ingredients and production methods. Changes in methods of production and manner of consumption dictate that the system of taxation of liquors be simplified to reduce the disparity between types of alcoholic beverages.

> **⇒ Explanation: Low malt beer *(happoshu)***
>
> Japanese beer is fairly expensive, due in part to the Liquor Tax on beer of ¥222,000 per kiloliter. For example, a 350 ml can of beer might cost ¥220 on average. The tax rate is determined by the percentage of malt in the product. If the malt rate is less than 50%, but not less than 25%, the tax rate drops to ¥178,125. Beer with a malt rate less than 25% is taxed at ¥134,250 per kiloliter. Recently, low malt beer (*happoshu*), which substitutes other ingredients such as corn syrup, rice or sugar for malt, has become popular and usually sells for between ¥125 and ¥145 a can.

- *Issues related to global warming*. The Kyoto Protocol that provides for the targeted reduction of the release of greenhouse gases into the atmosphere will come into effect in February 2005. Japan needs to consider the introduction of an environmental tax. However, at present, it is not clear how such a tax will relate to other policy measures. The tax should ultimately provide an economic incentive to decrease emissions. Careful consideration must be given to whether revenues raised by an environmental tax should be considered general-purpose funds or special-purpose funds for specified global warming countermeasures.
- *Other issues*. A comprehensive examination of the system of taxation for private pensions (including the corporation tax on retirement pension funds) needs to be performed, including the tax treatment of contributions, management and benefits. Countermeasures are needed to address the emerging problem of tax avoidance schemes using partnerships (*kumiai*).

Source: *The Tax Commission: 2005 Tax Reform Report (November 2004)*

¶1-124 The Tax Commission's 2006 Tax Reform Report

The Tax Commission's main conclusions regarding the outlook for Japanese tax reforms in 2006 were presented in a report issued in November 2005 and are summarised below.

General principles

- With the worst fiscal situation among the developed nations, Japan is undergoing structural changes, including a low birth rate, an ageing population and globalization.
- The Japanese Government is working on broad-based structural reforms to sustain a fair society in the future and to realize continued activity in the economic society.
- For example, in recent years the Government has promoted a programme for disposition of delinquent loans and has initiated bold regulatory reforms while developing plans focusing on strengthening the basics of the economy and civilian needs.
- Within the tax system, plans for the materialization of a "desirable tax system" (*arubeki zeisei*) are progressing.
- In addition to the Trinity Reform Package (*Sanmiitai no Kaikaku*), it will be necessary to take a closer look at the benefits, burdens and revenues and expenditures in the social security system in order to make drastic reforms.

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- While public service expenditure associated with an ageing population is increasing dramatically, the tax burden on our citizens is lower than in other developed countries.
- It is necessary to undertake a comprehensive examination of tax bases and tax burdens associated with the Income Tax, Consumption Tax and taxes on property.

Individual income taxation

- The Trinity Tax Reforms should be advanced in the 2006 tax reforms by amending the *Income Tax Law* and *Local Tax Law* to make permanent shifts in the source of taxation from the Income Tax to the Individual Inhabitants Tax.
- The fixed rate reduction (*teiritsu genzei*) in Income Tax was introduced as an emergency economic measure that is not suited to current conditions.
- The per capita local inhabitants tax amounts are very low compared to the expansion in the amounts of per capita national income, and the per capita local inhabitants tax amounts should be increased.

Corporation Tax

- In light of structural changes making the economic system more flexible and changes in the corporate laws regarding consolidations and corporate restructurings, adjustments to the corporation taxation system are needed.
- Moreover, the forms of economic entities are becoming more diverse and rules are needed to guarantee neutrality in the selection of a form of entity.
- The unfairness in relative tax burdens between businesses operating as proprietorships and those operating as corporations should be rectified.
- The current Corporation Tax rate is similar to other developed countries and should be maintained.
- Further consideration is required regarding the taxation of not-for-profit entities.

International taxation

- Negotiations to revise the existing tax treaties with the UK and India should be concluded at the earliest possible date.
- It is necessary to expand the information collection procedures for the exchange of information needed to prevent tax evasion under income tax treaties.
- In order to rationalize the tax system, it is necessary to reconsider the non-permanent resident system of taxation for resident aliens who stay in Japan for short terms in order to limit the scope of Japanese tax.
- Consideration must be given to dealing with cases of international tax avoidance taking advantage of the differences between tax treaty provisions and the civil law.

Special taxation measures

- The special provisions for research and development and for IT investment, introduced in 2003, are set to expire this year. The main points of these provisions should be temporarily continued.
- Special tax mitigation provisions for the Registration and Licence Tax relating to real property set to expire this year need not be extended.

- The public announcement system (*koshi seido*), whereby income tax information has been made public has the intended effect of using third-party scrutiny to provide a check on the tax system. However, instances of criminal activity and harassment connected with the public announcement system lead to the conclusion that it should be abolished.
- It is necessary to review the penalty tax system (*kasan zeisei*) in order to take steps to deal with non-reporting of income connected with internet commerce.

¶1-125 The Tax Commission's 2007 Tax Reform Report

The Tax Commission's main conclusions regarding the outlook for Japanese tax reforms in 2007 were presented in a report issued in December 2006 and are summarised below.

General principles

- Financial reconstruction cannot take place without growth of the overall economy.
- The priority should be to minimize burdens on the people and to minimize expenditure.
- Comprehensive tax reform over the mid-term should take place through an examination of the role of each item of taxation in the context of Japan's 21st century social-economic system.
- Social security systems and measures should be established to deal with declining birth rates that do not leave the burdens to future generations.
- Economic growth, stimulated by a shift of cash flows from the Government to the people, will provide the impetus for a sound system of public finance.
- Examination of a tax system that promotes economic activity includes the consideration of sound government finances, international competitiveness, fairness, simplicity, openness and promotion of innovation.
- Reduction of the effective tax rate for corporations is an issue requiring examination. The resulting increased value added in the business sector may also spread to the household sector. The comparability of corporation tax rates and social insurance premiums internationally and the impact of a rate reduction on employment also need examination.
- The impact of tax policy on innovation, the future of the research and development tax system, and the way the latter influences various means for financing the growth of enterprises need to be considered.
- The tax treaty network should be expanded to promote economic exchange to reduce the tax burden on investments and technology transfers.
- Future tax deliberations should make the best use of accumulated knowledge in the field and take into consideration, the relationship between the economy, public finance, industry and households, including social security issues.

Proposed tax reforms

- *Depreciation*. Depreciation is currently limited to 95% of the acquisition cost of assets and is generally calculated annually using a statutory residual value of 10% of the acquisition cost. To encourage investment and innovation, and to be more in line with international norms, these limits should be eliminated. Useful lives and asset classes should be re-examined and simplified. In particular, the specified useful lives of assets should be shortened to reflect the speed of innovation.

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- *Family corporation tax on retained earnings*. The tax basis for the tax on accumulated earnings of family corporations was reduced by legislation in 2006. Further consideration of this tax is needed in order to promote capital accumulation by medium- and small-sized companies, support innovation and strengthen competitiveness.
- *Angel taxation system*. Promotion of the supply of investment funds to venture businesses is necessary for the future of Japanese industry. Consideration needs to be given for ways to facilitate the angel taxation system and to broaden the range of eligible venture businesses.
- *Estate taxation for business succession*. Special estate tax provisions applicable to the succession of medium- and small-sized businesses need to be considered from the point of view of preserving economic vitality, fairness and impartiality. Appropriate consideration needs to be given to the estate tax valuation of new types of shares, including non-voting shares, authorised by the new *Company Law*.
- *International taxation*. Efforts should be made to expand and continue the role of the tax treaty network that serves as the infrastructure for the promotion of foreign economic exchanges. In the international transfer pricing area, means to clarify procedures should be continued, the mutual agreement process should be strengthened and the procedures for obtaining an advanced pricing agreement under the pre-confirmation system should be sped up. Procedures should be considered to reduce the burden of double taxation while mutual agreement procedures are pending.
- *Factor-based enterprise tax*. The factor-based enterprise tax system was introduced in 2003. Companies with at least ¥100m of capital use a tax basis made up of factors including income, value added and capital in lieu of the traditional income-only basis. Some companies have been decreasing their capital in order to avoid using the three factor tax basis. In ensuring fairness, considering the benefit principle of taxation, the criteria for companies being subject to the factor tax needs to be reviewed.
- *Triangular mergers*. The new *Company Law* provides new rules for triangular mergers (*sankaku gappei*) beginning May 2007. Appropriate adjustments to the tax system are needed to deal with such mergers based on principles that do not discriminate between domestic and cross-border reorganizations. Attention must also be given to tax haven issues raised by the new rules for triangular mergers.
- *Proposed changes to the trust laws*. A new law governing trusts is currently being deliberated on by the Diet. It is anticipated that the new trust law will provide for a wider range of types and uses for trusts. However, there are concerns that this may lead to use of trusts for tax avoidance. Various measures need to be considered, including taxation at the trust level, when necessary, to ensure tax neutrality and fairness.
- *Proposed changes in accounting rules for leases*. Changes in accounting rules to better reflect the economic realities of leases are currently being proposed. Corresponding changes in the tax rules should be considered in order to reduce the burden on taxpayers and reflect the economics of leases for tax purposes.
- *Reduced tax rates on dividends and capital gains*. Reduced rates of tax on dividends and capital gains from stocks of listed companies were introduced in 2003 to deal with widespread problems stemming from a sluggish stock market and poorly performing loans. These conditions have improved and these favorable treatments of dividends and capital gains should not be continued.

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⇒ Explanation: The Mid-Term Program

The Mid-Term Program on Fiscal Revenues and Government Finances, as outlined on 30 October 2008, was included in the Japanese Government's measures to counter difficulties in people's daily lives. The basic points of the Mid-Term Program are to (1) reduce taxes for up to three years to promote economic recovery, and (2) fundamentally reform the tax system after the economic situation has improved, including a fundamental reform of the consumption tax system.

2009 tax reform

Estate taxation

The estate tax has an asset redistribution function that must be considered, taking into account that:

(1) the burden of estate tax has been reduced and now applies to about 4% of deceased persons only

(2) the increased possibility that the asset gap among older persons is being passed on to succeeding generations, and

(3) social benefits contribute to the maintenance of assets of the elderly.

The current inheritance tax system has a number of unequal results. For example, because tax is imposed on each successor by allocation of the total tax, different successors receiving identical values may be taxed differently. Omissions from the tax return of one co-heir may result in penalties for the other co-heirs. Tax benefits arising from successors who continue to reside in inherited property may also result in lighter taxes to other co-heirs who do not reside in inherited property. From the angle of maintenance of job security and economic vitality, the examination of the inheritance tax system needs to take into consideration fairness in the succession of non-business assets among heirs as well as questions regarding the succession of business assets. Therefore, it is necessary to consider a review of the basic inheritance taxation formula as well as developing a consensus regarding the ideal way to tax succession impartially.

International taxation

In considering the taxation of cross-border transactions, in light of increasing globalization and diverse and complex corporate structures, it is necessary to keep in balance the need to guarantee Japan's appropriate taxing power while giving consideration to the stimulation of Japan's economic activity.

From the point of view of stimulating the domestic economy, it is important to consider that companies are limited in the amount of earnings that they are able to repatriate to Japan from overseas markets at any given time. For purposes of the foreign tax credit, neutrality in the decision policy for dividends and maintenance steps to prevent the double taxation of income can be obtained by replacing the indirect foreign tax credit with a system of excluding, from the income of parent companies, dividends received from foreign subsidiaries. Repatriated earnings can be used to invigorate the economy through capital investment, research and development and increased employment.

It is also necessary to re-examine countermeasures against international tax avoidance, including a review of the system for aggregating earnings of foreign subsidiary companies (used as tax havens) and the transfer pricing system.

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Tax treaties are an important part of the nation's economic infrastructure and, along with the civil law system, help promote investment and address international tax issues of double taxation and tax avoidance. Thus, it is necessary to continue to expand the treaty network system.

Fixed assets tax

Fixed assets are an important and stable tax base for Japan. For the fixed assets tax on land, from the point of view of impartiality, balancing the optimum tax burden and evening out the burden level has been progressing, but differences still remain in balancing the burden level in each region. In the future, it will be necessary to better balance and optimize the tax burden based on reassessments in 2009.

Table 8: Estimated annual revenue impact of 2009 tax reform (¥100m)

	2009 ¥	Average in later years ¥
Home loan deduction expansion (see ¶3-293)	110	1,530
Tax credits for the promotion of long-term quality housing (see ¶3-293)	110	240
Tax measures promoting investments in facilities for reforming the supply and demand of energy and promoting materials efficiency	1,190	1,280
Temporary reduction of corporation tax rate for medium- and small-sized companies (see ¶4-610)	1,100	1,100
Lifting the suspension of the loss carryback system for medium- and small-sized companies (see ¶4-460)	940	1,120
Establishment of a tax deferral system for estate and gift taxes for medium- and small-sized companies (see ¶6-511)	170	210
Expansion of inheritance tax deferral for farmlands	0	80
Allowing individual contributions to defined benefit pension plans (see ¶3-256)	50	270
Temporary reduction in tax rate for automobile tonnage tax (see ¶5-540)	1,020	1,020
Total	4,690	6,850

Source: *Japan Ministry of Finance*

¶1-128 The Tax Commission's 2010 Tax Reform Report

The Tax Commission's 2010 Tax Reform Report was issued in December 2009 by the Tax Commission, which was reorganised in October 2009 to include only members of Government ministries (see ¶1-120). The main points in the 2010 Tax Reform Report are summarised below.

Market concerns have been raised due to financial risks associated with the European debt crisis, so governmental financial strictness and financial strengthening in Japan are unavoidable. In these circumstances, a definite plan was drawn up in June 2011 to address a joint reform of the taxation and social security systems, and was followed up by cabinet decisions setting out policy in this area later in 2011. Tax reform proposals for 2012 reflect an effort to realize the goal of a significant reform of the tax system in combination with these overall issues.

¶1-131 The Tax Commission's 2013 Tax Reform Report

The Tax Commission's 2013 Tax Reform Report was issued in January 2013 and the main points of the report are summarised below.

General 2013 tax reform principles

Japan's economy is suffering from a strong yen and prolonged deflation-led recession. The trade deficit is expanding while domestic growth and employment opportunities for young people are decreasing. A delay in recovery is giving rise to a feeling of frustration. This situation is to be addressed through the "Three Arrows" policies of bold monetary policy, flexible fiscal policy and strengthening growth through the stimulation of private investment. A strong economy will be restored by moving from economy shrinking wealth redistribution policies to policies that create a positive cycle of growth and wealth creation. 2013 tax reform should depart from convention and take bold steps to promote private investment and employment that will enable sustained growth.

Decentralization will be promoted to enhance local tax bases because "without robust localities there is no robust nation". Furthermore, steps are needed to address the impact of the first sales tax rate increase in 17 years that is scheduled to take effect beginning in April 2014 and to provide tax relief to assist in the recovery from the Great Eastern Japan Earthquake. At the same time, the tax system must also address the medium- and long-term problems of strengthening the economy while reducing disparities and supporting adequate financing for the social security system at a time of population aging and declining birthrates.

Strengthening growth through the stimulation of private investment

In order to achieve a positive cycle of growth and wealth creation, the cautious approach toward capital spending needs to be reversed and replaced with a plan for reinforcement of industrial competitiveness with improved plant and equipment. Incremental tax credits and special depreciation should be provided for investment in new equipment. Also, extensions should be provided for existing incentives to invest in solar and wind-generation facilities and the range of incentives should be expanded to include co-generation facilities. Collaborative research should be made eligible for the incentive deductions for experimentation and research, and the limits on these deductions should be raised. Healthy international investment can be promoted by the expansion of Japan's tax treaty network through the conclusion of new treaties and revision of existing treaties.

Measures for employment and training

Growth and wealth creation are directly tied to utilization of the potential of Japan's human resources. So the tax system should provide measures encouraging maximization of individual potential, employment and income. Consumer demand can be stimulated through increased employment which can be encouraged through expansion of the tax credit for promoting employment, including increasing the allowable credit amount.

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The generation of persons 60 years or older holds about 60% of the wealth. Shifting of this wealth to the younger generation to support education and training can be promoted by permitting tax-free gifts to children and grandchildren for education and training.

The supply of funds for growth and the stability of household wealth formation can be promoted through implementation of the Japanese ISA (individual savings account) system.

Comprehensive reform of the social security and tax systems

As a result of large scale relaxation in the progress of the Income Tax, the income redistribution function has decreased and a tendency toward increasing disparities in the economy can be seen. Under these circumstances, an increase to the highest rate of income tax is warranted.

The income redistribution function has also been decreased as a result of the retention during the current period of drastically decreased land values of inheritance tax rates and basic deductions that were designed to address land price inflation during the bubble era. To address this, the tax base and tax rate structure should be re-examined.

Coordination with the Consumption Tax increase

A number of measures are proposed for the 2013 tax reform to coordinate with the increase in the rate of consumption tax from 5% to 8% scheduled to take effect on 1 April 2014. These measures include an expansion of the home acquisition loan credit, reform of the automobile acquisition and motor vehicle tonnage taxes, and consideration of a consumption tax rate reduction system for certain classes of taxable items when the Consumption Tax rate increases to 10% (the 10% rate is scheduled to be effective from 1 October 2015).

Improvement in the tax payment system

The rate of interest on tax payments in arrears and deferred tax payments has not been revised in 14 years, since 1999. Current interest rates are lower than the 1999 rates on late tax payments and the rates applicable to refunds should be updated.

¶1-132 2014 Tax Reform Report

The general issues underlying tax reform were included in the Outline for 2014 Tax Reform issued by the Liberal Democratic Party and New Komeito coalition on 12 December 2013, the main points of which are summarised below.

The Abe government has implemented a "bold monetary policy", "mobile fiscal policy" and "growth strategy to rouse private investment" as the "three arrows" policy to escape from deflation and to revitalise the Japanese economy. Taxation measures to stimulate private investment were developed during the 14 June 2013 and 1 October 2013 Cabinet Decisions. Although these policies are having a positive effect, it is felt that the economic recovery has not sufficiently reached medium- and small-sized businesses and regional economies.

In addition, the low birthrate and ageing population give rise to medium- and long-term fiscal problems including uneven resources within and among generations and the need to stabilize local tax revenues. The 2013 reforms of the Consumption Tax and reforms of funding for social security were indispensable steps in dealing with these issues. New taxation measures will be based on changes in the society from within and without and reflecting the ability to bear taxes.

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¶1-136 2018 Tax Reform Report (平成30年度税制改正の基本的考え方)

On 14 December 2017, the ruling coalition in the Japanese House of Representatives, consisting of the Liberal Democratic Party (LDP) and Komeito, issued an outline for tax reform legislation in 2018. According to the outline the most important issue facing the Abe government over the last 5 years has been breaking away from deflation and revitalizing the economy. The employment income environment has greatly improved. Employment has increased by nearly 2 million and the ratio of regular staff job offerings to job seekers has exceeded 1 to 1 for the first time since the Ministry of Health, Labor and Welfare began compiling these statistics in 2004 and wage increases have averaged above 2% for four consecutive years.

In order to maintain this growth track, the Abe cabinet aims to overcome the problem of low birthrates and an aging society by carrying out a "revolution in productivity" and a "revolution in human resource development". The cabinet will move to boost productivity greatly, further strengthen the momentum of wage increases for the fourth consecutive year, and aim for a departure from deflation.

With the 100-year life era in view, the ruling coalition believes that Japan is being challenged with the need to shake up its economic and social system to know where each person can help create a "100 million totally active society". Reforms in the taxation system will be used to support the overall program of "working way reform". In the individual income tax these include changes in the employment income deduction, the public pension deduction and the basic deduction. Tax measures will be implemented with a view towards stimulating productivity, improving capital spending and sustained wage increases, including tax measures directed towards local medium- and small-sized companies.

To facilitate the inter-generational transfers of medium- and small-sized companies, the ruling coalition will seek to implement a special tax measure expanding the business succession tax system for a ten-year period.

In order to provide funding for the expansion of tourism in Japan, an international tourist traveler tax will be established. Measures will also be taken to stabilize the tax base of local rural areas as part of an overall plan to regain the vitality and decrease population decline in rural areas.

A forest environment tax will be established to fund planning for the meeting of Japan's greenhouse gas reduction targets under the Paris Agreement and for disaster prevention.

For sustainable economic growth it will be important to promote the development of Japanese enterprises overseas and a virtuous cycle of returning the results of that activity to the domestic economy. An international tax system that secures conditions of fair competition and effectively deals with tax evasion will provide important infrastructure to achieve this purpose. Japan has been playing a leading role in the "BEPS (Base Erosion and Profit Shifting) Project," and will continue to actively participate in international rules making and advance the system taking into consideration changing economic situations and efforts of other countries.

In recent years, there has been a rapid progression in the transformation of economic society by ICT (Information and communication technology) and active use of this technology in the tax field is needed. Therefore, expansion of electronic tax filing and payment, etc, will be promoted.

The ruling coalition will also continue to consider new tax measures affecting the tax burden based on changing economic and social conditions in Japan and developments in the international

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area. While immediate economic concerns are important, tax reforms must also take into consideration medium- and long-term factors. The tax system is tightly connected to the economic society as a whole and a simply constructed system that does not hinder opportunity and provides fairness between generations will continue to be considered.

The goal of balancing governmental revenues and expenditures by 2020 making the basic fiscal balance surplus in 2020 appears unavoidable to the ruling coalition through the decisive implementation of the "revolution in human resource development", but Japan will continue to deal with the important issues of balancing economic revitalization and fiscal consolidation. Therefore, while aiming for a budget surplus the ruling coalition will also seek a reduction in the ratio of government debt to GDP and need to incorporate concrete plans to achieve this in the "Basic Policy on Economic Fiscal Management and Reform" for the upcoming year. In view of the current severe financial circumstances confronting the government, and considering the nature of tobacco, the ruling coalition will seek to raise the rate of tax on tobacco products.

The increase in the rate of Consumption Tax to 10% will take place as scheduled on October 1, 2019, but considering the needs of low-income persons the ruling coalition will seek to establish measures to secure stable resources to support the system of reduced rates (on necessities).

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DESCRIPTION OF THE MAIN JAPANESE TAXES

¶1-200 Description of the main Japanese taxes

Each of the major Japanese taxes is enacted in a separate statute. (The statutes are described in ¶1-330.) An overview of each of the major taxes is set out below.

¶1-210 Income Tax (*Shotokuzei* — 所得税)

The Income Tax applies to the income of Japanese residents and to the Japanese source income of non-residents of Japan. Corporations are generally taxed under the Corporation Tax, but pay Income Tax on certain types of income, subject to withholding, and receive a credit for income tax paid for purposes of the Corporation Tax (CTL Art 68, Art 144). Income subject to the Income Tax varies depending on the status of the taxpayer and the nature of the income. The scope of income subject to the Income Tax will vary depending on the status of the taxpayer and the type of income.

Diagram 2: Taxable income of residents of Japan

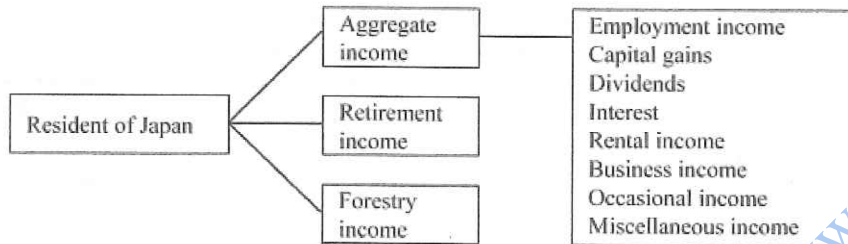

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Diagram 3: Taxable income of non-residents of Japan with a permanent establishment

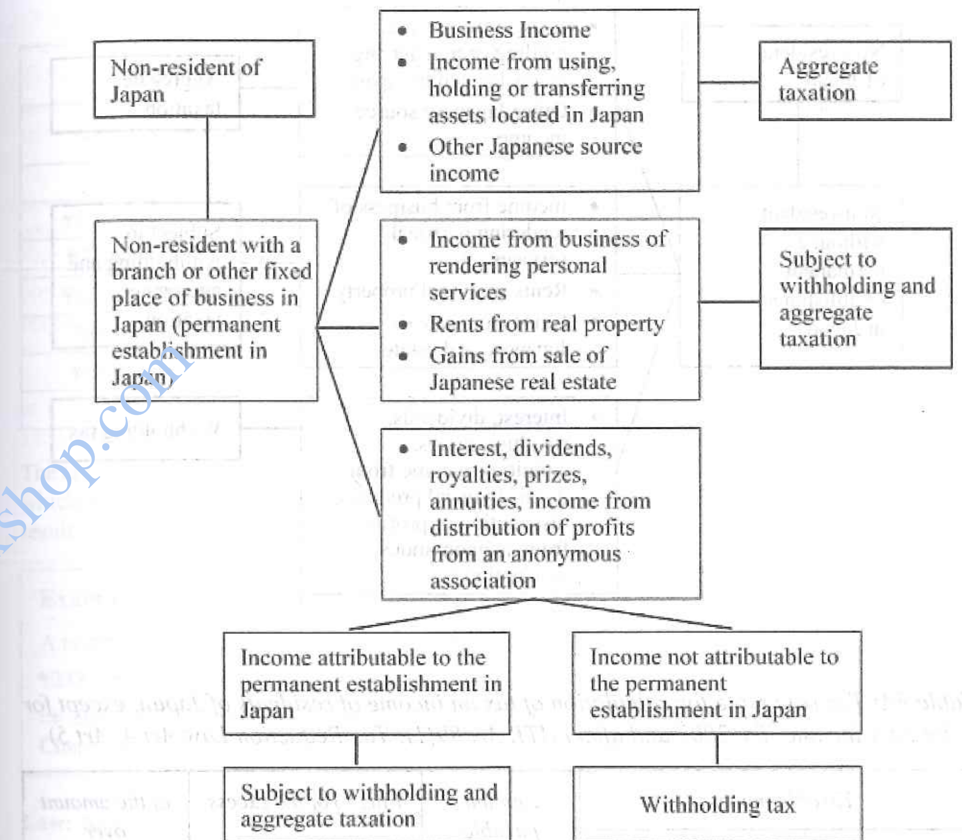

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Diagram 4: Taxable income of non-residents of Japan without a permanent establishment

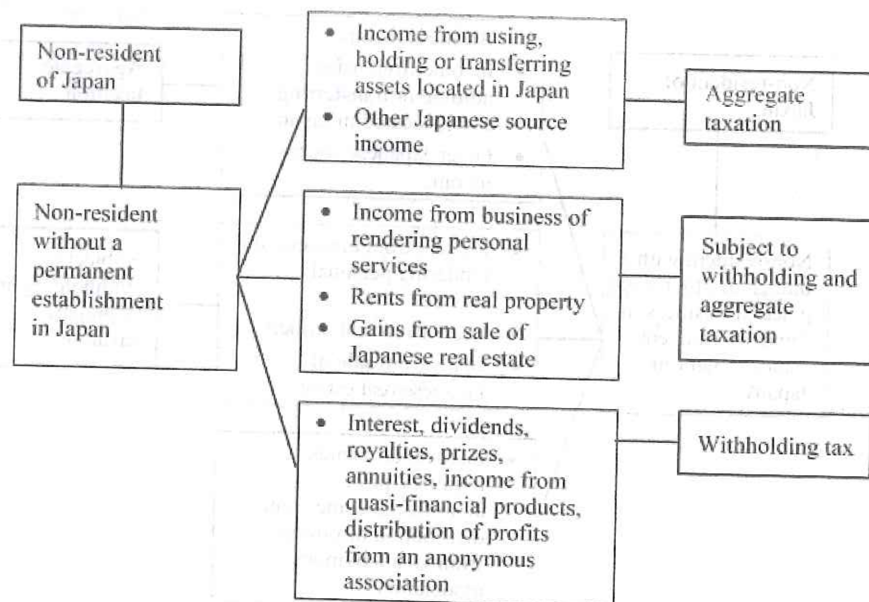

Table 9A: Tax rate table for calculation of tax on income of residents of Japan, except for forestry income (for 2007 and after) (ITL Art 89(1); Tax Reduction Law Art 4, Art 5)

Taxable income		*Amount payable*	*Plus % of the excess*	*of the amount over*
Over	*But not exceeding*			
–	¥1.95m	–	5%	–
¥1.95m	¥3.3m	¥97,500	10%	¥1.95m
¥3.3m	¥6.95m	¥232,500	20%	¥3.3m
¥6.95m	¥9m	¥962,500	23%	¥6.95m
¥9m	¥18m	¥1.434m	33%	¥9m
Over ¥18m		¥4.404m	40%	¥18m

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Table 9B: Tax rate table for calculation of tax on income of residents of Japan after 2014 (Law to Partially Revise the Income Tax Law, etc, Law No 5 of 2013, 30 March 2013, Art 1 — 所得税法等の一部を改正する法律)

Taxable income		*Pay*	*Plus % of the excess*	*of the amount over*
Over	*But not over*			
–	¥1.95m	–	5%	–
¥1.95m	¥3.3m	¥97,500	10%	¥1.95m
¥3.3m	¥6.95m	¥232,500	20%	¥3.3m
¥6.95m	¥9m	¥962,500	23%	¥6.95m
¥9m	¥18m	¥1.434m	33%	¥9m
¥18m	¥40m	¥4.404m	40%	¥18m
Over ¥40m		¥13.204m	45%	¥40m

The tax liability is computed by multiplying the taxable income by the tax rate for the tax bracket, which includes the amount of the income and subtracting the appropriate deduction from the result.

Example 1: Calculation of income tax

A taxpayer has taxable income of ¥6.5m. His/her tax is ¥872,500.

¥232,500 + 20% of (¥6.5m − ¥3.3m) = ¥872,500

⇒ Detailed discussion of the Income Tax is contained in Chapter 2 (Taxable Persons) and Chapter 4 (Corporation Tax).

Law: Art 68 and Art 144 of the *Corporation Tax Law*; Art 89(1) of the *Income Tax Law*; Art 4 and Art 5 of the *Tax Reduction Law*

¶1-211 Special Reconstruction Income Tax (*Fukko Tokubetsu Shotokuzei* — 復興特別所得税)

From 1 January 2013 through 31 December 2037, a surtax known as the Special Reconstruction Income Tax applies to domestic and foreign individuals and companies subject to Japanese Income Tax, either by assessment or through withholding (*Restoration Funding Act*, Law No 117, 2 December 2011, Art 8, Art 9 — 復興財源確保法). The surtax is computed as 2.1% of the standard Income Tax amount (*kijun shotoku zeigaku* — 基準所得税額) (*Restoration Funding Act* Art 13). The original 2011 proposal was for a surtax rate of 4% for 10 years, from 2013 through 2022, but the surtax rate as enacted was reduced to 2.1% and the period extended to 35 years in an amendment to the legislation on 24 November 2011.

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(5) a list of officers

(6) a document stating the names of all officers on the list of officers that received remuneration, and

(7) a document stating the names and addresses of 10 or more members.

Beginning 1 April 2012, administration of the NPO certification system has been transferred from the Japanese National Tax Agency (NTA) to local governmental units.

Law: Art 34 of the Civil Code; Art 2 of the Attached Schedule of the *Designated Non-Profit Activities Promotion Law*; Art 70 of the *Inheritance Tax Law*; Art 28, Art 29 and Art 46 of the *Law to Promote Specified Non-Profit Activities*; Art 41-18, Art 41-19, Art 66-11-2, Art 66-11-2(1) and Art 66-11-2(2)of the *Special Taxation Measures Law*; Art 39-22-2, Art 39-23(1)and Art 39-23(3)of the Special Taxation Measures Law Enforcement Order

¶2-342 Mutual benefit non-profit corporations (Chukan Hojin — 中間法人)

Chukan hojin are established under the *Chukan Hojin Law* (Law No 49, 2001, effective 1 April 2002) for the common benefit of their members and not to distribute surplus funds among its members. The law was designed to enable small groups such as township associations, alumni associations and social groups to incorporate easily.

A *chukan hojin* must have at least two members (it dissolves when the number of members falls below two). A corporation may be a member of a *chukan hojin*. A *chukan hojin* may be established as an unlimited liability (*mugen sekinin*) or a limited liability (*yugen sekinin*) corporation. A limited liability *chukan hojin* must be funded with at least ¥3m at the time it is established (*Chukan Hojin Law* Art 12).

A *chukan hojin* is subject to Japanese Corporation Tax on all income, including income from not-for-profit activities, in the same manner as an ordinary corporation (CTL Basic Circular 1-1-8).

Despite their origin as vehicles for small not-for-profit organizations, *chukan hojin* have been widely used as the parent company of SPCs used as securitization vehicles because the *chukan hojin* adds additional bankruptcy remoteness to the arrangement.

Abolition of the *Chukan Hojin Law*

On 2 June 2006, a law relating to *ippan shadan/zaidan hojin* entities (*Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin*, Law No 48, 2006) was enacted and the *Chukan Hojin Law* was abolished on the date the new law came into force, ie 1 December 2008. Existing limited liability *chukan hojin* automatically became general incorporated associations (*ippan shadan hojin*) at that time. The articles of incorporation of an existing limited liability *chukan hojin* must be amended to add "*ippan shadan hojin*" to the company name by a resolution passed at a general meeting of the members by the time of the first general meeting after the end of the year the new law comes into force.

An unlimited liability *chukan hojin* may continue as a special unlimited liability *chukan hojin* for up to one year after the date the new law becomes effective, during which time it must fulfil the procedures to convert to an *ippan shadan hojin*. If the conversion procedures are not performed during the one year grace period, the unlimited liability *chukan hojin* will be dissolved. Required procedures for conversion from an unlimited liability *chukan hojin* to an *ippan shadan hojin* are set

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out in the *Law Relating to Consolidation of the Execution of the Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin and the Law Relating to Koeki Shadan Hojin and Koeki Zaidan Hojin* (Law No 50, 2006). The procedures are as follows:

(1) By agreement of the members, the purpose of the *ippan shadan hojin*, its name and place of its main office, etc, must be recorded in the articles of incorporation and directors' names should be determined.

(2) Within two weeks from the time the determinations in (1) above are made, a notice must be given in an official gazette to creditors of the proposed conversion and a period of at least one month is allowed for objections to be received. Actual notice must be given to all known creditors. Response to creditors' objections may include payment of the debt, offering of collateral or placement of property in trust to secure the debt.

(3) After the creditors' procedures are completed, the dissolution of the unlimited liability *chukan hojin* and the establishment of the *ippan shadan hojin* should be officially recorded.

Law: Art 12 of the *Chukan Hojin Law* (repealed); *Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin*; *Consolidation Law Accompanying the Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin*

¶2-343 General incorporated associations/foundations (Ippan Shadan/Zaidan Hojin — 般社団•財団法人)

On 2 June 2006, three laws were enacted relating to *ippan shadan hojin* (general incorporated association) and *ippan zaidan hojin* (general incorporated foundation) entities. The laws came into force on 1 December 2008.

The three laws are:

(1) *Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin (Ippan Shadan Hojin oyobi Ippan Zaidan Hojin nikansuru Ho*, Law No 48, 2006)

(2) *Law Relating to Koeki Shadan Hojin and Koeki Zaidan Hojin (Koeki Shadan Hojin oyobi Koeki Zaidan Hojin no Nintei nikansuru Ho*, Law No 49, 2006)

(3) *Law Relating to Consolidation of the Execution* of the (above two laws) *(Ippan Shadan Hojin oyobi Ippan Zaidan Hojin nikansuru Ho oyobi Koeki Shadan Hojin oyobi Koeki Zaidan Hojin no Nintei nikansuru Ho no Shiko ni Tomonau Kankei Ho no Seibi nikansuru Ho)*.

Before the reforms, the acquisition of corporate status and the determination of a public purpose were part of a single process requiring the permission of the competent authorities having jurisdiction over the applicant's activities (the "licence principle" (*kyoka shugi*)). Under the new system's "rule principle" (*junsoku shugi*), an association (*shadan*) or foundation (*zaidan*) that does not intend to distribute its surplus may be established as an *ippan shadan hojin* or *ippan zaidan hojin* by registering the corporation without having to demonstrate a public purpose. An *ippan shadan hojin* or *ippan zaidan hojin* may apply for non-profit status as a *koeki shadan hojin* (public interest association) or *koeki zaidan hojin* (public interest foundation) through the office of the Prime Minister or a regional district governor (*todofuken chiji*). The Prime Minister and governors' offices will establish committees consisting of private sector specialists to determine the public interest character of the applicant.

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General requirements for an *ippan shadan hojin* (general incorporated association)

(1) An *ippan shadan hojin* must have at least two members, but there are no minimum property requirements.

(2) An *ippan shadan hojin* must have a director and a general members' meeting.

(3) A board of directors and independent auditor can be specified in the articles of incorporation.

(4) A fund system may be established in order to collect funds and maintain property.

General requirements for an *ippan zaidan hojin* (general incorporated foundation)

(1) The originators are expected to contribute at least ¥3m.

(2) The purpose of the foundation may not be changed without a provision for such change in the articles of incorporation.

(3) A board of trustees supervises the director and participates in important decisions of the foundation.

(4) A foundation has a board of directors, board of governors and an auditor. The articles of incorporation may provide for an independent auditor.

General requirements for non-profit status as a *koeki shadan hojin* (public interest association) or *koeki zaidan hojin* (public interest foundation)

(1) The organization must be engaged in one of 20 enumerated activities in the scientific, art, charitable, etc, fields.

(2) The public interest activity of the organization is assumed to be its main purpose; it will maintain adequate accounting and technical systems; it will not engage in activities that undermine public confidence; and its income and expenditure will be commensurate with the public interest activity.

(3) The public interest activity of the organization is expected to comprise at least 50% of its financial activity and idle assets are expected to be limited to a certain amount.

(4) The organization does not share more than one-third of its directors with related organizations; the organization has an independent auditor, except in cases where earnings do not exceed a certain amount; and standards for compensation not exceeding reasonable amounts are established for payments to directors, managers and members of the board of trustees.

(5) The organization does not own property such as stock of a corporation, etc, that allows it to take part in the decision-making of another corporation, etc; and the articles of incorporation provide that on the loss of public interest status, dissolution or merger, the organization's remaining assets relating to the organization's public interest activity will be donated to another public interest organization carrying on a similar activity.

(6) Organizations disqualified from non-profit status include those whose activities are directed by gangsters, or whose directors are gangsters; those whose taxes have been in arrears during the last three years; and an organization whose non-profit status has been cancelled during the last five years.

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Law: *Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin*; *Law Relating to Koeki Shadan Hojin and Koeki Zaidan Hojin*; *Law Relating to Consolidation of the Execution of the Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin and the Law Relating to Koeki Shadan Hojin and Koeki Zaidan Hojin*

¶2-350 Cooperatives (Kyodo Kumiai — 協同組合)

Cooperatives are associations of individuals or managers of medium- or small-sized enterprises that join together for mutual assistance and support. For Corporation Tax purposes, cooperatives are subject to a reduced rate of 22% (19% for tax years beginning on or after 1 April 2012) on their annual taxable income (CTL Art 66(3)). A reduced rate of 18% applies to annual taxable income not exceeding ¥8m in tax years ending between 1 April 2012 and 31 March 2015 (STML Art 42-3-2(1)). Distributions to members may be deducted from the income of a cooperative to the extent that the distribution is based on the member's activity within the cooperative or the extent to which the member utilised the facilities of the organization (CTL Art 60-2). Separate Schedule 3 of the *Corporation Tax Law* lists the cooperatives recognised for tax purposes (CTL Art 2(1)(vii)).

Table 12: CTL Separate Schedule 3 — Cooperatives

Name of cooperative	*Governing statute*
Life Hygiene Guild (limited to those requiring capital contributions from members)	Law No 164, 1957
Life Hygiene Guild Federation (limited to those requiring capital contributions from members)	
Life Hygiene Guild Small Association	
Mutual Aid Fishery Cooperative Association Federation	Law No 242, 1948
Fisheries Cooperative Association	
Fisheries Cooperative Association Federation	
Fishery Productive Society (excluding those that pay remuneration to members)	
Commercial and Industrial Association (limited to those requiring capital contributions from members)	Law No 185, 1957
Commercial and Industrial Association Federation (limited to those requiring capital contributions from members)	
Shopping Street Promotion Union	Law No 141, 1962
Shopping Street Promotion Union Federation	
Consumer's Cooperative Society	Law No 200, 1948
Consumer's Cooperative Society Federation	
Shinkin Bank	Law No 238, 1951
Shinkin Bank Federation	

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Forestry Cooperative	Law No 36, 1978
Federation of Forestry Cooperatives	
Marine Product Processing Industry Cooperative Association	Law No 242, 1948
Marine Product Processing Industry Cooperative Association Federation	
Production Forestry Cooperative (excluding those paying remuneration to members)	Law No 36, 1978
Shipowner Mutual Benefit Society	Law No 177, 1950
Cigarette Cultivation Union	Law No 135, 1958
Small and Medium-Sized Business Cooperative Association (excluding joint enterprise cooperatives)	Law No 181, 1949
Coastal Shipping Association	Law No 162, 1957
Federation of Coastal Shipping Associations	
Japan Agricultural Cooperative	Law No 132, 1947
Federation of Agricultural Cooperation Associations (excluding those designated by the Minister of Finance)	
Farming Affairs Union Corporation (excluding those carrying on designated businesses and paying remuneration to members)	
Norinchukin Bank	Law No 93, 2001
Export Association (limited to those requiring capital contributions from members)	Law No 299, 1952
Export Fishery Union	Law No 154, 1954
Import Association (limited to those requiring capital contributions from members)	Law No 299, 1952
Labour Credit Associations	Law No 227, 1953
National Federation of Labour Credit Associations	

Law: Art 2(1)(vii), Art 60-2, Art 66(3)and Separate Schedule 3 of the *Corporation Tax Law*; Art 42-3-2(1)of the *Special Taxation Measures Law*; *Forestry Cooperative Law*

¶2-360 Non-juridical organizations (Jinkaku No Nai Shadan — 人格のない社団)

A non-juridical organization (referred to in the *Standard Bilingual Dictionary* as an "association or foundation without juridical personality") is an unincorporated association (*shadan*) or foundation (*zaidan*) that has appointed a representative or manager (CTL Art 2(1)(viii)). There are numerous kinds of non-juridical organizations, including labour unions, political parties and parent-teacher associations. Under the *Corporation Tax Law*, they are generally treated the same as ordinary corporations (CTL Art 3) but, like public interest corporations (*koeki hojin*), non-juridical organizations are liable for Corporation Tax only on income derived from for-profit activities (CTL Art 4(1)).

Law: Art 2(1)(viii), Art 3 and Art 4(1) of the *Corporation Tax Law*

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UNINCORPORATED ASSOCIATIONS (*KUMIAI* — 組合)

¶2-400 Unincorporated associations (Kumiai — 組合)

There are four types of unincorporated associations (referred to in the *Standard Bilingual Dictionary* as "partnerships" or "unions") in Japan which are taxed at the member level rather than at the entity level. These are the Commercial Code anonymous association (*tokumei kumiai*), the Civil Code association (*nin-i kumiai*), the Japanese LLP (*yugen sekinin jigyo kumiai*) and the investment business limited partnership (*toshi jigyo yugen sekinin kumiai*).

Commercial Code anonymous association (*tokumei kumiai* — 匿名組合)

A Commercial Code anonymous association (referred to in the *Standard Bilingual Dictionary* as a "silent partnership") is created when one or more parties agree, by separate contracts, to make a contribution to a business operated by a proprietor and to divide the profits arising from the business (Commercial Code Art 535). Only the proprietor takes part in the management of the business (Commercial Code Art 542) and no party other than the proprietor has legal rights or obligations arising from acts of the proprietor with regard to third parties (Commercial Code Art 536(2)). A Commercial Code anonymous association is not an incorporated entity and is not subject to the Corporation Tax. Income is allocated to each of the parties under the agreement and, as in the case of a Civil Code association, is included in the taxable income of the parties in the tax year, which includes the last day of the association's tax year, whether or not the income has been distributed (CTL Basic Circular 14-1-3).

Losses from a Commercial Code anonymous association attributable to real estate are not allowed to an individual member who does not participate in the management of the association (STML Art 41-4-2). A corporate member of a Commercial Code anonymous association (*tokumei kumiai*) that is not involved in an important part of the management of the association cannot take losses for tax purposes in excess of its capital contribution (or take any loss if the partnership cannot be expected to bear the losses arising from its activities) (STML Art 67-12).

Beginning 1 April 2002, all distributions of profits from a Commercial Code anonymous association (*tokumei kumiai*) to a non-resident individual or foreign corporation are subject to withholding at a rate of 20% regardless of the number of members (ITL Art 161(1)(xii), Art 164(2)(ii); ITL-EO Art 288 (as amended by Order 103, 2002); CTL-EO Art 184 (as amended by Order 104, 2004)).

Civil Code association (*nin-i kumiai* — 任意組合)

A Civil Code association (or voluntary association) is a contract between parties who agree to carry on a joint undertaking by making a contribution, which may include services (Civil Code Art 667). The contributions of the parties belong to all of the parties jointly and the conduct of the affairs of the association is made by majority vote (Civil Code Art 668, Art 670). The association is not subject to the Corporation Tax. Unless the agreement states otherwise, profits and losses are allocated in proportion to the value of the contributions by each party (Civil Code Art 674). The allocable share of income from the association flows through to each party and is included in the tax return in the tax year, which includes the last day of the association's tax year, whether or not

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Law: Art 667, Art 668, Art 670 and Art 674 of the Civil Code; Art 485-2, Art 535, Art 536(2) and Art 542 of the Commercial Code; Art 161(1)(i), Art 161(1)(ii), Art 161(1)(xii), Art 164(2)(ii) and Art 212(5) of the *Income Tax Law*; *Law Related to Limited Liability Partnership Agreements*; Art 41-4-2 and Art 67-12 of the *Special Taxation Measures Law*; Art 184 of the Corporation Tax Law Enforcement Order; Art 281-2(1)(iii), Art 281-2(2) and Art 288 of the Income Tax Law Enforcement Order

¶2-420 Tax shelters (Takkusu Shieruta — タックス•シエルター)

The Japanese NTA is concerned with the increasing use of tax shelters by Japanese taxpayers. In particular, it is looking at the use of Japanese partnership associations (Civil Code associations (*nin-i kumiai*) and Commercial Code anonymous associations (*tokumei kumiai*)) as vehicles by which Japanese individuals and corporations are allocated tax shelter losses from investments in aircraft, motion pictures, container ships, and foreign residential and commercial real estate. Japanese partnership associations are also being used as receptacles (*ukezara*) for investments in US limited partnerships. The US has implemented a number of limitations on tax shelters, including limitations on losses to the amount the investor has at risk in the activity, and limits on the use of net losses from passive activities to offset other income. The need for similar limitations in Japan has been raised in a report of the Tax Commission (14 July 2000) and is being considered by the NTA.

Illustration of typical tax shelter using aircraft, etc, leveraged leasing

A typical tax shelter for the leasing of aircraft or other equipment may be organised and operated as follows:

(1) An investment company organises the venture and solicits investors.

(2) The investors and the investment company contribute capital and become members of a Civil Code association.

(3) Additional capital is obtained from a financial institution. Interest payments on this loan make up part of the tax shelter losses.

(4) The aircraft, etc, is purchased in the market.

(5) The aircraft, etc, is leased to an operator and lease fees are received.

(6) Depreciation on the aircraft, etc, is taken by the Civil Code association. Depreciation expenses make up a large part of the tax shelter losses (see limitations on accelerated depreciation when property is leased to a foreign person (CTL-EO Art 48(1)(vii)).

(7) Profits and losses (ie lease receipts less interest, depreciation and other costs) are passed through the Civil Code association to the investors.

(8) At the end of the lease term, the aircraft, etc, is sold in the market.

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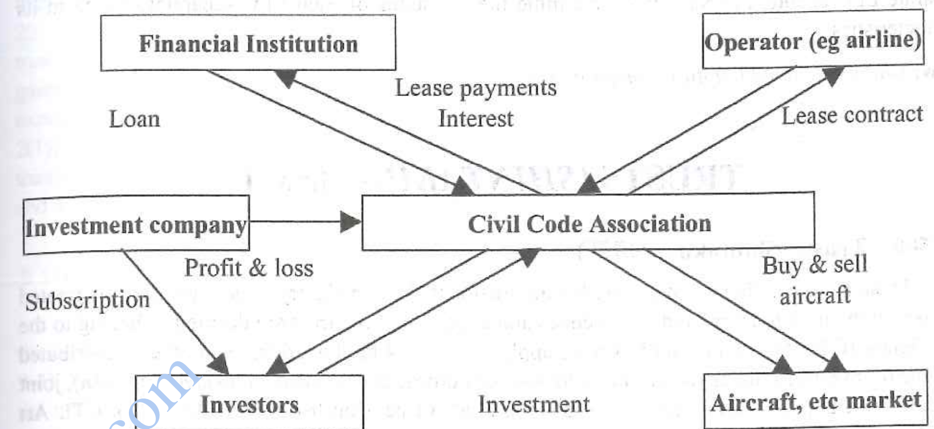
Diagram 6: Tax shelter structure using leveraged leasing



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Law: Art 48(1)(vii) of the Corporation Tax Law Enforcement Order

¶2-430 Limited liability companies (Beikoku No Rimiteddo Raiabiritei Kanpani — 米国のリミテッド•ライアビリティー•カンパニー)

Limited liability companies (LLCs) are organizations created under laws of the 50 States and the District of Columbia in the United States. The limited liability company (LLC) business form has its origin in the 1892 German company law known as *Gesellschaft mit beschrnkter Haftung* (GmbH). In 1977, Wyoming became the first American state to enact an LLC Act modelled after the 1892 German GmbH Code and the Panamanian LLC. LLCs generally require the use of the word "limited" in the company's name, they are given full juristic personality, the members are allowed to control the admission of new members to the company, the LLC must be dissolved by the death of a member, and members or managers of the LLC are usually excluded from litigation involving the business. The laws are not uniform and distinctions exist among the technical requirements from State to State. In 1988, the US IRS issued Revenue Ruling 88-76, which held that a Wyoming LLC would be treated as a partnership for US federal income tax purposes. LLCs generally provide their owners with limited liability, which is similar to corporations, but the income of LLCs flows through to the owners as in a partnership, eliminating the double tax on corporate income. For US income tax purposes, LLCs may also elect to be taxed as a corporation.

The Japanese NTA has taken the position that for tax purposes, an LLC most closely resembles a Japanese corporation. Under the *Uniform Limited Liability Company Act* (1995), an LLC "has the same powers as an individual to do all things necessary and convenient to carry on its business, not limited to listed specific powers". An LLC must register as a separate legal entity with the State and

is treated as a legal person subject to lawsuits. An entity with such characteristics would generally be treated as a corporation for Japanese tax purposes. However, since each of the US States has a separate LLC statute, the NTA will determine the tax status of each LLC separately based in its characteristics.

Law: *Uniform Limited Liability Company Act*

TRUSTS (*SHINTAKU* — 信託)

¶2-500 Trusts (Shintaku — 信託)

In Japan, a beneficiary of a trust (or the trustor if the beneficiary is not specified) is treated as owning the trust property and all revenues and expenses of the trust are deemed to belong to the beneficiary (CTL Art 12(1)). Special rules apply that do not tax beneficiaries on the undistributed income of investment trusts (*toshi shintaku*), special purpose trusts (*tokutei mokuteki shintaku*), joint operation trusts (*godo unyo shintaku*) and some kinds of pension trusts (ITL Art 13(1); CTL Art 12(1)).

2007 legislation

A new *Japanese Trust Law* was passed by the Diet on 8 December 2006. Legislation enacted in 2007 addresses various new forms of trusts and provides for Corporation Tax of the trustee in some cases. The 2007 tax revisions are applicable to new types of trusts.

2007 tax revisions applicable to new types of trusts

Trust taxed as a corporation (hojin kazei shintaku — 法人課税信託)

A trust will generally be taxed similarly to a corporation if the trust issues beneficial rights in the form of securities, the trust does not have beneficiaries that are deemed to own the income, expenses, assets and liabilities of the trust, and all or a major part of the business of a corporation has been entrusted to the trust and shareholders of the entrusting corporation own more than 50% of the beneficial interests in the trust (CTL Art 2(29-2), Art 4-6). Beneficial interests in a trust taxed as a corporation are generally treated as stock or capital investments in a corporation and the holders of those interests are treated as shareholders (CTL Art 4-7(1)(vi)).

Trusts issuing beneficiary certificates (jueki shoken hakko shintaku — 受益証券発行 信託)

A trust issuing beneficiary certificates that meet the following three requirements is treated as a "specified trust issuing beneficiary certificates" (特定受益証券発行信託) (CTL Art 2(29)(iii)):

(1) the trustee is a corporation approved by the head of the Tax Office

(2) the amount of undistributed earnings of the trust must be below 2.5% of the value of the principal aggregate amount of the trust, and

(3) each trust income calculation period must be one year or less.

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There is no trust-level tax on the trustee of a specified trust issuing beneficiary certificates and its beneficiaries are taxed on trust income and expenses at the time distributions are made. Dispositions of trust certificates are treated as capital gains from dispositions of shares. Tax legislation effective 1 June 2010 treats the proceeds of a termination (*shuryo*) or partial redemption (*ichibu no kaiyaku*) of a specified trust issuing beneficiary certificates in the same way as a disposition of stock shares, eligible for capital gains treatment to the extent the distribution represents a distribution of trust principal. Distributions in excess of trust principal are treated as dividends, subject to Income Tax withholding (STML Art 9-4-2(1)). If a trust issuing beneficiary certificates does not meet the requirements for a specified trust, the trustee is subject to Corporation Tax on the income of the trust separately from the trustee's other income and distributions from the trust will be treated as taxable dividends to the beneficiaries.

Trust without beneficiaries (juekisha nado no sonzai shinai shintaku — 受益者等の存在しない信託)

If no trust beneficiaries are specified, such as in a testamentary trust without named beneficiaries, the creation of the trust is treated as a gift from the trustor to the trustee (*Inheritance Tax Law* Art 9-4). Income from the trust is taxed to the trustee separately from the trustee's other income. When the trust is terminated, the recipient will be subject to Income or Corporation Tax on the residual assets. If a relative of the trustor later becomes the beneficiary of a trust without named beneficiaries, the receipt of rights in the trust by that relative is treated as a gift from an individual (*Inheritance Tax Law* Art 9-5). If a trust provides for beneficial interests to pass in sequence (*juekisha renzokugata shintaku*) among beneficiaries, each of the sequential beneficiaries will be deemed to have received their rights in the trust by inheritance or gift (*Inheritance Tax Law* Art 9-3).

Additional tax measures will be implemented to prevent avoidance of inheritance and gift taxes. For example, if the trust is used to take advantage of Corporation Tax rates that are lower than the inheritance tax rate, the trustee will be subject to the inheritance tax (with the Corporation Tax allowed as a deduction). When beneficiaries are later named and are the trustor's grandchildren, etc, gift tax will be imposed on the beneficiaries.

Serial beneficiary type trust (juekisha renzokugata shintaku — 受益者連続型信託)

If the trust provides for changes in beneficiaries, the initial beneficiaries and each succeeding beneficiary will be treated as having received their beneficial interest from the trustor or the prior beneficiary, as appropriate, and will be subject to inheritance or gift tax.

Tax treatment of losses from trusts

- *Individuals*. When trust income is taxed to the beneficiaries, no trust losses attributable to real estate income (*fudosan shotoku*) may be taken by the beneficiary.
- *Corporations*. Corporate beneficiaries may not recognise losses in excess of their investment in the trust (*shintaku kingaku*) or where it is evident that the corporation will not bear the loss (eg where there is an agreement to limit the losses of the corporation).

Tax avoidance measures

In order to prevent tax avoidance through the use of trusts, Corporation Tax will be imposed on the trustee for income of the trust in the following cases:

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- All or a major part of the business of a company is transferred to a trust (limited to such transfers requiring a resolution described in Art 467 of the *Company Law*) and more than 50% of the beneficial interests are expected to be distributed to the transferring company's shareholders.
- The trustee is the same person as the transferring company, or is an individual or corporation that has a specified relationship with the transferring company, and the term of the trust is more than 20 years (except if the main assets of the trust are depreciable assets with useful lives greater than 20 years; or non-depreciable assets; or monetary claims with redemption periods exceeding 20 years).
- A trust where the trustee is the transferring company or a related person and part of the beneficial interests are owned by a related person, if the income distribution rates are changeable.

Law: Art 467 of the *Company Law*; Art 12(1), Art 2(29)(iii), Art 2(29-2), Art 4-6 and Art 4-7(1)(vi) of the *Corporation Tax Law*; Art 13(1)of the *Income Tax Law*; Art 9-3, Art 9-4 and Art 9-5 of the *Inheritance Tax Law*; *Japanese Trust Law*; Art 9-4-2(1)of the *Special Taxation Measures Law*

¶2-510 General rules

The general rules for trusts in Japan are that the beneficiaries are considered to own the trust property and all revenues and expenses of the trust flow through to the beneficiaries (CTL Art 12(1)(a)). Under these general rules, the income of a trustee or trust company is usually limited to service fees (CTL Art 12(3)). No trust tax return or information return is required. If no beneficiary is specified, the grantor is considered the owner of the trust property (CTL Art 12(1)(b)). The identity or existence of a beneficiary is determined based on the circumstances at the time of the relevant item of income or expense (CTL-EO Art 15).

The flow-through rules do not apply to, and beneficiaries are not taxed on, the undistributed income of investment trusts (*toshi shintaku*) (see ¶2-530), Special Purpose Trusts (*Tokutei Mokuteki Shintaku*) (see ¶2-620), joint operation trusts (*godo unyo shintaku*) (see ¶2-520) and various types of pension trusts (ITL Art 13(1); CTL Art 12(1)).

Types of trusts

Investment trusts (*toshi shintaku*) in Japan are regulated under the *Law on Securities Investment Trusts and Companies* ("Investment Trust Law" — *Toshi shintaku oyobi Toshihojin ni kansuru Horitsu*, Law No 198, 1951). Investment trusts may invest in securities, bonds, real estate and other assets.

A trustor instruction trust (*itakusha sashizukei toshi shintaku*) is a trust where trust assets are transferred to a trust to be managed according to the instructions of the trustor, while a trustor non-instruction type trust (*itakusha hisashizukei toshi shintaku*) is managed by the trustee.

A joint operation trust (*godo unyo shintaku*) is a monetary trust undertaken by a trust company in which the trust assets of a number of trustors not cooperating with each other are invested jointly (ITL Art 2(11)).

Securities investment trusts (*shoken toshi shintaku*) are used to collect and manage diversified funds of stocks and bonds.

Bond investment trusts (*koshasai toshi shintaku*) are similar to securities investment trusts, but hold only bonds (ITL Art 2(1)(xv); CTL Art 2(1)(xxix)).

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Law: Art 2(1)(xxix), 12(1), 12(1)(a), 12(1)(b) and 12(3)of the *Corporation Tax Law*; Art 2(1)(xv), 2(11) and 13(1)of the *Income Tax Law*; *Law on Securities Investment Trusts and Companies*

¶2-520 Joint operation trusts (Godo Unyo Shintaku — 合同運用信託)

A joint operation trust is a monetary trust, other than a trustor non-instruction type investor trust, undertaken by a trust company in which the trust assets of a number of trustors not cooperating with each other are invested jointly (ITL Art 2(11)).

Law: Art 2(11) of the *Income Tax Law*

¶2-530 Investment trusts (Toshi Shintaku — 投資信託)

Investment trusts in Japan are regulated under the *Law on Securities Investment Trusts and Companies* ("Investment Trust Law" — *Toshi shintaku oyobi Toshihojin ni kansuru Horitsu*, Law No 198 of 4 June 1951, as amended on 31 May 2000, effective beginning 30 November 2000). Before revision of the law in 2000, trust assets were limited to bonds and securities, but now they may also include real estate and other assets. Investment trusts are of two types (*Investment Trusts and Investment Companies Law* Art 2(3)):

- *Trustor instruction type (itakusha sashizukei toshi shintaku)*. Trust assets, which may be securities, real property or other assets, are transferred to a trust to be managed according to the instructions of the trustor (*Investment Trusts and Investment Companies Law* Art 2(1)).
- *Trustor non-instruction type (itakusha hisashizukei toshi shintaku)*. Pursuant to a trust contract between a trustee and multiple trustors intended to pool the investment money of numerous investors. But the trust is not designed to be an investment in specific assets and the trustee does not manage the trust according to the orders of the trustors (*Investment Trusts and Investment Companies Law* Art 2(2)).

Foreign investment trusts

Beginning 15 December 1998, notification must be given to the Financial Supervisory Agency (FSA) before any foreign trust funds are offered or sold in Japan, including sales or offers to sell by third parties (*Investment Trusts and Investment Companies Law* Art 58 and Enforcement Regulations Art 98).

Securities investment trusts (*shoken toshi shintaku* — 証券投資信託)

Securities investment trusts are investment trusts used by trust companies to collect and manage funds obtained from investors (*Investment Trusts and Investment Companies Law* Art 2(4); ITL Art 2(1)(xiii); CTL Art 2(1)(xxviii)). Investments are generally in diversified portfolios of stocks and bonds, and income (or loss) is distributed to the investors based on the performance of the fund. Principal is not guaranteed and risks and returns are tailored to suit the needs of the investor.

Bond investment trusts (*koshasai toshi shintaku*)

Bond investment trusts are securities investment trusts which invest only in bonds (ITL Art 2(1)(xv); CTL Art 2(1)(xxix)).

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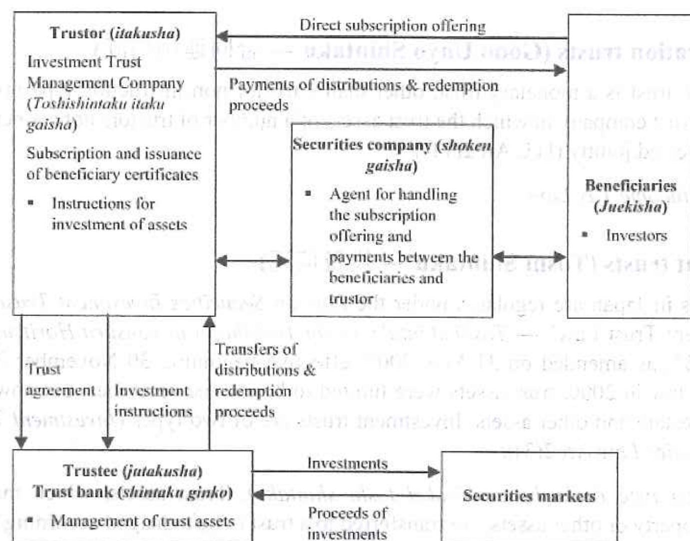
Diagram 7: Basic scheme of investment trusts



Law: Art 2(1)(xxviii) and Art 2(1)(xxix) of the *Corporation Tax Law*; Art 2(1)(xiii); Art 2(1)(xv) of the *Income Tax Law*; Art 2(1), Art 2(2), Art 2(3), Art 2(4) and Art 58 of the *Investment Trusts and Investment Companies Law*; Art 98 of the *Enforcement Regulations of the Investment Trusts and Investment Companies Law*

¶2-540 Parties to investment

Trustor (*itakusha* — 委託者)

The trustor of an investment trust is an investment trust management company which administers the trust and directs its investments, including making investment decisions. Trustors must be approved by the Prime Minister (*Investment Trusts and Investment Companies Law* Art 8). When the trust is first established, the trustor is the initial beneficiary.

Trustee (*jutakusha* — 受託者)

The trustee, which is generally a trust bank or trust company, is responsible for the custody and disposition of the trust property and follows the directions of the trustor regarding investments.

Beneficiary (*juekisha* — 受益者)

When the trust is subscribed to, the beneficial interests in the trust are distributed as beneficiary certificates (*jueki shoken*) among the investors who become the beneficiaries of the trust.

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Investment company (*toshi hojin* — 投資法人)

Investment companies handle sales of subscriptions, redemptions of interests and distributions of income to the investors.
Law: Art 8 of the *Investment Trusts and Investment Companies Law*

¶2-550 Types of investment trusts

The *Investment Trust Law* establishes two types of investment trusts: the contract type and the company type.

Contract type investment trusts (*keiyakugata toshi shintaku* — 契約型投資信託)

In a contract type investment trust (*toshi shintaku*), an asset manager can either entrust management to a trust bank or manage assets on its own. Typically, this type of trust is formed pursuant to a contract between an investment trust management company as the trustor and a trust bank as the trustee. Investment rights in the form of beneficiary certificates are then sold to the investors (beneficiaries). Most investment trusts in Japan are of the contract type.

Company type investment trusts (*kaishagata toshi shintaku* — 会社投資信託)

This type of investment vehicle consists of an investment company (*toshi hojin*) established to manage the investments. Investors receive shares in the company in return for their investment and receive distributions of profits in the form of company dividends. Company type investment trusts have been permitted since November 1998.

Special Purpose Trusts (*Tokutei Mokuteki Shintaku* — 特的目的信託)

See Special Purposes Trusts discussed with asset securitization vehicles at ¶2-620 below.

Real estate investment trusts (REIT or J-REIT)

Japan's REIT market began on 1 April 2001, based on amendments to the *Investment Trust Law* in November 2000. A REIT is a pool of funds collected from investors that makes diversified investments in real property. Legally, a REIT may be in the form of a contract or company type investment trust, but most of the REITs contemplated in Japan (J-REITs) are of the company type. 2013 tax legislation removes a provision in the J-REIT law that prevents a J-REIT from holding 50% or more of the stock or capital of a foreign company, provided the foreign investment is exclusively for the purpose of investment in foreign real estate (*Law to Partially Revise the Income Tax Law, etc*, Law No 5 of 2013, 30 March 2013, Art 8 — 所得税法等の一部を改正する法律). The investors receive shares of stock of the investment company and are allocated the rents and profits from sales of fund properties in the form of company dividends. The REIT may avoid or reduce Corporation Tax at the company level if it satisfies certain conditions, including distributing more than 90% of distributable profits to investors (STML Art 67-14).

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at least 80% of the shareholders of the divided corporation are expected to continue as shareholders of the succeeding corporation.

(4) For transfers on or after 1 April 2017, a qualified corporate division may take the form of a spin-off (スピンオフ) of a business to a new corporation where shareholders of the succeeding corporation receive only shares in the succeeding corporation in proportion to their shareholdings in the divided corporation and the corporation division satisfies the following criteria:

(a) the divided corporation is not controlled by any person before the division and it is not contemplated that the succeeding corporation will be continuously controlled by any person after the division.

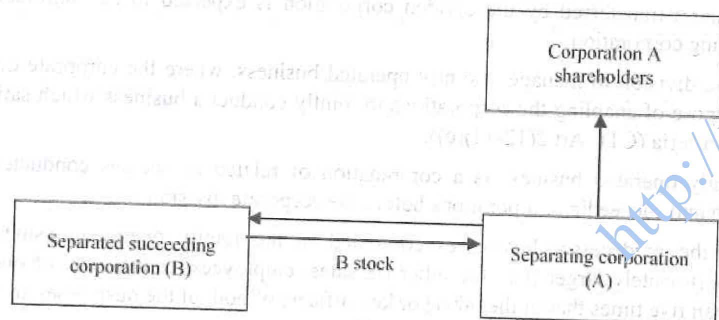
(b) the principal assets and liabilities of the business being divided are transferred to the succeeding corporation

(c) approximately 80% or more of the employees of transferred business are expected to be engaged in the business of the succeeding corporation

(d) the transferred business of the divided corporation is expected to be continuously carried out by the succeeding corporation, and

(e) it is expected that directors or key employees of the divided corporation will become specified directors of the succeeding corporation.

Diagram 11: Subsidiary-type corporate division



Tax-free incorporation of a subsidiary (*genbutsu shusshi* — 現物出資)

In a regular tax-free incorporation, the assets and liabilities are transferred by the transferring corporation and received by the subsidiary corporation (the "separated succeeding corporation", *bunkatsu shokei hojin* (分割承継法人)) at their market values (CTL Art 62). In a qualified tax-free incorporation, the assets and liabilities are transferred and received at their book values and gain is deferred (CTL Art 62-4). A qualified tax-free incorporation may be structured as a wholly owned industrial group internal investment-in-kind, a controlled industrial group internal investment-in-kind, or an investment-in-kind to manage a jointly-operated business (CTL Art 2(12-14)). The requirements for these qualified tax-free incorporations generally parallel those listed above for a wholly owned industrial group internal corporate division, a controlled industrial group internal corporate division or a corporate division to manage a jointly-operated business.

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Distribution-in-kind (*genbutsu bunpai* — 現物分配)

Beginning in 2017, a company may effect a corporate division that is tax-free to the corporation and to its shareholders by means of a distribution-in-kind of the shares of its 100% owned subsidiary to its shareholders where the distribution is in the form of a dividend of either profit or surplus if the following criteria are satisfied (CTL Art 2, Art 23, Art 61-2, Art 262-5):

(a) only shares in the subsidiary corporation in proportion to the shareholders' proportional shareholdings in the distributing corporation are distributed

(b) the distributing corporation is not controlled by any person before the distribution and it is not contemplated that the subsidiary corporation will be continuously controlled by any person after the distribution

(c) approximately 80% or more of the employees of the subsidiary are expected to continue their duties in business of the subsidiary

(d) the main business of the subsidiary is expected to continue to be carried on, and

(e) not all of the specified directors of the subsidiary will resign in connection with the distribution.

Transfers involving foreign assets and foreign companies

- Certain property located in Japan, including real property, rights to real property, mining or quarrying rights, or assets and liabilities of a business, may not be transferred to a foreign company in a qualified tax-free incorporation (CTL Art 2(12-14); CTL-EO Art 4-2(7)).
- For transfers on or after 1 April 2016, transfers of assets (but not real property located in Japan where a post-contribution inter-company transfer of the property is contemplated) to foreign companies may be permitted in a qualified tax-free incorporation if the assets will be directly attributable to the foreign company's permanent establishment in Japan.
- Transfers of foreign property by a Japanese company to a foreign subsidiary are generally qualified, but not if assets (other than cash, deposits, inventory or securities) have been transferred by the Japanese company to its foreign office within one year of the contribution in kind where the assets become directly attributable to an office of the foreign company.
- Transfers of foreign assets between foreign companies are not qualified where the assets become directly attributable to the transferee foreign company's permanent establishment in Japan.
- Effective for transfers on or after the date of promulgation of the 2011 *Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation* (30 June 2011), a contribution of assets located outside of Japan by a foreign corporation to a domestic Japanese corporation does not qualify as a tax-free transaction (*Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation* (2011) Art 3).

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Qualified subsequent contribution-in-kind incorporation (*tekikaku jigo setsuritsu* — 適格事後設立)

A subsequent contribution-in-kind incorporation occurs if, within two years of its incorporation, a transferee corporation (*hijigo setsuritsu hojin* — 被事業設立法人) buys pre-existing assets (and liabilities) from a transferor corporation (*jigo setsuritsu hojin* — 事業設立法人) under a contract described in *Japanese Company Law* Art 467(1)(v) or *Insurance Business Law* Art 62-2(1)(iv) (CTL Art 2(12-6, 7)). In a qualified subsequent contribution-in-kind incorporation, a gain or loss occurs if the consideration paid by the transferee is different from the cost basis of the net assets sold to the transferor (CTL Art 62-5). Any recognised gain or loss increases or decreases the basis of the transferee stock.

In order to be treated as a qualified subsequent contribution-in-kind incorporation, the four requirements listed below must be satisfied (CTL Art 2(12-15); CTL-EO Art 4-2(13)):

(1) From the time of incorporation of the transferee corporation to the time of the subsequent contribution-in-kind, the transferor corporation has held all of the stock of the transferee corporation.

(2) After the subsequent contribution-in-kind, the transferor corporation is expected to continue to hold all of the stock of the transferee corporation.

(3) The subsequent contribution-in-kind has been arranged at the time of the incorporation of the transferee corporation and the subsequent contribution occurs within six months from that time of incorporation. (The tax office may extend this time in the event of unavoidable circumstances delaying the transfer.)

(4) The price of the assets transferred in the subsequent contribution-in-kind is approximately the same as the amount paid in by the transferor corporation at the time of incorporation of the transferee corporation.

However, a qualified subsequent contribution-in-kind incorporation may not include the transfer of certain kinds of property located in Japan to a foreign corporation (CTL Art 2(12-15)), including real property, rights to real property, mining and quarry rights, liabilities or assets of a business establishment in Japan (other than an interest of 25% or more in the outstanding stock of a foreign corporation) (CTL-EO Art 4-2(7)).

> **Example 9: Qualified subsequent contribution-in-kind incorporation**
>
> Transferor Corporation incorporates Transferee Corporation by contributing ¥10,000 in exchange for all the Transferee Corporation stock. Within two years of the incorporation, Transferor Corporation sells assets with a book value of ¥8,000 and market value of ¥10,000 to Transferee Corporation for ¥10,000. Transferor Corporation recognises a taxable gain on the sale of ¥2,000 and a book value adjustment loss of ¥2,000. Transferor Corporation reduces its cost basis in the stock of Transferee by the amount of the book value adjustment loss, ¥2,000, and now has a basis in the Transferee stock of ¥8,000.

Transferee Corporation's cost basis in the assets is ¥8,000, which is the amount of the consideration paid (¥10,000) less the amount of the book value adjustment loss (¥2,000). The balance of Transferee Corporation's paid-in capital account is also reduced by ¥2,000, the amount of the book value adjustment loss.

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Share exchange or transfer (*kabushiki kokan/iten* — 株式交换　移転)

A share exchange occurs when the stock of an acquired company is received in exchange for stock of an acquiring company. A share transfer is a form of share exchange where the acquiring company is newly incorporated for the purpose of acquiring the stock of the acquired company. Unless a share exchange or share transfer is a qualified share exchange or qualified share transfer, the acquired company must include in income the capital gains or losses arising from the difference between the market value and book value of its fixed assets, land or rights to land, securities, monetary claims and deferred assets at the time of the exchange or transfer (CTL Art 62-9(1)), but only if the gain or loss on the asset is at least the lesser of one-half of the paid-in capital or ¥10m (CTL-EO Art 123-11(1)). If the shareholders of an acquired company that is a wholly owned subsidiary receive only shares of the acquiring company in return for their shares, they do not have to include in income capital gains or losses resulting from the exchange or transfer (ITL Art 57-4 (1, 2); CTL Art 61-2(7, 8)). However, payments such as money paid to dissenting shareholders for their shares or dividend payments are subject to tax.

Share exchange or transfer between members of a 100% corporate group. Effective for exchanges or transfers on or after 1 October 2010, gains or losses on transfers of assets within a 100% group are deferred (CTL Art 61-13(1)) (see ¶4-650). Under these rules, a share exchange or transfer between members of a 100% corporate group will not be subject to tax and the exchange or transfer is required to be treated in the manner described below for a qualified share exchange or transfer.

If an exchange or transfer is a qualified share exchange or transfer, the acquired company may defer taxation of the capital gains or losses arising from the difference between the market value and book value of its assets at the time of the exchange or transfer (CTL Art 61-2(7, 8)). A qualified share exchange may occur only when all of the stock of an acquired company (the wholly owned subsidiary) is received in exchange solely for stock of the acquiring company (the sole parent company) (CTL Art 2-12(16), CTL Art 61-2(7)). A qualified share transfer is a similar exchange where the sole parent company is newly incorporated for the purpose of acquiring the stock of the acquired company (CTL Art 2-12(17), CTL Art 61-2(8)). In either a qualified share exchange or qualified share transfer, cash paid to dissenting shareholders and payment of dividends will not disqualify the transfer.

A share exchange or transfer may be treated as a qualified exchange or transfer in either of the following two cases:

(1) All of the issued shares are owned directly or indirectly by the same person and this relationship is expected to continue. Alternatively, either of the companies owns between 50% and 100% of the stock of the other company and this relation is expected to continue if:

(a) at least 80% of the employees of the wholly owned subsidiary are expected to be employed by the wholly owned subsidiary after the exchange or transfer, and

(b) the business of the wholly owned subsidiary before the exchange or transfer is expected to be continued by the wholly owned subsidiary.

(2) There is a share exchange or transfer to manage a jointly operated business, where the corporate division is for the purpose of enabling the corporations to jointly conduct a business satisfying the following criteria (CTL Art 2(12-16)):

(a) the jointly operated business is a combination of related businesses conducted by the companies before the exchange or transfer

(b) the business of the sole parent company is not disproportionately larger than that of the wholly owned subsidiary (ie sales, employees, etc, are not more than five times those of the subsidiary) or key officers of the wholly owned subsidiary are not expected to resign in connection with the exchange or transfer

(c) at least 80% of the employees of the wholly owned subsidiary immediately before the exchange or transfer are expected to be continued to be employed in the business of the wholly owned subsidiary

(d) the business of the wholly owned subsidiary is expected to be continued after the exchange or transfer

(e) at least 80% of the shareholders of the wholly owned subsidiary before the exchange or transfer are expected to continue as shareholders of the sole parent company, and

(f) after the exchange or transfer, the sole parent company is expected to continue to own, directly or indirectly, the shares of the wholly owned subsidiary.

Special rules for share exchanges under the Industrial Competitiveness Enhancement Act. Recognition of capital gains income is deferred for both shareholders and companies that exchange shares under a plan approved under the Industrial Competitiveness Enhancement Act (*Sangyō Kyōsō-ryoku Kyōka-hō* — 産業競争力強化法、Law No 98 of 2005) during the time from the amendment of that Act to 31 March 2021 (STML Art 37-13-3, Art 66-2-2, Art 68-86).

Goodwill (*eigyoken* — 営業権 (のれん))

Goodwill acquired on or after 1 April 1998 is amortised over five years and prior to 2017 a full year amortisation was allowed for the year of acquisition (CTL-EO Art 13(8)(l), Art 48(2)). Beginning in 2017, first year amortisation must be calculated based on the number of months remaining in the year of acquisition.

Boot relaxation rule

Under the general rules for qualified reorganisations, only stock of the transferee company may be transferred tax-free to shareholders. For mergers or share exchanges on or after 1 October 2017 in an otherwise qualified reorganisation property other than stock of the acquiring company (boot) may be transferred to minority shareholders if the acquiring company owns at least two-thirds of the stock of the merged company or owns at least two-thirds of the stock of the acquired subsidiary.

Law: Art 467(1)(v) and Art 749 of the *Company Law*; Art 2(12-6), Art 2(12-7), Art 2(12-8), Art 2(12-8)(c), Art 2(12-9), Art 2(12-11), Art 2(12-11)(b), Art 2(12-11)(c), Art 2(12-14), Art 2(12-15), Art 2(12-16), Art 2(12-17), Art 61-2, Art 61-2(7), Art 61-2(8), Art 61-13(1), Art 62, Art 62-2, Art 62-3, Art 62-4, Art 62-5 and Art 62-9(1) of the *Corporation Tax Law*; Art 57-4(1) and Art 57-4(2) of the *Income Tax Law*; Art 3 of the *Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation*; Art 62-2(1)(iv) of the *Insurance Business Law*; Art 68-2-3 of the *Special Taxation Measures Law*; Art 4-2(7), Art 4-2(13) and Art 123-11(1) of the Corporation Tax Law Enforcement Order

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CORPORATION TAX RETURN

¶4-800 Corporation tax return

Requirement to use electronic filing for Corporation Tax Returns. For tax years beginning on or after 1 April 2020, designated corporations are required to use electronic filing (e-Tax) of corporation tax returns and required attachments, etc (see ¶4-120).

Corporation Tax Return (Blue Form 青色申告)

事業年度分の法人税 申告書

課税事業年度分の地方法人税 申告書

この申告書による法人税額の計算

この申告書による地方法人税額の計算

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Calculation of Enterprise Tax

The tax base for the Enterprise Tax is similar to the taxable income determined for the Corporation Tax, but with adjustments for various reserves, loss carry-overs, limits on deductibility of contributions and Income Tax and foreign taxes.

Table 46: Enterprise Tax rates for corporations with capital not exceeding ¥100m (LTL Art 72-24-7)

Income for the year — ordinary corporations	*Standard tax rate for tax years beginning 1 October 2014*	*Standard tax rate for tax years beginning on or after 1 October 2014*	*Higher than standard tax rate for tax years beginning on or after 1 October 2014*
Not more than ¥4m	2.7% (5%)	3.4%	3.65%
More than ¥4m, but not exceeding ¥8m	4% (7.3%)	5.1%	5.465%
More than ¥8m	5.3% (9.6%)	6.7%	7.18%

Rates in parentheses were those in effect before 1 October 2008.

Flat rate for larger corporations

Corporations with offices in at least three prefectures, and capital of at least ¥10m, are not eligible for the reduced rates applicable to corporations with income less than ¥8m.

Gross receipts tax base

Gross receipts are used as the tax base for Enterprise Tax for electric power and gas companies and insurance companies. The standard rate for these companies is 0.9% of gross receipts and the higher than standard rate is 0.965%.

Maximum rates

Prefectures may raise the tax rates to up to 110% of the standard rates (higher than standard rates).

Companies with offices in more than one prefecture

Companies with offices in more than one prefecture or municipality generally allocate the local enterprise tax based on the number of employees in each location on the last day of the tax year. But special rules apply to some industries.

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Law: Art 72-24-7 of the *Local Tax Law*

¶4-930 Factor-based enterprise tax for large corporations (*Gaikei Hyoujun Kazei* — 外形標準課税)

The local enterprise tax based on corporate income (see ¶4-920) is not applicable to corporations incurring tax losses. The fiscal authorities, led by the Ministry of Internal Affairs and Communications (*Somusho* — 総務省), believe it is necessary for companies incurring losses to share in the costs of the benefits provided by the local government. A factor-based tax, where tax is computed based on income, value added and capital, is used to tax some large corporations for tax years beginning on or after 1 April 2004 (LTL Art 72-12).

Large corporations subject to factor-based tax

Only corporations with at least ¥100m of capital are subject to the new factor-based tax (LTL Art 72-2(1)).

Calculation of value added

For purposes of the factor-based tax, value added is computed as the sum of the corporation's (LTL Art 72-14):

(1) profit or loss for the year
(2) employee compensation
(3) net interest expense, and
(4) net lease payments.

Value added is reduced by an employment stability deduction (*koyo ante kojo* — 雇用安定控除) equal to any excess of the amount of wages over 70% of the total of the wages, net interest and net lease payments (LTL Art 72-20(1)). For tax years beginning between 1 April 2015 and 31 March 2018, the increase in salary for purposes of the tax credit for increase in salaries may be deducted from the value added factor if the three criteria for minimum increase in salaries described in ¶4-644B are satisfied.

Factor-based enterprise tax rates

The standard tax rates imposed on the three factors are indicated in the table below (LTL Art 72-24-7(1); *Local Tax Law Attached Regulation* Art 40(10)). The maximum rates imposed by local governments may not exceed 2 times the standard rates (1.2 times the standard rates in tax years beginning before 1 April 2016) (LTL Art 72-24-7(8)). Tokyo (*Tokyo-to*), Kanagawa (*Kanagawa-ken*), Shizuoka (*Shizuoka-ken*), Osaka (*Osaka-fu*), Kyoto (*Kyoto-fu*) and Hyogo (*Hyogo-ken*) prefectures have each elected to increase the tax rates to 1.05 times the standard rate. Aichi prefecture (*Aichi-ken*) has elected to increase the rate to 1.03 times the standard rate.

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Table 47: Standard tax rates (LTL Art 72-24-7; Local Tax Law attached reg Art 40(10); Provisional Tax Measure (2008) Art 2)

	Tax years beginning before 1 April 2015	*Tax years beginning between 1 April 2015 and 31 March 2016*	*Tax years beginning on or after 1 April 2016*
Value-added factor	0.48%	0.72%	1.2%
***Capital factor** (the larger of capital plus capital surplus for tax or accounting purposes)*	0.2%	0.3%	0.5%

Income factor				
	Tax years beginning between 1 October 2014 and 31 March 2015	*Tax years beginning between 1 April 2015 and 31 March 2016*	*Tax years between 1 April 2016 and 30 September 2019*	*Tax years beginning on or after 1 October 2019*
Income over ¥8m	4.3% (7.2%)	3.1% (6%)	0.7% (3.6%) [0.88%]	3.6% [3.78%]
Income over ¥4m, but not exceeding ¥8m	3.2% (5.5%)	2.3% (4.6%)	0.5% (2.7%) [0.635%]	2.7% [2.835%]
Income not over ¥4m	2.2% (3.8%)	1.6% (3.1%)	0.3% (1.9%) [0.395%]	1.9% [1.995%]

The rates in parenthesis in Table 47 include the Local Corporation Special Surtax (see ¶4-940). For example, in tax years between 1 April 2016 and 30 September 2019 a company with income over ¥8m has a standard rate of 0.7%, which multiplied by the Local Corporation Special Surtax rate of 414.2%, results in a rate of 2.899%. The two combined rates, 0.7% and 2.899%, result in a combined rate of 3.6%. Rates in brackets [] indicate higher-than-standard rates which are used to determine the Enterprise Tax in higher-than-standard rate localities, but which are not used when computing the Local Corporation Special Surtax.

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Corporations with offices in at least three prefectures and capital of at least ¥10m are not eligible for the reduced rates for income not exceeding ¥8m in the above rate table.

Enterprise Tax mitigation rules. In order to mitigate the burden of increases in the factor-based enterprise tax rates, companies with value added less than ¥4m may deduct the amount described in the following table from their enterprise tax.

Table 48: Enterprise tax mitigation rules

Value added amount	*Tax years beginning on or after 1 April 2016 and before 1 April 2017*	*Tax years beginning on or after 1 April 2017 and before 1 April 2018*	*Tax years beginning on or after 1 April 2018 and before 1 April 2019*
Not more than ¥3m	¾ × (otherwise applicable enterprise tax – enterprise tax using 31 March 2016 rates)	½ × (otherwise applicable enterprise tax – enterprise tax (including the Local Corporation Special Surtax (see ¶4-940)) using 31 March 2016 rates)	¼ × (otherwise applicable enterprise tax – enterprise tax (including the Local Corporation Special Surtax (see ¶4-940)) using 31 March 2016 rates)
More than ¥3m but less than ¥4m	Percentage between zero and 75% depending on the amount of value added × (otherwise applicable enterprise tax – enterprise tax using 31 March 2016 rates)	Percentage between zero and 50% depending on the amount of value added × (otherwise applicable enterprise tax (including the Local Corporation Special Surtax (see ¶4-940)) – enterprise tax using 31 March 2016 rates)	Percentage between zero and 25% depending on the amount of value added × (otherwise applicable enterprise tax (including the Local Corporation Special Surtax (see ¶4-940)) – enterprise tax using 31 March 2016 rates)

Deferment of payment

Deferment of payment of the factor-based enterprise tax is available for up to three years in two cases (LTL Art 72-38-2(1)):

(1) the corporation has losses in each of the last three years and is considered to have a major impact on the local economy or labour market, or

(2) the corporation has been established within the last five years and is considered to have highly developed technology, or a new business, which is expected to make a contribution to the local economy.

Law: Art 72-2(1), Art 72-12, Art 72-14, Art 72-20(1), Art 72-24-7; Art 72-24-7(1), Art 72-24-7(8) and Art 72-38-2(1) of the *Local Tax Law*; Art 40(10) of the Local Tax Law Attached Regulation; Art 2 of the Provisional Tax Measure (2008)

¶4-940 Local Corporation Special Surtax (*Chiho Hojin Tokubestu Zei* — 地方法人特別税) and Local Corporation Special Transfer Tax (*Chiho Hojin Tokubestu Joyo Zei* — 地方法人特別譲与税)

Since 2008, a Local Corporation Special Surtax, imposed by the national Government, but collected through returns filed with local governments, has been implemented as an interim measure in connection with an overall reform of taxes, including the Consumption Tax (Provisional Tax Measure 2008 Art 6, Art 8). Under the interim measure, the Local Corporation Special Surtax is offset by reduced rates of the existing enterprise tax, resulting in no net change in the corporation tax burden. The national Government will transfer the proceeds of the tax back to local prefectures through the Local Corporation Special Transfer Tax based on measures such as population in order to mitigate imbalances in tax revenues among the prefectures.

The Local Corporation Special Surtax will be abolished for tax years beginning on or after 1 October 2019 when it will be replaced by an increased rate in the enterprise tax. The Local Corporation Special Transfer Tax will be abolished as of February 2021 (*Tax System Measures Accompanying the Change in Timing for the Consumption Tax Rate Increase*, Law No 85, 28 November 2016).

Table 49: Local corporation special surtax

Surtax computed as a percentage of the income-based portion of the enterprise tax as revised				
	Tax years beginning before 1 October 2014	*Tax years beginning on or after 1 October 2014 but before 1 April 2015*	*Tax years beginning between 1 April 2015 and 31 March 2016*	*Tax years beginning between 1 April 2016 and 31 March 2017*
Companies subject to the factor-based enterprise tax	148%	67.4%	93.5%	414.2%
Other companies	81%	43.2%		

¶4-941 Local Corporation Tax (*Chiho Hojin Zei* — 地方法人税)

Effective for tax years beginning on or after 1 October 2014, a new Local Corporation Tax has been established in connection with a reduction in rates of corporation local inhabitants tax (¶4-910) (*Chiho Hojin Zei Ho* — 地方法人税法, Law No 11, 31 March 2014, Art 6).

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Table 50: Local Corporation Tax

Tax base	Corporation tax before credits such as the income tax credit or foreign tax credit
Tax rate	10.3% (4.4% for tax years beginning before 1 October 2019)
Payee agency	(National) district tax office (*zeimusho* — 税務署)

Law: Art 6 and Art 8 of the Consumption Tax (Provisional Tax Measure 2008)

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Tax rate — acquisition of land

The rate of special landholding tax for acquisition of land is 3% of the tax basis (LTL Art 594, Art 596(1)(ii)).

Tax basis

The tax basis for land is the acquisition cost (LTL Art 593). But if the land is transferred for no consideration or low consideration, the regular market price is used (LTL Enforcement Reg Art 54-3(2)).

Tax amount — holding of land

Special landholding tax	=	Tax basis (acquisition cost)	×	Tax rate (1.4%)	–	The corresponding fixed assets tax on the property

Tax amount — acquisition of land

Special landholding tax	=	Tax basis (acquisition cost)	×	Tax rate (3%)	–	The corresponding real property acquisition tax

Tax returns and payments

The tax is paid by filing a tax return. For tax on holding of land, the return and tax payment are due on 31 May. For tax on the acquisition of land, the return and payment are due on the last day of February if the one-year period during which land was acquired was determined using the year ending 1 January. If the one-year period was determined using 1 July as the ending date, the tax and return are due on 31 August (LTL Art 599(1)).

Property not subject to tax

Land not subject to tax includes (LTL Art 586, Art 587):

- land owned by the national or local governments
- land acquired by inheritance or succession
- land acquired in a corporate merger
- land used to achieve designated public purposes, such as the enlargement of the scale of agricultural enterprises or the dispersion of industry, and
- land for residential use.

Law: Art 5 of the *City Planning Law*; Art 252-19(1) of the *Local Government Act*; Art 585, Art 585(3), Art 586, Art 587, Art 593, Art 594, Art 596(1)(i), Art 596(1)(ii) and Art 599(1) of the *Local Tax Law*; Art 54-3(2) of the Local Tax Law Enforcement Regulations

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REAL PROPERTY ACQUISITION TAX (*FUDOSAN SHUTOKU ZEI* — 不動産取得税)

¶5-291 Real property acquisition tax (*Fudosan Shutoku Zei* — 不動産取得税)

The real property acquisition tax is a prefectural tax on individuals or corporations who acquire land or who acquire or construct houses located in the prefecture during the year (LTL Art 73-2(1)).

Time property is acquired

- *Transferred property*. Transferred property is treated as acquired at the time the rights to the property are obtained, based on the contract or other facts, regardless of whether the rights are registered (LTL Art 73-2).
- *Newly constructed property*. If the property is newly constructed, it is deemed to be acquired at the time it is first placed in use or transferred (LTL Art 73-2(2)). However, if a house is not used or transferred within six months of the time of construction, it is deemed acquired at the end of those six months.
- *Renovated property*. If the value of a house increases as a result of a renovation, the renovation is deemed acquired as of the date of the renovation.

Tax basis

The basis for the tax is the fair market value of the property at the time of acquisition (LTL Art 73-13). An adjustment to take into account the greater value of higher floors in high-rise condominiums is made in the same manner as the adjustment for purposes of the fixed assets tax (see ¶5-240).

- *Housing lots*. The tax basis of housing lots acquired between 1 January 2003 and 31 March 2018 is reduced by one-half (LTL Attached Reg Art 11-5).
- *Newly constructed residences*. A deduction from the tax basis of ¥12m is allowed for a residence that is newly constructed, enlarged or rebuilt and the floor space is 50 square metres or more, but not more than 240 square metres (LTL Art 73-14).
- *Residential construction on newly acquired land*. If a residence is constructed within three years after the residential land is acquired or if a residence is constructed on leased land and the land is acquired within one year from the time of the construction, the real property acquisition tax is reduced by the lower of (a) ¥45,000 (the tax rate times ¥1.5m, but limited to the amount of the tax), or (b) the value of land with twice the floor space of the new residence (limited to 200 square metres) times the tax rate (LTL Art 73-24). Where difficulties are encountered in satisfying the three-year requirement, the period may be extended to four years for land acquired between 1 April 2004 and 31 March 2018.

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Table 10: Real property acquisition tax rates (LTL Art 73-15; LTL Attached Reg Art 11-2(1))

Date of Acquisition	*Land*	*Building (Residential)*	*Building (Non-residential)*
From 1 April 2003 to 31 March 2006	3%		
From 1 April 2006 to 31 March 2008	3%		3.5%
From 1 April 2008 to 31 March 2021	3%		4%

ExemptionsNo tax applies if the acquisition cost does not exceed the maximum amount indicated in the following table (LTL Art 73-15-2).

Table 11: Maximum acquisition cost for exemption from tax

Type of property acquired		*Maximum acquisition cost (¥)*
Land		100,000
House	Newly constructed or renovated	230,000
	Other	120,000

Non-taxable acquisitions

No tax applies to transfers of property by inheritance, succession or in a corporate merger (LTL Art 73-7).

The taxpayer must file a tax return and pay the tax at a time specified by the prefecture (LTL Art 73-16). For example, Osaka requires the return and payment within 20 days of the acquisition; Tokyo and Hokkaido within 30 days of the acquisition; and Shizuoka, Hiroshima and Akita within 60 days of the acquisition.

Law: Art 73-2, Art 73-2(1), Art 73-2(2), Art 73-7, Art 73-13, Art 73-14, Art 73-15, 73-15-2, Art 73-24 and Art 73-16 of the *Local Tax Law*; Art 10-2(2) and Art 11-5 of the Local Tax Law Attached Regulations

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BUSINESS OFFICE TAX (*JIGYOSHO ZEI* — 事業所税)

¶5-300 Business office tax (*Jigyosho Zei* — 事業所税)

The business office tax is a specific purpose municipal tax used to fund maintenance and improvement of urban environments, including roads, water and sewers, subways, and trash collection and disposal (LTL Art 701-30). The basis of the tax is designed to reflect the relation between the level of activity of a business and the services provided by the municipality.

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Taxing municipalities

The business office tax is imposed by the following municipalities (LTL Art 701-31):

(1) Large metropolitan cities, including Tokyo (the 23 special wards) and cities specified in Art 252-19 of the *Local Government Act* (*chiho jichiho* — 地方自治法), including Sapporo, Sendai, Niigata, Chiba, Saitama, Yokohama, Kawasaki, Sagamihara City, Shizuoka, Hamamatsu, Nagoya, Kyoto, Osaka, Sakai, Kobe, Okayama, Hiroshima, Kitakyushu and Fukuoka.

(2) Cities designated in Art 2(3) of either the *Capital Region Improvement Act* or *Kinki Region Development Act*, including Kawaguchi, Musashino, Mitaka, Moriguchi-shi, Higashi-Osaka, Amagasaki, Nishinomiya and Ashiya.

(3) Other cities with a population of at least 300,000 specified in Local Tax Law Enforcement Order Art 56-15, including Asahikawa, Akita City, Koriyama, Iwaki, Utsunomiya, Kawagoe, Tokorozawa, Koshigaya, Ichikawa, Funabashi City, Matsudo, Kashiwa, Hachioji, Machida, Yokosuka, Fujisawa City, Toyama, Kanazawa, Nagano, Gifu, Toyohashi, Okazaki City, Kasugai City, Toyota City, Toyonaka, Suita, Takatsuki City, Hirakata City, Himeji, Nara, Wakayama, Otsu, Kurashiki, Fukuyama City, Takamatsu, Matsuyama, Kochi, Nagasaki, Kumamoto, Oita, Miyazaki, Kagoshima, Naha, Maebashi, Yokkaichi City, Kurume, Aomori, Ichinomiya and Takasaki.

Taxpayers

The obligation to pay the business office tax falls on individuals or corporations who either maintain a business office within the municipality or who construct a business office there (LTL Art 701-32(1)).

Tax basis — existing business

The tax for an existing business is the sum of the amount computed separately for each of two factors (LTL Art 701-40, Art 701-43):

(1) *Floor space portion of the tax*. The portion of the tax computed based on the number of square metres of floor space in the office. The floor space portion of the tax does not apply if the total floor space does not exceed 1,000 square metres.

(2) *Employee portion of the tax*. The portion of the tax based on the number of employees working in the office. The employee portion of the tax does not apply if the number of employees does not exceed 100.

Tax basis — construction of a new office (repealed)

The newly constructed office portion of the business office tax was abolished as of 1 April 2003. Prior to that date, the business office tax for a new office was based on the floor space of a newly constructed office (or expansion of an existing office) and applied only once to persons who constructed an office in the municipality (LTL Art 701-32(2)). The business office tax for a new office did not apply if the floor space of the new office did not exceed 2,000 square metres (LTL Art 701-43(3)).

Table 12: Business office tax rates

Tax basis		Tax rates (LTL Art 701-40(1), Art 701-42)
Existing business	Floor space portion of the tax	¥600 per square metre
	Employee portion of the tax	0.25% of gross wages
Construction of a new office (repealed)		¥6,000 per square metre

Tax exemptions

Exemptions from the business office tax are provided to the national and local governments, public interest corporations (limited to their non-profit activities, see ¶2-340), public baths, hospitals, clinics, special facilities of railway enterprises, etc (LTL Art 701-34).

Tax returns and payments

The tax is paid by filing a tax return (LTL Art 701-45).

Table 13: Due date for return and payment of tax
(LTL Art 701-46, Art 701-47, Art 701-48)

Existing business	*Corporation*	*Within 2 months from the end of the corporation's tax year*
	Individual	By 15 March of the following year
Construction of a new office (or expansion of an existing office) (repealed)		Within 2 months from the construction date

Law: Art 701-30, Art 701-31, Art 701-32(1), Art 701-32(2), Art 701-34, Art 701-40, Art 701-40(1), Art 701-42, Art 701-43, Art 701-43(3), Art 701-45, Art 701-46, Art 701-47 and Art 701-48 of the *Local Tax Law*; Art 252-19 of the *Local Government Act*; Art 2(3) of either the *Capital Region Improvement Act* or *Kinki Region Development Act*; Art 56-15 of the Local Tax Law Enforcement Order

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REGISTRATION AND LICENCE TAX (*TOROKU MENKYO ZEI* — 登録免許税)

¶5-400 Registration and licence tax (*Tōroku menkyo zei* — 登録免許税)

The registration and licence tax is a national tax imposed on a person who registers a transaction listed in Schedule 1 to the *Registration and Licence Tax Law* (LTL Art 2, Art 3). These transactions include the registration of real estate, ships, aircraft, personal property, intellectual property, and the registration of commercial companies and professions such as attorneys, medical doctors, accountants and real estate appraisers, as well as the licensing of businesses such as banking and liquor businesses.

If more than one person registers an item, those persons are jointly and severally liable for the tax (LTL Art 3).

Real property

The value of real property for purposes of the registration and licence tax is the same as the value for the fixed assets tax (see ¶5-200). During the period from 1 April 1999 through 31 March 2003, only one-third of the value of land was included in the registration and licence tax basis (former STML Art 84-5). The provision for a reduced tax basis for land has not been extended beyond 31 March 2003.

Tax base and rates

The following table contains examples of the tax bases and rates contained in the schedule of registration and licence taxes (*Registration and Licence Tax Law*, Schedule 1).

Table 14: Registration and licence tax rates (STML Art 72)

Type of transaction	*Tax basis*	*Tax rate*
Registration of real estate:	Value of the property at the time of registration	
Buying or selling		20/1,000 (15/1,000 for land before 31 March 2019)*
Inheritance, corporate merger, partition of commonly owned property		4/1,000
Other (gift, exchange, expropriation, auction, etc.)		20/1,000
Preservation of rights		4/1,000**
Acquisition of mortgage (pledge or hypothecation)	Amount of the claim	4/1,000

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Law: Art 701-30, Art 701-31, Art 701-32(1), Art 701-32(2), Art 701-34, Art 701-40, Art 701-40(1), Art 701-42, Art 701-43, Art 701-43(3), Art 701-45, Art 701-46, Art 701-47 and Art 701-48 of the *Local Tax Law*; Art 252-19 of the *Local Government Act*; Art 2(3) of either the *Capital Region Improvement Act* or *Kinki Region Development Act*; Art 56-15 of the Local Tax Law Enforcement Order

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Other (gift, exchange, expropriation, auction, etc.)		20/1,000
Preservation of rights		4/1,000**
Acquisition of mortgage (pledge or hypothecation)	Amount of the claim	4/1,000

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Table 2: Composition of Japanese indirect tax revenues 2017–2018

Indirect tax	*Indirect tax revenues (¥1m)*		*% of indirect tax revenues*	
	2017	*2018*	*2017*	*2018*
Consumption Tax	171,380	175,580	68%	69%
Gasoline Tax	23,940	23,330	9%	9%
Liquor Tax	13,110	13,110	5%	5%
Stamp duty revenue	10,920	10,540	4%	4%
Tobacco Tax	9,290	8,470	4%	3%
Customs duty	9,530	10,070	4%	4%
Other	14,410	14,970	6%	6%
Total indirect taxes	252,580	256,070	100%	100%

Although politically unpopular, indirect taxes are projected to become an increasingly important component of the Japanese tax system in the future due to a "hollowing out" of the tax base for the Income Tax as the population ages. Most of this increased burden is expected to be taken up by increases in the Consumption Tax rate, which increased from 5% to 8% in 2014. An increase in the rate to 10% originally scheduled to take place on 1 October 2015 was delayed to 1 April 2017. Legislation to further delay the implementation of the 10% rate was passed by the Diet in November 2016 and the rate increase to 10% is now scheduled to take effect on 1 October 2019 (Law No 85 (national tax) and Law No 86 (local tax) of 2016, 28 November 2016). The Tax Commission, Japan's tax policymaking panel, believes that an increase in the Consumption Tax rate to 20% will be needed to handle Japan's fiscal needs.

THE CONSUMPTION TAX (*SHOHIZEI* — 消費税)

¶7-200 The Consumption Tax (*Shohizei* — 消費税)

The *Consumption Tax Law* was enacted on 30 December 1988, effective for transactions on or after 1 April 1989. The original rate of 3% was raised to 5% (4% national tax and 1% Local Consumption Tax, which is set at 25% of the national rate) in April 1997.

Table 3A: Consumption Tax rates from 1 April 1997 through 31 March 2014

Combined Consumption Tax rate:	5%
National rate:	4% (*Consumption Tax Law* Art 29)
Local rate:	25% of the national rate (1%) (*Local Tax Law* Art 72-82, 72-83)

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Increase in the rate of Consumption Tax. As part of a comprehensive plan to strengthen the stability of the social security system, on 22 August 2012, legislation was enacted which includes a two-stage increase in the Consumption Tax (*Law to Partially Revise the Consumption Tax Law in Order to Secure Stable Resources for Social Security* — 社会保障の安定財源の確保等を図る税制の抜本的な改革を行うための消費税法の一部を改正する等の法律, Law No 68, 22 August 2012, effective 1 April 2014).

Table 3B: Consumption Tax rates from 1 April 2014
(Law No 68, 22 August 2012, Art 2 and Art 3)

Effective dates	*Combined Consumption Tax rate*	*National rate*	*Local rate*
Beginning 1 April 2014	8%	6.3%	1.7%
Beginning 1 October 2019	10%	7.8%	2.2%
Reduced tax rate for food, drink and newspaper subscriptions beginning 1 October 2019	8%	6.24%	1.76%

The two-stage increase in Consumption Tax rates beginning 1 April 2014 was originally conditioned on continuing favorable economic conditions. The increase to an 8% combined rate was formally adopted on 1 October 2013, effective 1 April 2014. Implementation of the second-stage increase to a 10% combined rate had been initially set for 1 October 2015 but was delayed to 1 April 2017 and further postponed to 1 October 2019 by legislation in late 2016. A transition period for implementation of the 10% rate affecting construction projects, etc, had been set to begin on 1 October 2016. A provision allowing for reconsideration of implementation of the 10% rate based on economic indicators such as real and nominal rates of growth and price trends has been repealed (Law No 68, 22 August 2012, Supplementary Provisions Art 18 as revised by Law No 9, 1 April 2015).

Delay in increase of rate to 10%. Legislation to postpone the implementation of the 10% Consumption Tax rate was passed by the Diet in November 2016 and the rate increase to 10% is now scheduled to take effect on 1 October 2019 (Law No 85 (national tax) and Law No 86 (local tax) of 2016, 28 November 2016).

System of reduced rates (on necessities) (*keigen zeiritsu seido* — 軽減税率制度). The 2012 tax rate increase legislation did not contain any provision for lower Consumption Tax rates on daily necessities such as food. However, effective with the Consumption Tax rate increase to 10%, scheduled to occur on 1 October 2019, a reduced tax rate of 8% (6.24% national tax and 1.76% local tax) is allowed for certain food and drink and for subscriptions to newspapers which feature articles on politics, economics, society and culture, etc, and that publish at least twice weekly (*Law to Partially Revise the Income Tax Law*, etc, Law No 15 of 2016, 29 March 2016, Art 5, Supplementary Provisions Art 34).

Food and drink items not eligible for the reduced rate include:

- Alcohol described in the Liquor Tax Law.
- "Dining out" (*gaishoku* — 外食) — meals consumed in restaurants, cafes, etc. But food eligible for the reduced tax rate includes:

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- "Take out" food put in a container or packaging for off the premise consumption or home delivery
- Food provided at an elderly care facility
- Food provided to students at kindergarten, elementary and middle schools, etc.

• Catered meals.

• Food that is combined with a non-food product generally is not eligible for the reduced rate. But if the selling price of the combined product before tax does not exceed ¥10,000 and the food component of the product accounts for at least ⅔ of the selling price then the entire combined product is eligible for the reduced rate (Consumption Tax Law Enforcement Order Partial Revision Order No 148 of 2016).

Transitional rules. During the period that the 8% Consumption Tax rate is in effect, under the following transition rules the pre-change 5% rate will continue to apply (Law No 68, 22 August 2012, Supplementary Provisions Art 5). Similar measures are expected to apply retaining the 8% rate during a transition period when the 10% rate comes into effect.

Table 4: Items covered by transitional rule

Item covered by transitional rule	*Details*
Entrance fees to a race track, bicycle race track, art museum, amusement park, film or play or amounts received for passenger	Amounts received before 1 April 2014 for services rendered after that date
Electricity, gas, telephone, etc, utility costs	Amounts received for services contracted before 2013 April 2014 under a contract continuously in effect before 1 April 2014
Construction contract concluded between 1 October 1996 and 30 September 2013	Amounts received for transfers of taxable materials after 1 April 2014 under preexisting contract
Lease contract concluded between 1 October 1996 and 30 September 2013	Amounts received under lease contract after 1 April 2014 under preexisting contract provided certain conditions are satisfied regarding definiteness of payments and changes in contract terms, etc
Labour contract concluded between 1 October 1996 and 30 September 2013	Amounts received under labour contract after 1 April 2014
Publication subscriptions continuously in effect before 1 October 2013	Amounts received by 1 April 2014 for publications delivered after that date or for delivery of weekly, monthly, etc, magazines or newspapers with sales date before 1 April 2014
Mail order goods where price and conditions have been determined before 1 October 2013	Amounts received for goods after 1 April 2014 where the order has been received before that date
Elderly lifetime care facility contract concluded between 1 October 1996 and 30 September 2013	The portion of a lump-sum payment received upon commencing elderly care for services provided after 1 April 2014

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Overview of the Consumption Tax. The Consumption Tax is a multi-step, broad-based consumption tax on most transactions in goods and services in Japan and the receipt of foreign goods from bonded areas in Japan. The tax is assessed at each stage of manufacturing, wholesale and retail processes. Deductions for consumption taxes paid at previous stages by businesses result in the consumer bearing the full burden of the Consumption Tax.

Example 1: Assessment of Consumption Tax

(A) Materials provider

Sale price to manufacturer	¥100,000	
Consumption Tax	¥ 5,000	→ ¥5,000

(B) Manufacturer

Sale price to wholesaler	¥200,000	
Consumption Tax	¥ 10,000	
Less: tax on purchases	¥ (5,000)	
Net Consumption Tax	¥ 5,000	→ ¥5,000

(C) Wholesaler

Sale price to retailer	¥300,000	
Consumption Tax	¥ 15,000	
Less: tax on purchases	¥(10,000)	
Net Consumption Tax	¥ 5,000	→ ¥5,000

(D) Retailer

Sale price to consumer	¥400,000	
Consumption Tax	¥ 20,000	
Less: tax on purchases	¥(15,000)	
Net Consumption Tax	¥ 5,000	→ ¥5,000

	Consumer		**Total received by government from A, B, C and D**
Purchase price	¥ 400,000		
Consumption Tax	¥ 20,000	=	¥20,000
Total cost	¥ 420,000		

Display of tax-inclusive pricing. Product price labels and handbills advertising products are required to present the price inclusive of the Consumption Tax (including local Consumption Tax). However, in light of the changes in tax rates this requirement has been suspended until 31 March 2021 provided that sellers take steps to avoid misleading consumers regarding the tax-inclusiveness of the price.

Law: Art 29 of the Consumption Tax Law; Art 72-82 and Art 72-83 of the Local Tax Law; Law to Partially Revise the Consumption Tax Law in Order to Secure Stable Resources for Social Security

¶7-210 Scope of taxation for the Consumption Tax (*Kazei No Taisho* — 課税の対象)

The scope of the Consumption Tax includes (*Consumption Tax Law* Art 4(1), (2)):

1 The transfer of property or the provision of services in Japan by an enterprise in return for payment (*Consumption Tax Law* Art 2(1)(viii), Art 4(1)).

2 The removal of foreign goods from a bonded area (*Consumption Tax Law* Art 4(2)).

- "Japan" refers to the enforcement area of the Consumption Tax (*Consumption Tax Law* Art 2(1)(i)).
- "Enterprise" means either a sole proprietorship (operated by a natural person) or a corporation (*Consumption Tax Law* Art 2(1)(iii), (iv)). For this purpose, a business conducted by a local public body or a non-juridical organization is considered to be a corporation (*Consumption Tax Law* Art 3, Art 60).
- "Property" includes not only inventory and fixed assets but also intangible property rights (Consumption Tax Law Basic Circular 5-1-3).
- "Bonded area" includes a specific bonded area, a bonded warehouse, bonded factory, bonded exhibiting area and comprehensive bonded area (*Consumption Tax Law* Art 2(1)(ii); *Customs Law* (*Kanzeiho*) Art 29).
- The supply of property or services not involving an enterprise within Japan is not subject to Consumption Tax, but the importing of goods by a person other than an enterprise is subject to Consumption Tax.
- Sale of personal assets, such as sale of a personal residence, is not subject to Consumption Tax.

Law: Art 2(1)(i), Art 2(1)(ii), Art 2(1)(iii), Art 2(1)(iv), Art 2(1)(viii), Art 3, Art 4(1), Art 4(2) and Art 60 of the *Consumption Tax Law*; Art 29 of the *Customs Law* (*Kanzeiho*)

¶7-211 Domestic transactions (*Kokunai Torihiki* — 国内取引)

Provision of services

Services are considered domestic transactions if the services are provided within Japan (*Consumption Tax Law* Art 4(3)(ii); Consumption Tax Law Basic Circular 5-7-15) (see ¶7-212).

Artists and athletes. Prior to 1 April 2016, a foreign enterprise that provides the services of artists or athletes in Japan is obligated to pay the Consumption Tax arising from the services. Beginning 1 April 2016, Consumption Tax payment for services of artists and athletes is the obligation of the Japanese recipient of the services under the "reverse charge" system (see ¶7-212).

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Transfers or leases of property

Generally, if a property is located in Japan at the time it is transferred or leased, the transaction will be treated as a domestic transaction. A transfer or lease of a ship, aircraft, patent, etc, registered with a body in Japan is treated as a domestic transaction.

If an enterprise purchases a property outside of Japan and transfers it without bringing it into Japan, the transaction is not subject to Consumption Tax (Consumption Tax Law Basic Circular 5-7-1).

Transfers for payment

Only transfers for payment are subject to Consumption Tax. Excluded are transfers without payment, such as gifts, financial assistance, dividends, lottery winnings, etc (Consumption Tax Law Basic Circular 5-2-8).

Deemed transfers and other transactions subject to Consumption Tax

The following are examples of deemed transfers and other transactions subject to Consumption Tax:

- the consumption of inventory or other business property by a sole proprietor in his/her household (*Consumption Tax Law* Art 4(4)(i))
- a gift by a corporation to an officer (*Consumption Tax Law* Art 4(4)(ii))
- an accord and satisfaction (*Consumption Tax Law* Art 2(1)(viii))
- exchange of property, investment-in-kind, or onerous gift (Consumption Tax Law Enforcement Order (Consumption Tax Law-EO Art 2).

Imports

All properties removed from a bonded area are subject to Consumption Tax regardless of whether the transfer is for payment. This includes items used for personal consumption by the importer (Consumption Tax Law Basic Circular 5-6-2). This rule is necessary to maintain the tax balance between foreign and domestic goods. Consumption or use within bonded areas is considered a removal from the bonded area subject to tax. But if imports are used within bonded areas as raw materials in the manufacture of products subject to Consumption Tax, that consumption or use is not subject to tax.

Law: Art 2(1)(viii), Art 4(3)(ii), Art 4(4)(i) and Art 4(4)(ii) of the *Consumption Tax Law*; Art 2 of the Consumption Tax Law Enforcement Order

¶7-212 Cross-Border Services (*Kokkyo o Koetta Ekimu no Teikyo* — 国境を越えた役務の提供)

In order to provide equitable treatment to domestic and foreign companies, beginning 1 October 2015, Consumption Tax will apply to electronic commerce such as the delivery of an electronic book, music, advertisements, or cloud services that an overseas company performs outside of Japan (*Consumption Tax Law* Art 2, Art 4 as amended by Law No 9, 1 April 2015). This rule overrides the general rule that services are considered domestic transactions if the services are provided within Japan (see ¶7-211). The method of tax collection differs depending whether the recipient of the

services is a business or consumer. Foreign businesses with taxable sales less than ¥10m during the base period (generally the second year before the current year) may qualify for tax-exempt status (see ¶7-310). Other foreign companies with a business establishment in Japan related to the services or which have a tax representative in Japan may apply to the tax office to be "registered overseas business" eligible for the credit for taxable purchases (see ¶7-610).

Business recipients of cross-border services (B2B). If a business in Japan receives services from outside of Japan, the Japanese business service recipient has the obligation to file the Consumption Tax return and pay the tax on the service under a "reverse charge" system. Effective 1 January 2017, B2B digital services received by a foreign permanent establishment of a Japanese business in connection with foreign business activity is not subject to Consumption Tax but such services received by a Japanese permanent establishment of a foreign business for purposes of sales in Japan will be treated as Japanese domestic transactions subject to the reverse charge rules.

Consumer recipients of cross-border services. A consumer in Japan who receives services from outside of Japan is not obligated to pay the Consumption Tax. Instead, the foreign service provider has the obligation to file the Consumption Tax return and pay the Tax on the service.

¶7-220 Non-taxable transactions (*Hikazei* — 非課税)

Transfers of certain designated types of property are non-taxable under the *Consumption Tax Law* either because the property is not of the type contemplated for the Consumption Tax or for reasons based on social policy concerns (*Consumption Tax Law* Art 6(1), Table 1).

1 *Sales and leases of land and rights to land.* Transfers of land, including superficies, air rights, easements, rights to lease land, etc, are not taxed under the *Consumption Tax Law*. However, transfers of mining rights, quarry rights and rights to use hot springs are taxable:

- *Short-term use of land.* A lease or other use of land for less than one month is not considered a non-taxable use of land and is subject to Consumption Tax (Consumption Tax Law-EO Art 8). Use of improvements to land, such as buildings, parking lots, and sports facilities, is subject to Consumption Tax.
- *Transfer of land and buildings.* If land (not taxable) and buildings (taxable) are transferred in a single transaction, the transfer price is allocated between the land and buildings based on the normal transaction price for each (Consumption Tax Law Basic Circular 10-1-5).

2 *Transfers of securities.* Non-taxable property includes:

- national and local government bonds
- corporate stocks and bonds
- beneficial interests in investment trusts and bond trusts
- commercial paper
- mortgage bonds
- membership interests in limited companies (*yugen kaisha*) and cooperatives (*kyodo kumiai*)
- loans, deposits, receivables, and other monetary claims
- means of effecting payment, including cheques, traveller's cheques, foreign exchange conversion fees, postal orders and letters of credit.

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3 *Financing transactions.* Lending and other financial transactions and services are non-taxable under the *Consumption Tax Law*, including (Consumption Tax Law Basic Circular 6-3-1):

- national and local government bonds, corporate bonds, convertible bonds, stock rights, deposits, savings and loans
- distributions from joint operation trusts or investment trusts
- credit guarantee fees, insurance premiums, mutual aid premiums and discounts on bills
- commissions on instalment payment sales
- insurance and interest included in financing lease payments (limited to amounts specified in the contract).

4 *Sales of postage stamps and document stamps.* Government postage stamps and stamps used for the Stamp Tax are not subject to Consumption Tax. Other mail-related items sold by the post office are also non-taxable, including postcards, cash envelopes, prepayment cards and parcel post wrapping materials (Consumption Tax Law Basic Circular 6-4-2). However, sales of collectible stamps are subject to tax.

5 *Merchandise and service cards.* Transfers (including sales from vending machines) of prepaid telephone cards, prepaid railway fare cards, book cards, gift certificates, etc, are not subject to Consumption Tax.

6 *Government fees.* Fees collected by the national or local governments or public bodies for permits, registration fees, document fees, etc, are not subject to Consumption Tax.

7 *International money orders and foreign exchange.* International postal money orders, traveller's cheques, letters of credit and foreign exchange transaction fees are not subject to Consumption Tax.

8 *Medical services received under public medical security laws.* Medical services received under public laws regarding health are not subject to Consumption Tax, including the *Health Insurance Act*, the *Seaman's Insurance Law*, the *Elderly Persons' Health Protection Act*, the *Physically Handicapped Person's Welfare Law*, the *Compensation to Victims of Damage to Health from Pollution Law*, the *Livelihood Protection Act*, the *Workers' Injury Compensation Insurance Act*, etc, (Consumption Tax Law Basic Circular 6-6-1).

9 *Nursing care services provided under the Nursing Care Insurance Act* (Consumption Tax Law Basic Circular 6-7-1).

10 *Social welfare services.* Various enterprises provide goods and services under the provision of the social welfare laws (Consumption Tax Law Basic Circular 6-7-5). Examples include:

- enterprises providing relief facilities under the *Livelihood Protection Law*
- day care centres, infant and mother support facilities, and nursing homes under the *Child Welfare Act*
- homes for the aged under the *Elderly Persons Welfare Act*
- home services, day services, and short stay facilities provided under various welfare laws for children, the elderly and handicapped persons.

11 *Property transferred in connection with medical and midwife services for childbirth* (Consumption Tax Law Basic Circular 6-8-1).

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12 *Burial and cremation fees*. However, funeral expenses are taxable (Consumption Tax Law Basic Circular 6-9-1).

13 *Transfers and leases of special items for the handicapped*. Tax-exempt items include wheelchairs, safety canes, artificial eyes, Braille machines, and other equipment or structures with special facilities for the handicapped (Consumption Tax Law Basic Circular 6-10-1).

14 *School and education costs*. Tax-exempt education costs are those related to schools, Job Ability Development Schools and special training colleges specified under the *School Education Law*. Examples of tax-exempt costs include tuition, entrance fees, facilities fees and fees for proof of student status documents, etc, (Consumption Tax Law Basic Circular 6-11-1).

15 *Textbooks specified in the School Education Law* (Consumption Tax Law Basic Circular 6-12-1).

16 *Residential lease*. Tax exemption applies to leases of homes, apartments, dormitories, company housing, etc. Short-term leases for less than one month are generally taxable (Consumption Tax Law-EO Art 16). Costs of hotels, *ryokan*, or resorts are taxable even if for a period of greater than one month (Consumption Tax Law Basic Circular 6-13-1).

17 *Receipt of tax-exempt foreign goods from bonded areas*. Tax exemption applies to the receipt from bonded areas of foreign property of the types otherwise qualifying for exemption, including securities, postage stamps, special articles for the use of the disabled, textbooks, etc.

18 *Sale of virtual currencies*. Pursuant to a revision in the Law for Settlement of Funds (Law No 59, 24 June 2009), beginning 1 July 2017 the sale of virtual currencies is no longer subject to the Consumption Tax.

Law: Art 6(1) and Table 1 of the Consumption Tax Law; Art 8, Art 16 of the Consumption Tax Law Enforcement Order; Child Welfare Act; Compensation to Victims of Damage to Health from Pollution Law; Elderly Persons' Health Protection Act; Elderly Persons Welfare Act; Health Insurance Act; Livelihood Protection Act; Livelihood Protection Law; Nursing Care Insurance Act; Physically Handicapped Person's Welfare Law; Workers' Injury Compensation Insurance Act; Seaman's Insurance Law; School Education Law

¶7-230 Exempt transactions (*Menzei Torihiki* — 免税取引)

The Consumption Tax is based on the principle of taxing goods and services in the place where they are consumed. Exemptions from the Consumption Tax are therefore provided for goods for export and international communications and transport activities.

¶7-231 Tax-free exports (*Yushutsu Menzei* — 輸出免税)

An exemption from the Consumption Tax applies to the transfer of goods or provision of services in Japan by an enterprise that is described in one of the following classes of exempt export transactions (*Consumption Tax Law* Art 7(1)(i)):

1 A transfer or lease of property that is an export from Japan (*Consumption Tax Law* Art 7(1)(i)):

- This exemption applies only to enterprises involved directly in exporting. It does not apply to subcontractors who provide goods to exporters or others who sell products to enterprises engaged in exporting (Consumption Tax Law Basic Circular 7-2-2).

2 A transfer or lease of foreign goods (*Consumption Tax Law* Art 7(1)(ii)):

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- This exemption applies to goods that have entered a bonded area in Japan without undergoing import processing and is then shipped outside of Japan (Consumption Tax Law Basic Circular 7-2-3).

3 Transportation of passengers or goods or telecommunications between Japan and outside Japan (*Consumption Tax Law* Art 7(1)(iii)).

4 A transfer, lease, or repair of ships or aircraft used for the transport of passengers or goods between Japan and outside Japan (*Consumption Tax Law* Art 7(1)(iv)).

5 Similar transfers or services specified in regulations (*Consumption Tax Law* Art 7(1)(v)).

Examples

Examples of exempt export transactions include (Consumption Tax Law Basic Circular 6-11-1):

- transfer or lease of foreign freight
- international transport of travellers or freight (including domestic transport which is a part of the international transport)
- provision of ships or aircraft for international transport (including those of Japanese registry)
- repairing of ships or aircraft used for international transport
- transfer or lease or repair of containers used for export shipping or for shipping between foreign countries
- services and facilities provided to ships and aircraft for entering and leaving harbours, mooring, taking off and landing, etc
- loading and unloading, warehousing, inspecting, etc, of foreign freight
- communications or mail between Japan and a foreign country
- transfer or lease of intangible assets to a non-resident of Japan
- services provided to a non-resident other than:
  a transport or safekeeping of property in Japan
  b provision of food or lodging in Japan
  c services similar to (a) and (b) provided in Japan.

Law: Art 7(1)(i), Art 7(1)(ii), Art 7(1)(iii), Art 7(1)(iv) and Art 7(1)(v) of the *Consumption Tax Law*

¶7-232 Tax-free shops (*Yushutsu Buppin Hanbai-ba* — 輸出物品販売場)

Non-residents of Japan may purchase items for personal use at specially designated "tax-free shops" without paying Consumption Tax on the purchase (*Consumption Tax Law* Art 8; *Consumption Tax*). Among the most visible of these shops are the duty-free shops found in international airports and in the Akihabara "Electric Town" neighbourhood of Tokyo. Prior to 1 October 2014, exempt purchases included only such items as electric goods, handbags and clothing and were limited to purchases over ¥10,000, but the limit was subsequently reduced to ¥5,000 (*Consumption Tax Law*-EO Art 18). Beginning 1 April 2015, exempt purchases were separated into two categories, the goods previously exempt and a new category of consumable items used in daily life such as food, beverages, medicines, and cosmetics. Special packaging is required for consumable items and they must be taken

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out of Japan within 30 days. Each category provided for separate exemptions for each purchase of items costing at least ¥5,000 (but not more than ¥50,000 in the case of consumable items). Beginning on 1 July 2018, the ¥5,000 minimum purchase limitation is no longer applied to the separate categories and items in both categories may be combined to meet the ¥5,000 minimum purchase requirement.

Retailers must obtain permission from the tax office to operate tax-free shops (*Consumption Tax Law* Art 6). Consumption Tax will be exempted on purchases from a tax-free shop on the condition that the article is to be taken out of Japan. The purchaser must present his/her passport at the shop and receive a "Record of Purchase of Consumption-Tax-Exempt for Export", which is attached to the passport. The card is collected by a customs officer at the time the purchaser leaves Japan. To facilitate qualifying purchases to meet the minimum purchase amounts, beginning 1 April 2015 merchants in shopping streets and centers, etc, may establish tax exemption counters where consumers who pay Consumption Tax on purchases at authorised individual stores may apply for refund based on the combined amount of the qualified exempt purchases. Beginning on 1 April 2020, the paper "Record of Purchase of Consumption-Tax-Exempt for Export" and the requirement to attach that paper to the purchaser's passport is eliminated and replaced with a digital system. But sellers may continue to use the paper system through 30 September 2021.

Law: Art 6 and Art 8 of the *Consumption Tax Law*; Art 18 of the Consumption Tax Law Enforcement Order

¶7-233 Special export exemptions

Special exemptions from the Consumption Tax are provided for:

- items for foreign commerce loaded into ships and aircraft of Japanese registry (STML Art 85(1))
- goods provided to a foreign embassy (STML Art 86(1))
- goods provided to a Navy shop or PX operated by the US Navy under the Japan-US Mutual Cooperation and Security Agreement
- property supplied for the use of the US military (Consumption Tax Law Basic Circular 15-2-1).

Law: Art 85(1) and Art 86(1) of the *Special Taxation Measures Law*

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TAXPAYERS (*NOZEI GIMUSHA* — 納税義務者)

¶7-300 Taxpayers (*Nozei Gimusha* — 納税義務者)

For purposes of the Consumption Tax, taxpayers are either:

1. an enterprise that transfers property or provides services in Japan in return for payment (*Consumption Tax Law* Art 5(1)), or
2. any person who removes foreign goods from a bonded area (*Consumption Tax Law* Art 5(2)):

- An enterprise includes a sole proprietorship or a corporation, including a business conducted by a local public body or a non-juridical organization (*Consumption Tax Law* Art 2(1)(iv), Art 3, Art 5, Art 60).

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- It is not necessary for a taxpayer to have a residence or domicile in Japan in order to be subject to the Consumption Tax.
- The obligation to pay Consumption Tax is extended beyond enterprises to consumers in the case of imports in order to maintain the tax balance between domestic and imported goods.

Trusts

Generally, the beneficiary of a trust is treated as the owner of trust property and bears the obligation to pay Consumption Tax on transactions performed by the trust. However, this rule does not apply to joint investment trusts (*shudan toshi shintaku* — 集団投資信託), corporate taxation trusts (*hojin kazei shintaku* — 法人課税信託), retirement pension trusts (*taishoku nenkin nado shintaku* — 退職年金等信託) or specified public trusts (*tokutei koeki shintaku* — 特定公益信託) (*Consumption Tax Law* Art 14(1)).

Law: Art 2(1)(iv), Art 3, Art 5, Art 5(1), Art 5(2), Art 14(1) and Art 60 of the *Consumption Tax Law*

¶7-310 Exempt enterprises (*Menzei Jigyosha* — 免税事業者)

In order to lessen the clerical burden on small-volume businesses, an exemption from obligation to pay Consumption Tax has been provided since the inception of the *Consumption Tax Law* for small businesses. Small businesses continue to collect the tax from consumers, but are not obligated to pay it to the Government, resulting in a perceived windfall to exempt enterprises. More than 60% of businesses by number qualified for the exemption.

Election to be a taxable enterprise

A small business otherwise qualifying as an exempt enterprise may elect to be subject to the obligation to pay Consumption Tax by filing a notification with the district director of the tax office with jurisdiction over the taxpayer (*Consumption Tax Law* Art 9(4)). The election may be revoked upon notice to the tax office, but the notice of revocation may not be filed before the beginning of the second tax period following the period of the election (*Consumption Tax Law* Art 9(5), Art 9(6)).

Application of exemption

For tax periods beginning on or after 1 April 2004, the exemption only applies to enterprises with not more than ¥10m of taxable sales (net of refunds, etc) during the base period.

The tax period for individuals is the calendar year, so the first year when the new rule applies will be 2005 for which the base year is 2003.

Corporations with a March year end are subject to the new rule for the first time for their tax year beginning on 1 April 2004 and the base year at that time will be their tax year beginning on 1 April 2002.

Legislation enacted in 2011 and effective for tax years beginning on or after 1 January 2012 disallows the exemption to companies with sales of ¥10m or more in the first half (six months) of the prior year (January to June for a calendar year taxpayer) (*Consumption Tax Law* Art 9-2).

Newly established sole proprietorships

A newly established sole proprietorship without a base period or with no sales during the base period is exempt from Consumption Tax for its first two years (Consumption Tax Law Basic Circular 1-4-6).

Newly established corporations

Newly established corporations without a base period or with no sales during the base period may be exempt only if their capital is not more than ¥10m at the beginning of the tax year (*Consumption Tax Law* Art 12-2). Effective for companies established on or after 1 April 2014, the disqualification from the exemption for companies with capital in excess of ¥10m includes certain controlled companies. A controlled company for this purpose is a corporation in the first two years of its operation that has been established by an enterprise (*jigyosha* — 事業者), that may be individual or corporate in nature, if the establishing enterprise has taxable sales in excess of ¥500m and owns, directly or indirectly, more than 50% of the new corporation (*Law to Partially Revise the Consumption Tax Law in Order to Secure Stable Resources for Social Security*, Law No 68, Art 2 — 社会保障の安定財源の確保等を図る税制の抜本的な改革を行うための消費税法の一部を改正する等の法律).

Restrictions on use of the exempt enterprise system

Effective for tax years beginning on or after 1 April 2010, for companies established on or after that, there is no limitation on the use of the exempt enterprise system for companies acquiring fixed assets. If, during one of the two periods listed below, a company acquires fixed assets (assets other than inventory with a cost of at least ¥1m net of tax) and the simplified tax system (¶7-620) does not apply during that period, the exempt enterprise system may not be used during the tax year the assets were acquired or the following two tax years (*Consumption Tax Law* Art 9-7):

1 The two-year period following an election to be subject to the Consumption Tax, during which the election may not be revoked by the taxpayer.

2 The two-year period following the establishment of a new company with capital of at least ¥10m, during which the company is treated as a taxpayer, but does not have a base period.

The simplified tax system may not be used during the period that this restriction prevents the exempt enterprise system from being used.

For purchases of high-value assets on or after 1 April 2016, neither the exempt enterprise system or the simplified tax system may be used for three years from the first day of the year of the transaction by a business that constructs or purchased designated fixed assets or inventory with a unit cost of ¥10m or more other than purchases under a contract entered into on or before 31 December 2015.

Tax period (*kazei kikan* — 課税期間) (*Consumption Tax Law* Art 19-1)

Sole proprietorships

The tax period for individuals is the calendar year.

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Corporations

The tax period for corporations is their fiscal year.

Base period (*kijun kikan* — 基準期間) (*Consumption Tax Law* Art 2(1)(xiv))

Sole proprietorships

The base period for individuals is the calendar year two years before the current tax year.

For 2004, the base period is the calendar year 2002.

Corporations

The base period for corporations with a tax year of one year is the tax year two years before the current tax year. If that prior tax year is less than a full year, the base year is obtained by combining all business years starting during the one year period beginning on the day two years before the start of the current tax year.

Taxable sales during the base period (*kijun kikan no kazei uriagedaka* — 基準期間の課税売上高)

Taxable sales during the base period are equal to the total amount of sales less returns, rebates and discounts computed before application of the Consumption Tax (*Consumption Tax Law* Art 9(2)).

Corporations with a short tax year

If a corporation's base year is not a full 12 months, the taxable sales during the base year is obtained by dividing the sales net of discounts, etc, by the number of months in the base period and multiplying the result by 12 (*Consumption Tax Law* Art 9(2)(ii)).

Deemed transactions and exempt transactions

Deemed transfers and other transactions subject to the Consumption Tax (see ¶7-211) and exempt transactions (¶7-230) are included in taxable sales during the base period (*Consumption Tax Law* Basic Circular 1-4-2).

Non-taxable transactions

Non-taxable transactions (¶7-220) are not included in taxable sales during the base period.