary domiciled in Japan, regardless of nationality, at the time of the deceased’s death is subject to inheritance tax on all worldwide assets acquired, with the exception of a temporary stay under certain visas.

Other – Other taxes include registration and license taxes. Share registration tax is assessed at 0.7% on the registration of new or additional share capital.

Tax treaties: Japan has concluded 75 income tax treaties and one inheritance/estate tax treaty. The OECD multilateral instrument (MLI) entered into force for Japan on 1 January 2019.

Tax authorities: National Tax Agency