102K7N

Send to: PUREVDORJ, MUNKHSELENGE
WAKE FOREST UNIVERSITY SCHOOL OF LAW
1834 WAKE FOREST DR
WINSTON SALEM, NC 27109-8758

Time of Request: Tuesday, November 02, 2010 00:30:08 EST
Client ID/Project Name:
Number of Lines: 1043
Job Number: 1842:250748585

Research Information

Service: Terms and Connectors Search
Print Request: Current Document: 1
Source: Doing Business in Japan
Search Terms: § 10.02 Corporation Tax

Doing Business in Japan

CHAPTER 10 Taxation

4-10 Doing Business in Japan § 10.02

§ 10.02 Corporation Tax

[1] Classes of Taxpayers

Japanese tax law classifies corporations as either domestic or foreign. n1

A domestic corporation is defined as a corporation having its head office located in Japan, n2 while a foreign corporation is defined as any corporation other than a domestic corporation. n3

[a] Domestic Corporations

Any corporation having its head office in Japan is a domestic corporation. It does not necessarily follow that a domestic corporation is always a corporation organized under the laws of Japan. If a corporation organized under the laws of a country other than Japan has its head office in Japan, it will be regarded as a domestic corporation for corporate tax purposes.

[i] Five Categories. Domestic corporations under the Japanese tax law are classified into five cateogories as follows:

(1) Public corporations (*Kokyo Hojin*);

(2) Public interest corporations (*Koeki Hojin*);

(3) Cooperatives (*Kyodo Kumiai*);

(4) Nonjuridical organizations (*Jinkaku no nai Shadan*); and

(5) Ordinary corporations (*Futsu Hojin*).

The Corporation Tax Act expressly designates those organizations deemed to be public corporations and public interest corporations. It also designates some cooperatives and the type of organization eligible for treatment as a cooperative. n4 Public corporations are tax-exempt and public interest corporations are taxed only on income arising out of their profit-making business activities. Such activities include sales, manufacturing, and other business as specified by

Cabinet Order, conducted continuously through an established place of business. n5

The Corporation Tax Act is also fully applicable to non-juridical organizations. n6 A nonjuridical organization is an unincorporated association having a specified representative or administrator. n7 Whether an association comes within this definition is determined case by case.

[ii] Ordinary Corporations. All other domestic corporations are considered to be ordinary corporations n8 or cooperatives. They are subject to corporate taxes on their entire income regardless of the source of such income. n9 Most corporate taxpayers in Japan fall within this category. Ordinary corporations consist mainly of the following legal entities established pursuant to either the Commercial Code or the Limited Liability Company Act: n10

(1) Stock Companies (*Kabushiki Kaisha*);

(2) Partnership Companies (*Gomei Kaisha*);

(3) Limited Partnership Companies (*Goshi Kaisha*); and

(4) Limited Liability Companies (*Yugen Kaisha*).

[b] Foreign Corporations. As stated above, any corporation other than a domestic corporation is considered to be a foreign corporation for tax purposes.

Foreign corporations are classified into four of the five categories used for domestic corporations:

(1) Public Corporations;

(2) Public Interest Corporations;

(3) Non-juridical Organizations; and

(4) Ordinary Corporations.

(The domestic category of "cooperatives" is included within the "ordinary corporation" category.)

Foreign public corporations and public interest corporations must be designated as such by the Minister of Finance in order to receive the same special tax treatment as that enjoyed by domestic public and public interest corporations. n11 Such a designation is not made unless the country where the foreign public or public interest corporation has its domicile extends the same tax benefits to similar Japanese corporations. n12

The same principles applicable to domestic non-juridical organizations also apply to foreign non-juridical organizations.

[2] Principles of Income Determination

[a] Taxable Income

[i] Domestic Corporations. Corporation Tax is imposed upon the net income of domestic corporations realized during the accounting period stipulated in the articles of incorporation of each such corporation. Corporation Tax is also imposed on liquidation income of domestic corporations as of the date of liquidation or merger into another entity. n13

As mentioned in § 2.01, public interest corporations and nonjuridical organizations are subject to Corporation Tax only on income derived from profit-making business. n14 No Corporation Tax is levied on liquidation income of these

taxpayers.

[ii] Foreign Corporations. Foreign ordinary corporations are liable to pay Corporation Tax on income from sources in Japan. No tax is imposed on their liquidation income. Foreign public interest corporations and non-juridical organizations are taxed on income derived from profit-making business in Japan. n15

[iii] Basic Principle of Income Determination. Taxable income in each accounting period is calculated by subtracting deductible expenses from gross income in that period. n16

The term gross income (*ekikin*) is defined as receipts realized from: the sale of assets, the transfer of assets with or without receiving counter-value, the rendering of services, the acquisition of assets without giving counter-value, and other non-capital transactions. n17 Capital transactions do not affect gross income. Capital transactions (*shihon to torihiki*) include distributions of dividends (or surplus) and all other transactions resulting in an increase or decrease in the capital of a corporation. n18

The term deductible expenses (*sonkin*) is defined to include inventory acquisition costs, the cost of completion of construction and similar costs, sales expenses, general administration expenses, other types of ordinary and necessary expenses, and losses except for those incurred through capital transactions. n19

[b] Accounting

[i] Accounting Period. The accounting period is generally identical to the business year of the corporation as set out in the articles of incorporation, the memorandum of association, or a similar document. For tax purposes, an accounting period may not exceed one year. Accordingly, any portion exceeding a one year period will be considered an additional accounting period. n20

In the event that the business year is not specified in the articles of incorporation or a similar document, the taxpayer is required to submit written notification of the accounting period to the relevant national tax office (*zeimusho*) within two months after the date of incorporation in the case of a domestic corporation, and, in principle, within two months after the date of making a permanent establishment in Japan in the case of a foreign corporation. n21 If a taxpayer fails to file such notification, the tax office itself may determine the accounting period. n22

[ii] Accounting Methods. The Corporation Tax Act does not specify the overall accounting method to be followed by a taxpayer corporation in computing taxable income. The only general reference made to accounting methods states that the computation should be made pursuant to "generally accepted accounting principles." n23 It does not follow, however, that the business accounts of a corporation automatically become the basis for determining tax liability, even if the accounts have been prepared in accordance with generally accepted accounting principles. The Corporation Tax Act and other tax laws often provide for specific accounting methods in particular situations that are not always in accordance with generally accepted accounting principles. Therefore, the taxpayer is entitled to adopt generally accepted accounting principles only in matters not otherwise specifically provided for in the tax laws.

Computation of tax liability is made on an accrual basis.

[c] Place of Tax Payment. A domestic corporation must pay Corporation Tax as levied on its entire net income at the tax office which has jurisdiction over the head office of the corporation. n24

In the case of a foreign corporation having a permanent establishment in Japan, the tax office having jurisdiction over the branch, office, or other premises used for the pursuit of business in Japan becomes the place of tax payment. If two or more such places exist, the most important location is the place of tax payment. n25

If a foreign corporation has no permanent establishment in Japan but receives counter-value from a transaction such as

lease involving immovables in Japan, n26 the tax office with jurisdiction over the location of such property will be the place of tax payment. (One specific place has to be designated in cases where the taxpayer corporation owns immovables in different places.) n27

In the event that the place of tax payment cannot be determined by the foregoing rules, the place of payment is determined by the tax authorities through consideration of various factors concerning the foreign corporation's contacts with Japan. n28

[d] Substance Over Form. The tax laws of Japan recognize the principle of taxation according to substance rather than form. Article 11 of the Corporation Tax Act provides that in cases where the gain from an asset or business only nominally accrues to a person, the provisions of the Corporation Tax Act will apply to impose tax upon a corporation which substantially enjoys the gain. n29 This principle has long been recognized in Japan. The goal is fair imposition of taxes in accordance with the underlying economic substance of business transactions.

Application of the principle is, for example, in the following situation. For various reasons, a director of a corporation often holds shares of stock issued by the corporation in such a way that the dividends will be received by the corporation rather than by the director. (Under Japanese law a company may not hold its own shares except on a limited number of occasions.) The tax on the dividends will be levied upon the company rather than upon the individual since the company is actually enjoying the benefit of the dividends, although the shares legally belong to the director.

Due consideration must be paid to this "substance over form" principle in transactions between affiliated companies, such as between a foreign parent and its Japanese subsidiary or between a so-called "family corporation" and its shareholder(s). Special scrutiny is often given to these transactions since they are often not consummated at arm's length.

[3] Gross Income

Article 22, paragraph 1 of the Corporation Tax Act provides:

"The amount of taxable income of a domestic corporation for each business year shall be the amount of gross income (*ekikin*) for the business year minus the amount of deductible expenses (*sonkin*) for the business year."

Paragraphs 2 and 3 of the Article, respectively, define the terms "gross income" and "deductible expenses."

Paragraph 4 of the same Article further provides that "gross income" and "deductible expenses" are to be calculated in accordance with the accounting principles generally accepted for the determination of corporate taxable income, unless otherwise expressly provided in the law.

Article 22, paragraph 2 of the Corporation Tax Act provides:

"In computing the amount of taxable income of a domestic corporation for each business year, the amount to be included in gross income shall, unless otherwise provided, be the amount of revenue in the business year resulting from sale of assets, transfer of assets or rendering of services with or without counter-value, acquisition of assets without counter-value, and other transactions excluding capital transactions."

Gross income includes not only revenue from sales of merchandise and revenue from services, but also gains realized from transfer of assets without counter-value. The definition of gross income in the tax law has been said to be broader than the concept of revenue in accounting.

Through the requirement of a "transaction," the Act excludes appreciation in value from gross income. In other words,

holding unrealized gains are not included in gross income. All types of income resulting from "transactions," including both operating income and nonoperating income, are included in gross income. Revenue from all illegal or invalid transactions, such as interest received at usurious rates, is also included in gross income. There has been an accumulation of judicial decisions to this effect over the years. Release from indebtedness also constitutes gross income.

An asset received without payment of counter-value is regarded as revenue. In such cases, the fair market value of the asset at the time of the transfer is regarded as gross income.

If an asset is transferred at a price lower than the market price, the difference between the market price and the transfer price must be excluded in the gross income of the transferee. The difference constitutes a donation from the transferor to the transferee. A donation can, within certain limits, be deducted from the gross income of the donor. To the extent that those limits are exceeded, donations are taxable income to the donee, even though the donor is allowed no deduction.

[4] Excluded Income

[a] Exempt Income

Certain types of income are excluded from gross income (*ekikin*) as it is defined in the Corporation Tax Act. The reasons for exclusion are various, ranging from accommodation to the concept of "income" in Japanese tax law, to the multifarious concerns of public policy. Income excluded from gross income is thereby exempted from the Corporation Tax.

The following exemptions are deemed particularly important.

[i] Gains From Capital Transactions. n30

Capital transaction gains such as premiums, profits from capital reduction, and a portion of the profits from consolidation (that is, profits consisting of the capital surplus and earned surplus of a merged corporation and the profit from capital reduction of a merged corporation upon consolidation) are not included in gross income.

[ii] Dividends. n31 Dividends received from domestic corporations less interest payable on funds borrowed for acquisition of the shares on which such dividends are paid are excluded from gross income.

When a domestic corporation receives a distribution of profits from a securities investment trust other than a bond or debenture investment trust, the abovementioned rule is applicable to the amount out of such distribution deemed to be dividends received from domestic corporations.

Dividends will not be excluded from gross income if received on shares obtained within one month of the end of the accounting period for which such dividends are paid, and if the recipient corporation sells shares of the same corporation within two months after the end of such accounting period. Dividends paid by foreign corporations are included in gross income, while foreign income tax imposed on such dividends is within certain limitations creditable against Japanese Corporation Tax. Dividends received by a foreign corporation from a Japanese corporation should be included in the income from Japanese sources of such a foreign corporation.

[iii] Constructive Dividends. n32 The rule as described in [o]b[c] above is applicable to constructive dividends, such as distributions of retained earnings by domestic corporations on the occasion of redemption of stock, capital reduction, liquidation, or merger.

[iv] Appreciation in Value. n33 When a corporation increases the book value of its property by the amount of its appreciation in value, the amount of the increase is not included in gross income except in the case of merger or corporate reorganization of the company or other transformation of corporate structure.

[v] Tax Refunds. n34 Refunds of amounts withheld for taxes which are not deductible in computing the Corporation Tax, such as the Corporation Tax itself, the Inhabitants Tax, and Interest Tax, are not included in gross income.

[b] Nonrecognition of Income

Tax deferral is permitted with respect to certain types of income. For example, a taxpayer may choose to defer recognition of income from government subsidies granted for acquisition or improvement of a fixed asset (i.e., immovables and depreciable assets). The mechanism for such deferral is a current deduction from gross income in an amount equivalent to the governmental subsidy received. This deduction offsets the government subsidy included in gross income. As a result, the subsidy is excluded from taxable income. On the other hand, the basis of the fixed asset improved or acquired through the government subsidy must be reduced by an amount equal to the government subsidy. Consequently, when the fixed asset is sold, income equivalent to the government subsidy is recognized as an item of gross income with no offsetting deduction. If the fixed asset is a depreciable asset, the amount of the reduction in basis has the effect of directly reducing the amount available for depreciation deductions. Thus, the government subsidy is effectively recognized as taxable income over the useful life of the depreciable asset.

The more significant categories of income subject to deferral are listed below:

[i] Government Subsidies. n35 An amount equivalent to government subsidies granted to a taxpayer corporation for the purpose of acquisition or improvement of fixed assets can be deducted from gross income. Details are set forth above.

[ii] Private Subsidies. n36 The same treatment pertaining to government subsidies is applicable to customer contributions to the cost of constructing utility, railroad, and wire broadcasting facilities.

[iii] Insurance Proceeds. n37 If a corporation repairs damaged fixed assets or purchases property for replacement of damaged or lost fixed assets using casualty insurance proceeds within the accounting period in which the payment of such insurance proceeds is made, a deduction from gross income in the amount of such insurance proceeds is allowed, with certain limitations. This deduction is allowed even if the repair or replacement is not made in the same accounting period that the insurance proceeds are received, if the corporation receiving the proceeds decides to make the repair or replacement within two years of the end of that period. The basis of the repaired property or the replacement must be reduced by the amount of such deduction.

[iv] Tax-free Exchange. n38 In the case of the exchange of certain fixed assets for new property to be put to the same use as the exchanged asset, subject to certain conditions, the taxpayer may defer recognition of any gain from the exchange. The taxpayer's basis in the old asset must be carried over to the new asset. Any gain must be recognized upon disposition of the new asset.

[v] Investment of Property Other Than Money. n39 If shares of a corporation issued upon its incorporation are obtained in exchange for property other than money, recognition of the corporation's capital gain, if any, resulting from transfer of the property may be deferred under certain circumstances, as in the case of the tax-free exchange described in [o]d[c], above.

[Vi] Gains From Involuntary Sale or Exchange. n40 When a corporation acquires property as a substitute or in exchange for condemned property in the accounting period in which such condemnation is made or within two years after the date of such condemnation, the basis of the condemned property may be carried over to the new property and no recognition of gain need to be made. If the corporation pays any additional amount for the new property, the basis of the new property must be increased from the carry-over basis by such amount. Any difference between the cost of replacement property and the basis so carried-over is deductible from gross income. In lieu of such deferral of recognition, the corporation may elect to report capital gains earned from the condemnation with a special deduction in

the maximum amount of 50 million yen. n41

[vii] Nontaxable Substitution of Certain Immovables. n42 If a corporation disposes of certain immovables located within specified areas (typically densely populated), acquires similar property located in other specified (underdeveloped) areas in the same accounting period in which the sale is made or in the next accounting period, and furthermore, puts the new property to use within one year from the date of acquisition, the basis of the old property may be carried over to the newly acquired property and recognition of any gain delayed until disposition of the latter. Any difference between the cost of the new property and the basis so carried over is deductible from the gross income. The current statute is applicable to such dispositions made during the period from April 1, 1970, to March 31, 1996.

The above rule applies to exchanges of certain immovables for similar property, and Corporation Tax on gains from such exchanges is deferred until disposition of the acquired property.

[5] Timing of Income Reporting

Although there is no provision in the Corporation Tax Act specifically addressing the issue of accrual, it is generally agreed that the Corporation Tax Act adopts the accrual method.

This conclusion follows from interpretation of Article 22, paragraph 2 of the Corporation Tax Act, which provides in part " ... the amount to be included in the amount of gross income shall ... be *the amount of revenue in the business year* ... " It is generally considered that generally accepted accounting principles are applicable in this determination except where the Corporation Tax Act specifically provides otherwise, as in the cases of installments and deferred payments.

The Corporation Tax Basic Act Circulars interpret the following cases as adopting the accrual method:

(1) Revenue from the sale of an inventory asset is included in gross income in the business year of the date of delivery. n43

(2) Revenue from work undertaken is included in gross income in the business year of the date of completion and delivery of the subject property if the work includes delivery of the property, or the date of completion of all services promised if the work does not include delivery of the property. n44

(3) Revenue from the transfer of a fixed asset is included in gross income in the business year of the date of delivery, or at the taxpayer's option, in the business year of the effective date of the transfer contract. n45

(4) Revenue from the consignment sale of an inventory asset is included in gross income in the business year of the date of sale by the consignee, or at the taxpayer's option, the date the taxpayer receives a sales report by the consignee, if such treatment is consistently made. n46

In the case of installment sales, gross income accrues on the date of each installment payment as provided for in the installment contract. n47 Deferred-payment sales agreements are similarly treated. n48

In the case of long term construction work, the percentage-of-completion method is permitted. n49

[6] Deductible and Nondeductible Expenses in General

Ordinary and necessary expenses, as well as losses, are deductible in computing taxable corporate income. Such deductions include inventory acquisition costs, production and other costs, sales expenses, and general administration expenses except for those incurred through capital transactions. n50

The Corporation Tax Act also expressly provides that some types of expenditures may not be deducted in computing taxable income.

The following will detail the most significant categories of deductible and nondeductible expenses.

[7] Inventory Assets

Inventory acquisition costs are deductible expenses. For purposes of the Corporation Tax Act, inventory is defined as goods, finished products, semi-finished products, goods in process, raw materials, supplies in stock, and other assets similar in nature to any of the above items. n51 Inventory does not include securities such as shares, bonds, and debentures.

A taxpayer corporation is free to apply either of two basic methods of inventory evaluation recognized by the Corporation Tax Act. The first is the cost method, which has eight different variations, including actual cost basis, first-in first-out, last-in first-out, and the weighted average basis. n52

Under the second basic method, the taxpayer corporation reports inventory at the lower of cost or market value. n53

A corporation may evaluate inventory through either of the above two methods (in the case of the cost method, any one of the eight variations). Each corporation must report the evaluation method it has selected by the due date for filing the tax return for the year of commencement of business (in the case of a foreign corporation, the year during which it made a permanent establishment in Japan). n54 If the corporation does not so notify the competent tax office, the tax office will assume use of the last-purchase-price method. n55

The corporation may change its evaluation method if it obtains prior approval from the taxation office. n56

[8] Securities

Either of the basic methods of inventory evaluation, the cost method or the lower-of-cost-or-market-value method, may be used in evaluating securities held by a corporation. Cost in both methods means acquisition cost of each security. The cost method is divided into two variations: the weighted average method and the moving average method. n57

In the case of securities not listed on any of the Japanese Securities Exchanges, the cost method must be applied. n58 A substantial interest in a corporation (25 percent or more of the outstanding shares held by one shareholder and his/its relatives/affiliates) is also subject to evaluation by the cost method. n59

The means of determination of acquisition cost depends on the manner of acquisition. In the case of subscription or purchase of the shares, acquisition cost is the price paid. In the case of acquisition by amalgamation or capital contribution, acquisition cost is the book value of the securities acquired plus any expenses incurred. The market value prevailing at the time of acquisition is employed if the securities are acquired by other means. n60

The administrative requirements regarding selection and change of method are the same as in the case of inventory assets. n61

[9] Depreciation

[a] Accounting Principles. Depreciation is allowed for fixed assets such as buildings, structures, machinery and equipment, vessels, and vehicles, for tools, furniture, and fixtures having a useful life of one year or more, and for goodwill, industrial property rights, mining rights, and fishery rights. n62

Generally accepted accounting principles recognize depreciation as a procedure for systematic cost-assignment over a period of time and require that depreciation be reported systematically and regularly. The straight-line, declining-balance, sum-of-years'-digits, production, and replacement methods are recognized. Replacement cost value has not yet been adopted as an allowable depreciation base in generally accepted accounting practice.

Generally accepted accounting principles allow a corporation to apply any of these accounting methods, subject to the restriction of consistency, and they allow a corporation to set any useful life it deems reasonable for an asset.

[b] Treatment Under the Corporation Tax Act

[i] In General. Under the Corporation Tax Act, however, applicable useful lives, salvage values, and depreciation methods are to be fixed by an ordinance of the Ministry of Finance. To the extent they are so fixed, no room is left for taxpayer discretion. n63 This uniform treatment is commonly criticized in accounting circles.

The depreciation base is the acquisition cost. All other depreciation bases, including replacement cost, are unacceptable.

Acceptable depreciation methods are specified as follows:

(1) Tangible fixed assets--straight-line, declining-balance or other depreciation method approved by the tax authorities;

(2) Intangible fixed assets (excluding mining rights and goodwill) and living things--straight-line or other depreciation method approved by the tax authorities;

(3) Goodwill--amortizaton, with the acquisition cost as the amortization limit;

(4) Replacement assets--straight-line, declining-balance, or replacement method.

The depreciation method applied must be reported in advance to the tax office having jurisdiction, and any change of depreciation method requires approval. Depreciation expenses are deductible to the extent that they are entered in taxpayers' books.

The useful lives specified in the tax law are generally regarded as fair and appropriate for accounting purposes and are adopted by almost all Japanese corporations for those purposes. This is one of the areas where tax law influences accounting principles.

A declared useful life may be shortened upon approval of the tax authorities in certain specified cases in which deterioration has been more rapid than expected.

If machinery and equipment are used more intensively in a particular taxable year than is typical, an increased depreciation expense is allowed.

[ii] Special Depreciation Methods

The Special Taxation Measures Act provides for two kinds of special depreciation methods which are not in accord with generally accepted accounting principles. n64

[A] Special Depreciation. One is called Special Depreciation and allows increased depreciation for the first year of useful life. In some cases, 50 percent of the acquisition cost may be depreciated in the first year in certain cases.

The Special Depreciation is permitted, for example, for the following items:

(1) designated plant, equipment or other assets contributing to energy policy (30% of acquisition cost).

(2) designated electronic equipment acquired by a small or medium-sized enterprise (30% of acquisition cost).

(3) machinery encouraging small or medium-sized enterprise, etc. (30% of acquisition cost).

(4) designated plant or equipment for the prevention of pollution (18% of acquisition cost).

(5) designated machinery or equipment for the waste recycling (14% of acquisition cost).

[B] Additional Depreciation. The other special method is called Additional Depreciation. It allows additional depreciation at an increased rate each taxable year. In some cases one and a half times the ordinary depreciation expense is allowed in each taxable year.

The Additional Depreciation is allowed, for example, for the following items:

(1) assets owned by a member of a cooperative carrying out an authorized plan for promotion of its business (20% of normal depreciable amount for five years).

(2) designated plant or other assets owned by a corporation which employs certain number of handicapped people (14% of normal depreciable amount for five years).

(3) newly constructed rental housing in designated areas (20% of normal depreciable amount for five years).

(4) designated multistory buildings in designated areas (18% of normal depreciable amount for five years).

[c] Expenditure for Improvements and Repairs to Depreciable Assets. A basic and consequential distinction is made between improvements to depreciable assets and repairs to such assets. Expenditures for improvements must be added to the cost basis of the property concerned and may then be depreciated. On the other hand, repair expenses are deductible in the year the payment is made. An expenditure which adds to the value or useful life of a fixed asset is, in principle, considered to be a permanent investment or capital expenditure n65 and must be treated as an expenditure for an improvement.

[10] Deferred Charges

[a] Accounting Principles. Under modern accrual-basis accounting principles, if the effects of an expenditure (e.g., for research and development) incurred in a given accounting year will continue into future years, reporting of the expenditure should properly be prorated over the period of such effects.

Such expenditures should be charged to a capital account in the year incurred. They are termed deferred charges or expenses or even deferred assets. These expenditures are credited by means of amortization over the years affected by the expenditure.

[b] Treatment Under the Corporation Tax Act. The Corporation Tax Act defines the term "deferred charges" (*kurinobe shisan*) as expenditures the effect of which can be seen for a period of one year or more after they are incurred. n66

The Corporation Tax Act Enforcement Order further identifies the following items as deferred charges: n67

(1) Expenditures properly attributable to a corporation and incurred in relation to its establishment;

(2) Special dividends payable to shareholders before a corporation realizes profits, as provided for in the Commercial Code; n68

(3) Expenditures incurred after incorporation in preparation for commencement of business;

(4) Research and development costs;

(5) Expenditures incurred for new managerial systems, market exploration, resource exploration, etc.;

(6) Expenditures incurred in issuing new shares, such as printing costs and Registration and License Tax;

(7) Expenditures incurred in issuing debentures; and

(8) The discounted portion of a debenture issued pursuant to the Commercial Code. n69

The following and other expenditures, the effect of which continues for one year or more after the expenditure is made:

(1) Expenditures incurred in connection with the establishment or renovation of public facilities or facilities for joint use, the use of which will benefit the taxpayer corporation (e.g., imposts for roads, parks, river banks, parking areas, etc.);

(2) Security deposit moneys, and other expenditures necessary for the lease or use of properties belonging to others (e.g., lease of office space); n70

(3) Deposits, initial payments, or other expenditures necessary for obtaining services from others (e.g., initial payment in case of know-how licensing);

(4) Expenditures incurred through donation or discount sale for purposes of sales promotion and advertising (e.g., donation of neon signs, show-cases, etc., from makers to retailers).

[c] Amortization Period. The Corporation Tax Act and Corporation Tax Act Enforcement Order do not specify the lengths of periods over which deferred charges may be amortized. Accordingly, in contrast with the rules for depreciation (§ 2.09), the taxpayer corporation has discretion to determine amortization periods in accordance with generally accepted accounting principles. In general, however, if the expenses pertain to fixed assets, the useful life of such assets should be taken into account in determining the amortization principles. Similarly, if the expenditures are to be incurred in accordance with an agreement, the valid period of the agreement should become the basis for determination of the amortization period. n71

Deferred charges of less than 200,000 yen may be expensed in the year incurred. n72

[11] Reduction in Book Value n73

Except for the following, losses from reductions in book value of assets (excluding monetary claims such as deposits, loans, and accounts receivable) are not deductible.

In the case of inventories, losses due to: n74

(1) disaster, if significant damage results;

(2) obsolescence; or

(3) compulsory revaluation of inventories due to corporate reorganization, as provided for in the relevant law.

A decrease in the market price of inventories does not constitute an acceptable basis for recognizing a deductible loss.

In the case of fixed assets, losses due to: n75

(1) disaster, if significant damage results;

(2) non-use for one year or more;

(3) use for purposes other than the original purposes for which the assets were purchased;

(4) change in the circumstances of the physical location of the assets (for instance, land obtained for factory site subsequently not usable for that purpose due to changes in zoning regulations); or

(5) compulsory revaluation due to corporate reorganization as provided for in the relevant law.

In the case of securities, loss due to: n76

(1) marked decline in value of securities listed on an exchange;

(2) marked decline in value of unlisted shares or "corporation control shares" (blocks of 25 percent or more of outstanding shares) due to the financial difficulties of the issuing corporation; or

(3) compulsory revaluation due to corporate reorganization as provided for in the relevant law.

[12] Directors' Compensation

Salaries and bonuses paid to employees of a corporation are deductible expenses in computing the taxable income of the corporation. n77 Retirement allowances are included in salaries for these purposes. Deductibility of compensation paid to employees seldom raises problems.

Remuneration paid to directors and statutory auditors (hereinafter "directors, etc.") is generally of three types: salary, bonuses, and retirement allowances.

"Salary" paid to directors, etc., means the fixed amount of remuneration payable at regular fixed times. The term "salary" includes various economic benefits, such as the gain from release from an obligation. n78

"Bonus" means extra remuneration other than retirement allowances, such as compensation calculated according to the corporation's profit. n79

Salaries paid to directors, etc., are a deductible expense unless the amount is unreasonably high. There are two criteria for determining the reasonableness of salaries:

(1) If the amount of the salary is fixed in advance in the articles of incorporation or by resolution of a shareholders' meeting, any amount exceeding such fixed amount is considered unreasonable, and accordingly, the excessive portion is denied deductibility. n80

(2) If the salary is within the amount fixed in advance, or if no such amount is fixed in advance, the salary may be deemed to be unreasonably high if it is considered inappropriate for services actually rendered by the recipient director, etc., in light of:

(a) the scope of the duties of the director, etc.;

(b) the profits of the corporation;

(c) the salaries paid to employees of the corporation; and

(d) the salaries paid to directors, etc., in corporations engaged in similar business activities and of like size. n81

Bonuses paid to directors, etc., are not deductible. n82 This treatment is based on the notion that such bonuses are paid out of the after-tax profit of the corporation.

However, directors of Japanese companies very often also hold positions as employees. In such cases, the portion of the bonus paid which is reasonably attributable to services as an employee is deductible.

"Bonus" also includes any economic benefit enjoyed by directors, etc., such as payments in kind and benefits from the release from monetary obligations. If a director, etc., realizes any economic gain from a transaction with the corporation not at arm's length, the gain is very often regarded by the tax office as a bonus to the director, etc. For example, if a corporation sells its property to its director, etc., for an unreasonably low price, the difference between the amount actually paid and the fair market value of the property transferred will be considered a bonus to the director, etc. The deemed bonus would be taxable income to the director, etc., but not a deductible expense for the corporation.

[13] Donations

Certain donations made by corporations are deductible. The Corporation Tax Act establishes three categories of donations:

(1) donations made to the Japanese Government or local governments; n83

(2) donations made to public corporations, public interest corporations, or other legal entities established by special laws for the promotion of the public interest such as education and social welfare; n84 and

(3) ordinary donations.

Donations deductible under item (1) are not subject to any limitation in amount. Donations under item (2) are deductible subject to certain limitations. Other ordinary donations under item (3) are deductible if the total amount of donations actually made during any fiscal year does not exceed a certain limit. This limit is calculated on a year-to-year basis pursuant to the following formula (assuming a fiscal year of 12 months): n85 [(Paid-in capital and capital surplus) x 0.0025 + (ordinary income) x 0.025[c] x 1/2. No ordinary donations exceeding the limit are deductible.

Ordinary donations include gratuitous transfers of cash or other property and grants of economic benefits without reasonable counter-value, regardless of the designation of the transfer. Donations do not include payments classified as

advertising expenses, costs of samples, entertainment expenses, payments for employees' welfare, salaries, bonuses, or retirement allowances, although a problem of classification sometimes arises. n86

[14] Entertainment Expenses

Entertainment expenses necessary to carrying on a business constitute deductible expenses, subject to a special provision created in 1954 in the Special Taxation Measures Act to limit the deductibility of entertainment expenses.

The portion of entertainment expenses that is not deductible is currently calculated as follows: n87

No entertainment expenses are deductible, except that a corporation with paid-in capital of 50,000,000 yen or less may deduct a certain fixed amount of its entertainment expenses in accordance with the size of its paid-in capital as of the last day of the business year as follows:

Paid-in capital	Amount deductible
10,000,000 yen or less	90% of 4,000,000 yen, or of the amount of entertainment expenses if less than 4,000,000 yen
more than 10,000,000 yen but not more than 50,000,000 yen	90% of 3,000,000 yen, or of the amount of entertainment expenses if less than 3,000,000 yen

Entertainment expenses are considered to include expenses incurred in connection with receptions, banquets, amusements, donations, and other entertainment of the corporation's customers, suppliers, and other persons closely connected with the corporation's business. In this sense, ordinary donations, advertising expenses, rebates, salaries, disbursements for employees' welfare, and petty items, such as the cost of gifts, such as calendars, Japanese fans, and toiletries, as well as the cost of luncheons and refreshments and other expenses necessary for business meetings are not considered entertainment expenses. n88

[15] Taxes and Public Dues

Some taxes paid by a corporation are deductible expenses. Deductible taxes include the Enterprise Tax, various property taxes, various consumption taxes, and taxes on transactions. Obviously, these taxes are a part of the cost of doing business. Foreign taxes may be deductible if the corporation does not choose to take a foreign tax credit.

On the other hand, the following taxes are explicitly excluded from deductible expenses: n89

(1) Corporation Tax, although the Corporation Tax on Approved Pension Funds, the Interest Tax in case the due date for filing a return has been extended with the approval of the competent tax office, and other similar taxes are deductible;

(2) Delinquency taxes, and various penalty taxes, both national and local;

(3) Prefectural Inhabitant Tax and Municipal Inhabitant Tax; and

(4) Criminal fines and administrative fines.

[16] Contractual Profit Distribution

Insurance companies often distribute monies out of surplus pursuant to insurance agreements due to the non-occurence of events insured against. This distribution of monies is not deemed to be a distribution of profits stemming from the

business activities of the insurance companies, but is deemed to be an expense. n90 Accordingly, the total amount of the distribution, within certain limitations, can be shown as an expense by any insurance company licensed under the Insurance Business Act. n91

Similar expense treatment is allowed for payments by cooperatives to their members made on the basis of certain activities of the cooperative and its members. n92

[17] Loss Carry-Over and Carry-Back

In principle, the tax base consists of current income realized during each business term. Current net operating losses should not influence the determination of taxable income for prior or subsequent business terms.

However, as exceptions to this general principle, all or a portion of a net operating loss may be carried back or carried forward in accordance with the following four provisions:

(1) The corporation may carry back a net operating loss and use it to offset the taxable income of a business term(s) commencing within the twelve months immediately preceding the first day of the current business term in which such loss is incurred. In such cases the tax previously paid on that income will be refunded fully or partially if the corporation files a blue form return for the business term to which the loss is to be carried back and for the subsequent business term in which the loss was incurred. n93

(2) The corporation may carry forward a net operating loss and use it to offset current income within the following five years if the corporation files a blue form return for the business term in which the loss was incurred and continues to file tax returns, either blue or non-blue form, for subsequent business terms. n94

(3) The corporation may carry forward a net operating loss and use it to offset current income within the following five years to the extent that such net operating loss was caused by casualties as defined, i.e., earthquake, storm, flood, fire, or similar casualty. n95

(4) The corporation may carry forward a net operating loss and, without time limitation, use it to offset special benefits as defined, i.e., those benefits granted by a director, a shareholder, or a creditor in the form of a waiver of claims against the corporation at a time of financial difficulties. n96

[18] Intercompany Pricing

There are two provisions in the Corporation Tax Act dealing with the arm's length transaction rules.

[a] Denial of Transactions or Book-Entries of a Family Corporation n97

Article 132 above is made applicable to foreign corporations by Article 147.

[i] Statutory Provisions. Article 132 of the Corporation Tax Act provides:

"(1) When effecting a correction or determination with respect to the Corporation tax liability of any of the corporations defined below, the head of a tax office may compute the taxable income or deficit or the amount of the Corporation Tax according to what he considers to be proper, regardless of said corporation's characterization of the transactions or accounts in question, if not to do so would result in an unreasonably low Corporation tax liability for said corporation.

1. A family corporation which is a domestic corporation.

2. A domestic corporation meeting all of the requirements listed in (a) through (c) below:

(a) It has not fewer than three branches, factories, or other places of business;

(b) With respect to one half or more of those places of business, the heads or chiefs of the places of business, other persons who control the affairs of such places of business or the relatives of such persons or other individuals (as defined by Cabinet Order) who have a special relationship to such persons (hereinafter referred to as the "Heads, etc.") conducted business on an individual basis at such places of business in the past; and

(c) The aggregate number of issued shares or the aggregate amount of investment in the domestic corporation concerned held by the Heads, etc., of the places of business with respect to whom (b) above applies is not less than two-thirds of the total number of issued shares or of the total amount of investment in such domestic corporation.

(2) In the case of the preceding paragraph, the judgment as to whether said domestic corporation is included within the definition of any of the corporations mentioned therein shall be based on said corporation's current situation at the time such transactions or accounts which are the subject of said paragraph are carried out or made."

[ii] Analysis. This provision is considered to set up the arm's length transaction rules applicable to corporations that are closely held. It gives the head of a tax office the power to deny for tax purposes a transaction or book-entry of such a corporation which would otherwise result in an unreasonable decrease in the tax liability and to compute the taxable income or deficit and tax liability of the corporation by restructuring the transaction or book-entry on a more reasonable basis. This provision exists because the financial matters of corporations that are closely held are considered to be capable of easy manipulation by a small number of controlling shareholders. This legislative purpose shares a common ground with that of Article 482 of the Internal Revenue Code of the United States.

Certain special considerations should be noted in connection with the application of this provision.

First, there is no requirement of an intent to avoid the tax. The objective requirement of an unreasonable decrease in tax liability is sufficient.

Second, the transaction or book-entry covered by this provision does not have to be one between two family corporations. It is sufficient that the taxpayer in question be a family corporation as defined in the CTA. A transaction or book entry of a family corporation may be denied pursuant to this provision even if it is made in relation to another independent corporation.

Third, this provision is also made applicable to corporations other than family corporations whose places of business are managed by a small number of controlling shareholders.

Neither the CTA nor the Cabinet Order specifically spells out what kinds of unreasonable transactions are subject to such denial. However, the power of the head of a tax office to deny such transactions is very broad, and circulars, administrative practice, and court decisions have outlined a variety of transactions and book-entries which are subject to denial.

Transactions and book-entries of related corporations which are typically denied under the provision are: n98

(1) overvaluation of an asset contributed as capital;

(2) purchase of an asset at a price in excess of fair market value;

(3) sale of an asset at a price which is less than fair market value;

(4) donation by a corporate taxpayer that should normally be made by a shareholder individual;

(5) contribution toward paid-in capital or purchase by a family corporation of a house which is for the personal use of a shareholder;

(6) payment of excessive compensation to a shareholder-director;

(7) use by a shareholder of a corporate asset without payment therefor or for an unreasonably low rental fee;

(8) excessive rental payments by a family corporation to a shareholder for an asset of the shareholder;

(9) purchase of bad debts from a shareholder by a family corporation;

(10) assumption of another corporation's debt by a family corporation controlled by a shareholder of both corporations; and

(11) interest-free loans or loans bearing an extraordinarily low rate of interest.

In determining the reasonable terms of a transaction or book-entry under this provision, the following standards can be formulated from court decisions: (1) what a non-family corporation would ordinarily do under similar circumstances (the comparison method), (2) what is ordinary or reasonable in light of generally accepted practices, and (3) what is appropriate given the taxpayer corporation's particular circumstances, such as its scale and type of business.

With respect to loans, a High Court decision held that an interest rate of 6 percent per annum was not unreasonably low. n99

Consequences of restructuring by the head of a tax office are varied, depending upon the nature of the case involved. The difference between fair market value and the artificial price could be, for example, treated either as a dividend to the shareholders (if the benefit is given to the shareholders in proportion to their shares), a bonus to the directors, or a donation to the corporation which is the opposite party to the transaction being denied.

[b] Transfer of Assets or Rendering of Services Without Receiving Counter-Value or Acquisition of Assets Without Paying Counter-Value. Corporations other than family corporations are also subject to the arm's length transaction rules.

Article 22, paragraph 2 of the Corporation Tax Act provides:

> "In computing the amount of taxable income of a domestic corporation for such taxable year, the amount to be included in the amount of gross income shall, unless otherwise provided for, be the amount of revenue in the taxable year resulting from the sale of assets, *transfer of assets or rendering of services* with or *without counter-value, acquisition of assets without counter-value,* and other transactions excluding capital transactions." n100 (Emphasis added.)

A transfer or acquisition of assets or a rendering of a service is regarded as producing revenue at fair market value even

if no counter-value is actually received. In such a case a donation is deemed to have been made. Article 22, paragraph 2 makes such deemed donation taxable to the recipient and, in addition, the amount limitation on the deductibility of donations means that these transactions may give rise to tax liability to the donor. Where a lower-than-market price is received, the discount is treated as a donation in the same way. n101

[19] Tax Rates

The tax rates of the Corporation Tax are as follows: n102

	Taxpayer	*Tax Base*	*Tax Rates*
(1)	Ordinary corporations		
	(a) Paid-in capital is yen100,000,000 or less	Total taxable income	28% on the first yen8,000,000 of the taxable income 37.5% on the rest of the taxable income
	(b) Paid-in capital is more than yen100,000,000	Total taxable income	37.5%
(2)	Public interest corporations	Taxable income arising out of profit-making business	27%
(3)	Cooperatives	Total taxable income	27%
(4)	Nonjuridical organizations	Total taxable income	28% on the first yen8,000,000 of the taxable income 37.5% on the rest of the taxable income

[20] Corporate Reorganizations, Liquidations, and Incorporation of Subsidiaries

[a] Statutory Merger and Statutory Consolidation

[i] Concept of Statutory Merger and Statutory Consolidation. The Commercial Code provides for two methods whereby two or more Japanese corporations may be combined into one Japanese corporation. One is statutory merger under which an existing corporation (herein called "Acquiring Corporation") absorbs one or more existing corporations (herein called the "Acquired Corporation"). n103 The other type is statutory consolidation under which two or more existing corporations (herein also called the "Acquired Corporations") are joined into one new corporation (herein also called the "Acquiring Corporation"). n104 Under both statutory merger and statutory consolidation (1) all the assets and obligation-duties of the Acquired Corporation(s) are taken over by the Acquiring Corporation, (2) the Acquiring Corporation issues new shares to the shareholders of the Acquired Corporation, and (3) the Acquired Corporation disolves and immediately disappears.

[ii] Tax Consequences of Statutory Merger and Statutory Consolidation in General. In connection with the statutory merger and statutory consolidation, Income Tax or Corporation Tax is imposed (1) on the shareholders of the Acquired Corporation with respect to the new shares of the Acquiring Corporation and money and other property given to the shareholders to the extent that such shares, money, or property are considered as dividends paid by the Acquired Corporation and/or that such shares, money or property are considered as profit arising from sale of the shares in the Acquired Corporation, (2) on the Acquired Corporation with respect to the appreciation in value of its assets which the Acquiring Corporation enters into its books and for which the Acquiring Corporation issues new shares or gives money or other property to the shareholders of the Acquired Corporation, and (3) on the Acquiring Corporation with respect to the appreciation in value of its assets which the Acquiring Corporation enters into its books but for which it does not give new shares, money or other property to the shareholders of the Acquired Corporation. These tax consequences are explained below in more detail.

If all of the assets, debts, capital, capital surplus, and retained earnings (or losses) of the Acquired Corporation are taken over and succeeded to by the Acquiring Corporation at the same book value as given by the Acquired Corporation, no tax will be imposed on the Acquired Corporation, Acquiring Corporation, or their shareholders unless the merger is considered to have been used as a means of tax avoidance.

[iii] Tax Consequences to Shareholders of Acquired Corporations. For the purposes of the Commercial Code and the Corporation Tax Act, the amount of net assets of any domestic corporation consists of (1) paid-in capital, (2) capital surplus, and/or (3) retained earnings (or accumulated losses) including current profits (or losses). n105 Accordingly, if the total value of new shares in the Acquiring Corporation and money and other property which a shareholder of the Acquired Corporation receives for his shares in the Acquired Corporation exceeds the amount of capital and capital surplus of the Acquired Corporation which is proportionately allocable to his shares in the Acquired Corporation, such excess will be attributable to the retained earnings and/or the unaccounted appreciated value of the assets of the Acquired Corporation. To the extent of such excess, the new shares, money, and other property are deemed and treated as dividends paid by the Acquired Corporation to the shareholder. n106 In the case of a corporate taxpayer, however, such excess is treated as dividends only if and to the extent that the value of the new shares, money, and other property exceeds the acquisition cost to the corporate taxpayer of the shares of the Acquired Corporation. n107 For the purpose of these calculations the value of new shares of the Acquiring Corporation is calculated at face value (or, in the case of shares without face value, at the amount of the increase in the capital of the Acquiring Corporation proportionately allocable to the shares) but the value of property received is calculated at current fair market value. n108

If the total value of such new shares, money, and other property given to the shareholder of the Acquired Corporation less the abovementioned deemed dividends exceeds the shareholder's acquisition cost of the shares in the Acquired Corporation, such excess is treated as profit arising from sale of the shares of the Acquired Corporation.

[iv] Tax Consequences to Acquired Corporation. If the total value of new shares in the Acquiring Corporation, and money and other property which all the shareholders of the Acquired Corporation receive for their shares in the Acquired Corporation exceeds the amount of capital and capital surplus plus the amount of retained earnings of the Acquired Corporation, such excess is taxed as "liquidation income" n109 at a rate which is about 3/4 of an ordinary corporation tax rate. n110

This is because such excess is attributable to unaccounted (or unrealized) appreciation in the value of assets held by the Acquired Corporation, which appreciated value is considered as realized upon receipt of such new shares, money, and/or other property from the Acquiring Corporation. Since such tax on liquidation income is paid by the Acquiring Corporation on behalf of the Acquired Corporation, the amount of such tax is also included in liquidation income. n111

If all or a part of the capital surplus and/or retained earnings of the Acquired Corporation is taken over and succeeded to as such by the Acquiring Corporation, the amounts succeeded to will be excluded from the amount of the capital surplus and/or retained earnings of the Acquired Corporation for the purposes of the above calculation of liquidation income. n112

In the event that the Acquiring Corporation owns shares in the Acquired Corporation immediately before merger and, upon merger, new shares in the Acquiring Corporation are not issued for all or part of such shares owned by the Acquiring Corporation in the Acquired Corporation, the amount of capital and capital surplus of the Acquired Corporation proportionately corresponding to such shares in the Acquired Corporation will be excluded from the amount of capital and capital surplus of the Acquired Corporation for the purposes of the abovementioned calculation of liquidation income. n113

A pre-merger sale of shares in the corporation to be acquired would normally give rise not to liquidation income but to profit from the sale of shares, without a permanent establishment in Japan and foreign corporations are taxed on profit

from the sale of shares only in limited situations. For this reason, when new shares in the acquiring corporation are not issued in exchange, appreciated prices paid at such pre-merger sales which unduly reduce liquidation income are treated as paid at the time of merger for the purpose of calculating capital and capital surplus of the acquired corporation. n114

[v] Tax Consequences to Accquiring Corporation. If the book value given by the Acquiring Corporation for the net assets taken over from the Acquired Corporation exceeds (1) the value of new shares, money, and other property given to the shareholders of the Acquired Corporation, plus (2) the amount of capital surplus and retained earnings of the Acquired Corporation taken over and succeeded to by the Acquiring Corporation, such excess in book value is considered to be attributable to appreciated value in the assets of the Acquired Corporation which has not been entered into the books by the Acquired Corporation, and it is taxable at an ordinary Corporation Tax rate as profit of the Acquiring Corporation realized at the time of the merger. n115

If the amount of capital of the Acquired Corporation exceeds the value of new shares, money, and other property given to the shareholders of the Acquired Corporation, such excess will be excluded from the taxable profit of the Acquiring Corporation since this part of the profit is attributable to capital reduction of the Acquired Corporation. n116

[vi] Examples. An example of the balance sheets of an Acquired Corporation and of an Acquiring Corporation before and after a merger follows:

Acquired Corporation			
property	1,000	capital	500
		capital surplus	250
		retained earnings	250
	1,000		1,000
Acquiring Corporation (before merger)			
property	1,000	capital	1,000
Acquiring Corporation (after merger)			
property	2,100	capital	1,800
		capital surplus	150
		retained earnings	150
	2,100		2,100

In this example, it is assumed that (1) the acquisition cost to the shareholders of the Acquiring Corporation of the shares in the Acquired Corporation is 700; (2) that at the time of the merger the Acquiring Corporation gave money in the amount of 50 to the shareholders of the Acquired Corporation in addition to the new shares in the Acquiring Corporation in the face value of 800; and (3) that the Acquiring Corporation did not have any shares in the Acquired Corporation before the merger.

The amount of deemed dividends to the shareholders of the Acquired Corporation would be calculated as follows:

```
[800 (new shares) + 50 (money)] - [500 (capital of Acquired Corp.)
+ 250 (capital surplus of Acquired Corp.)] = 100
```

The amount of the deemed profit arising from sale of the shares in the Acquired Corporation would be as follows:

```
[800 (new shares) + 50 (money)] - 100 (deemed dividends)
 - 700 (acquisition cost) = 50
```

Liquidation income of the Acquired Corporation would be calculated as follows:

```
[800 (new shares) + 50 (money)] - 500 (capital of Acquired Corp.)
- [250 (capital surplus of Acquired Corp.) - 150 (a part of the
same succeeded to by the Acquiring Corp.)[c] - [250 (retained
earnings of Acquired Corp.) - 150 (a part of the same succeeded
by the Acquired Corp.)] = 150 (liquidation income less tax thereon)

[150 + A (additional liquidation income)] x 50.7% (aggregate tax
rate on
liquidation income) = A. Accordingly, A = 154.3

Total liquidation income = 150 + A = 304.3
```

Since the book value given by the Acquiring Corporation to the assets succeeded to from the Acquired Corporation (1,100) is smaller than the sum of the amount of new shares (800), the money given to the shareholders of the Acquired Corporation (50), the capital surplus succeeded to from the Acquired Corporation (150), and the retained earnings succeeded to from the Acquired Corporation (150), there is no taxable profit to the Acquiring Corporation arising from the merger.

[b] Nonrecognition Upon Incorporation of Subsidiaries. Nonrecognition of gain is permitted when property is transferred by a domestic corporation or a foreign corporation which has a permanent establishment in Japan to a domestic subsidiary as a contribution in kind at the time of incorporation of the subsidiary, provided that:

(1) upon incorporation, the transferor owns at least 95 percent of the issued and outstanding shares of the subsidiary; n117 and

(2) the basis of the property in the hands of the transferor does not exceed the basis of the property in the hands of the transferee. n118

In the event that the transferor first incorporates the subsidiary by cash, and without delay after the incorporation, the transferor transfers property to the subsidiary in one transaction, nonrecognition of gain is permitted under the same conditions as mentioned above, if the transferor owns, upon incorporation of the subsidiary, 100 percent of the issued shares of the subsidiary and if the transfer of the property is planned at the time of incorporation. n119

In both of the above cases, a certain limitation was introduced to the nonrecognition if the property to be transferred is land or certain rights to land. n120

[21] Family Corporations (*Dozoku Kaisha*)

[a] Definition. The Corporation Tax Act provides special treatment for "family corporations"--corporations controlled by a limited number of shareholders. Although family corporations do not constitute an independent class of corporate taxpayers with a separate tax rate, they require a separate explanation because of the special treatment. Share ownership is the only test for this category. A family corporation is defined as a corporation in which 50 percent or more of the stock issued or of contributions made is owned by three or fewer shareholders. n121

Stock owned by a corporation itself is taken into account when the percentages stated above are computed. n122 Shares owned by the national or local governments are treated likewise. n123 The beneficiary owner of stock held in the name of another person is treated as a shareholder for the purpose of defining a family corporation. n124

In counting the number of shareholders, a shareholder and the persons (both natural persons and corporations) specially connected with him are counted as one. n125 For natural persons, the term "persons specially connected with a shareholder" means:

(1) relatives (*shinzoku*), that is, spouse, relatives by blood up to the sixth degree of relationship, and relatives by affinity up to the third degree of relationship; n126

(2) de facto spouse, that is, spouse without marriage registration;

(3) employees (this does not include an employee of another business corporation over which the shareholder holds control); n127

(4) any other individual economically supported by the shareholder (an individual who for his living depends principally on money or other property given by the shareholder); n128

(5) the relatives of the persons mentioned in (2) through (4) who share a common source of livelihood with such persons (this does not necessarily mean living under the same roof but means sharing the source of economic support). n129

If another corporation which holds shares of the business corpration in question is controlled by a shareholder, it is also deemed a person specially connected with the shareholder.

Control is defined as ownership of 50 percent or more of the issued stock of a corporation. Such "ownership" includes the stock or contributions owned by individuals defined above as "persons specially connected with the shareholder." n130

In calculating the percentage of stock or capital as stated above, the stock or contributions owned by the following business corporations are counted together:

(1) the stock or contributions owned by the business corporations controlled by the shareholders and "individuals specially connected with him" as mentioned above (e.g., the grandfather-grandson relationship);

(2) the stock or contributions owned by the business corporations controlled by the shareholder, "individuals specially connected with him," and the business corporations controlled as provided in (1) above (e.g., the great-grandfather and great-grandson relationship). Subsidiaries and joint ventures down to great-grandson business corporations are easily caught by this category and cannot escape this class by means of the pyramid-pile-up device.

It should also be noted that a non-juridical organization, i.e., an unincorporated association or foundation recognized as a taxable entity under the CTA will be treated as a shareholder in counting the percentages of stock controlled. n131

[b] Special Treatment. The special treatment of family corporations can be summarized as follows:

(1) special additional tax on retained earnings;

(2) denial of transactions or book-entries in certain cases; and

(3) creation of secondary taxpayers.

The first two of these have a significant impact on tax accounting practice.

[c] Special Surtax. A special additional tax is levied on the undistributed profits a family corporation earned during the taxable year which exceed the allowance for retained earnings. n132

In order for the additional tax to apply, the three shareholders or three groups of shareholders must consist of three individuals or corporations judged to be family corporations on the basis of their shareholding. Thus, the additional tax does not apply if the three shareholders include independent corporations. Therefore, the additional tax is not applicable to a corporation wholly-owned by another non-family corporation.

Not all retained earnings are subject to the additional tax because Japanese tax law recognizes the necessity of retaining certain portions of taxpayers' income for business operations. Retained income is exempted from such additional tax (retained earnings deduction) in an amount which is the largest of the following three amounts: n133

(1) 35 percent of the annual ordinary income (taxable income subject to certain minor adjustments);

(2) yen15,000,000 per annum; or

(3) the sum chosen by the shareholders to be allocated to profit reserve, which may be up to 1/4 of the paid-in capital together with the profit reserve accumulated in the past (cf. the Commercial Code, Article 288 requires each corporation to accumulate a profit reserve gradually until it is equal to 1/4 of the paid-in capital).

Generally speaking, a family corporation is allowed to retain earnings of at least 35 percent of its annual income without having to pay the additional tax.

The additional tax is levied at an additional rate of 10 percent through 20 percent: 10 percent on the first yen30,000,000 excess; 15 percent on the next yen70,000,000 excess; and 20 percent on the excess over yen100,000,000. n134

[d] Denial of Transactions or Book-Entries. n135 See § 2.18, Intercompany Pricing, *supra*.

[e] Creation of Secondary Taxpayers. Generally speaking, shares in Japanese stock companies are freely transferable. The articles of incorporation may provide, however, that the transfer of shares is subject to approval by the board of directors. n136 For other types of business companies, the transfer of shares is limited to some extent. n137

The shares of a family corporation, even when transferable, are in fact, not easy to transfer because of the closed nature of the corporation. When a tax office seeks to attach and sell the shares of a family corporation owned by a shareholder in order to satisfy his tax liability, it often encounters difficulty in finding a purchaser. In such a case, the Corporation Tax Act makes the family corporation secondarily liable for the tax liability of the shareholder to the extent of the value of the shares.

The requirements are: n138

(1) That the shareholder in question be one of the shareholders whose presence enables a finding of family corporations status;

(2) That the other properties of the shareholder do not satisfy his tax liability;

(3) That the shares of the family corporation have been put up for sale twice with no purchaser being found, or that the transfer of the shares be hindered by prohibition of law or the articles of incorporation, or by the fact that their certificates have not been issued.

Another type of secondary tax liability concerns the disallowance of unreasonable transactions or entries explained above. If a transaction of a family corporation is disallowed and the assets of the corporation cannot satisfy the payment of the tax liability assessed by reconstructing the book-entry, the shareholder who got the benefit of the transaction becomes liable for the payment to the extent of the benefit he received. n139 For instance, if an entertainment expense entered in the book of a family corporation is disallowed as an outlay for the president's own benefit, the increased tax liability caused by the elimination of the expense deduction falls on the president himself. The outlay is then treated as compensation to him out of the earnings after tax.

[22] Tax Credits

Credits against Corporation Tax calculated as described in § 2.19 are provided for in both the Corporation Tax Act and the Special Taxation Measures Act. The following credits are allowed under the Corporation Tax Act.

(a) a credit for Income Tax withheld. n140

(b) a credit for foreign tax. n141

Credits allowed under the Special Taxation Measures Act include credits for the increase of research and development expenses.

The credit for foreign tax is designed to avoid double taxation of income by the Japanese government and a foreign government. Therefore, no foreign taxes other than foreign corporate taxes are creditable. There is a ceiling on the foreign tax credit equal to the amount of Japanese Corporation Tax that could be levied on income from sources outside Japan. n142 The foreign tax credit is taken after all other credits. If any portion of foreign tax paid in a taxable year cannot be credited against Japanese Corporation Tax in the year incurred, such portion may be carried forward for three years. n143

[23] Taxation on Foreign Corporations

[a] Taxpayers and Scope of Taxable Income. The Corporation Tax Act provides two categories based on the location of the head office for classification of corporate taxpayers: "domestic corporation" and "foreign corporation." Domestic corporations are subject to Corporation Tax on all income regardless of source. Foreign corporations are subject to Corporation Tax only on income from sources within Japan. n144

Therefore, in defining the scope of taxable income, the first step is to determine the residence status of the taxpayer, n145 and the second is to determine the source of the income. A discussion of source rules follows.

[b] Income from Sources within Japan. The following items are deemed to be income from sources within Japan under the Corporation Tax Act: n146

(1) Industrial or commercial income from business carried on in Japan, income from the utilization, holding, sale, or other disposal of assets location in Japan, and similar items of income as specified by Cabinet Order, excluding the income described in items (1-a) through (1),

(1-a) Income from transfer of land located in Japan or rights to such land, a building located in Japan, or

annex to such building,

(2) Income from business primarily for providing personal services performed in Japan, such as services of entertainers, athletes, lawyers, accountants, architects, engineers, or consultants,

(3) Rents or other compensation for use of real property located in Japan or for rights thereon, royalties for use of quarrying rights or mining rights granted under Japanese law, and charter fees from a bare boat charter of a ship or aircraft the charterer of which is a resident in Japan or a Japanese corporation,

(4) Interest on bonds or debentures issued by the Japanese government, Japanese local governments or Japanese corporations, interest on deposits with banks or other financial institutions in Japan, and distribution of profits on joint operation trusts or open end bond investment trusts in Japan,

(5) Dividends received from Japanese corporations and distribution of surpluses, or distribution of profits from securities investment trusts in Japan,

(6) Interest on loans to a person who carries on business within Japan for use in his business operated within Japan,

(7) Royalties for use, or compensation for transfer, of patents, know-how, copyrights (including the rights to use movie films, television films, or videotapes) or other industrial property rights, and rents for use of machine and equipment, received from a person who carries on business in Japan for use in his business in Japan,

(8) Awards, goods, or other benefits provided in connection with advertisements performed in Japan,

(9) Annuities on life insurance or similar contracts concluded through a place of business located in Japan,

(10) Profit from certain financial products,

(11) Distribution of profits received in the taxpayer's capacity as a silent partner of a silent partnership carrying on business in Japan.

Article 139 of the Corporation Tax Act expressly states that if an applicable tax treaty provides for source rules different from the above, the treaty source rules control. n147

[c] Classification of Foreign Corporations and Respective Taxable Income

[i] Scope of Activities and Taxable Income. Foreign corporations are classified into four categories based upon the nature of their activities in Japan. Which items of income are subject to standard tax treatment (the same as that applicable to Japanese corporations) depends on the applicable category of activity. These categories are set forth in the chart below. n148

Activity of Foreign Corporation	Income Subject to Standard Tax Treatment
1. Maintenance of a branch office, other place of business, factory, mine, or quarry.	1. All items (1) through (11) (all income from sources in Japan), regardless of whether such income is earned by the branch, etc. in Japan.
2. Provision of services in construction, in-	2. Items (1) through (3) and such portion of

	stallation or assembling activities, or provision of personal services for supervision or superintendence of such activities, for more than a year in Japan.		items (4) through (11) as are attributable to the said activities of the corporation in Japan.
3.	The employment of (i) a person who has and habitually exercises authority to conclude contracts in Japan on behalf of the corporation, unless the authority of such agent is limited to the purchase of goods, (ii) a person who keeps a stock of goods in Japan and habitually delivers such goods on behalf of the corporation, or (iii) a person who habitually secures orders, negotiates or conducts other important activities in Japan exclusively or almost exclusively for, or on behalf of the corporation.	3.	Items (1) through (3) and such portion of items (4) through (11) as are attributable to the business conducted in Japan through the said person.
4.	Other (i.e., no "permanent establishment" in Japan).	4.	Income within (a) that arises from the operation or possession of assets in Japan, from the transfer of real property or otherwise as specified by Cabinet Order.

The categorization of activities parallels application of the concept of permanent establishment in the OECD Model Double Taxation Convention. The most salient difference is the adoption of the "force of attraction" rule by the Corporation Tax Act. This rule is replaced by the rule of attributability in almost all tax treaties concluded by Japan.

[ii] Calculation of Tax. Tax payable on Japan-source income subject to standard treatment is calculated in the same manner as is applicable to Japanese corporations (and described in § § 2.02 through 2.21 *supra*). n149

[d] Withholding Tax on Foreign Corporations. The Japan-source income of a foreign corporation set forth in the above items (1-a) through (11) is subject to withholding if it is paid in Japan, n150 or if payment is made outside Japan and the payor is a resident of Japan or has a dwelling place or place of business in Japan. n151 In either case, the payor is required to withhold and pay the withholding tax to the competent Japanese tax office. n152

The withholding tax rates are as follows n153 unless reduced by treaty.

Rate	Items
10%	(1-a)
15%	(4) and (10)
20%	Others

A foreign corporation with a permanent establishment (engaged in activities within categories one through three in the chart provided in § 2.22[o]3[c][o]a[c] *supra*) may obtain an exemption from withholding with respect to all items of income subject to standard treatment except such items which are subject to withholding tax even in the case of Japanese corporations (mainly interest and dividends). The exemption is secured by obtaining an appropriate certificate from the competent tax office prior to payment and presenting it to the payor. n154

[24] Special Rules for International Transactions

[a] Anti-Tax Haven Rules n155

[i] Introduction. In 1978, Japan introduced anti-tax haven rules. Under the rules, retained earnings of a foreign corporation established in a tax haven and controlled by Japanese shareholders are added to the taxable income of the Japanese shareholders.

[ii] Relevant Foreign Corporation. A foreign corporation is caught by these rules, if:

(1) one or more Japanese residents, one or more Japanese corporations or both totally own more than 50% of the outstanding shares or outstanding voting shares of the foreign corporation and

(2) the foreign corporation has the head office or the principal place of business in a country or area where there is no corporate income tax or where the corporation is taxed at a rate of 25% or lower.

Before April 1, 1992, there used to be an official blacklist of tax havens announced by the Ministry of Finance. It was, however, abolished on April 1, 1992 and replaced with the current case-by-case approach.

[iii] Relevant Shareholder. A Japanese resident or Japanese corporation which individually owns 5% or more of a relevant foreign corporation is caught by these rules.

A group of affiliated shareholders is treated as one for the purpose of determining the 5% threshold.

[iv] Taxable Retained Earnings. Total taxable retained earnings are the balance of the relevant foreign corporation's income calculated in accordance with Japanese tax laws or the same calculated in accordance with local tax laws and then adjusted in accordance with Japanese tax laws, less dividends paid (excluding those paid to another relevant foreign corporation) and local corporate income tax.

The total taxable retained earnings are then prorated to each relevant shareholder in accordance with his shareholding against the total outstanding shares of the relevant foreign corporation.

[v] Exemption. In order for these rules not to impede sound business operations, certain exemption is provided for. However, a relevant foreign corporation whose business is the holding of shares or other securities, the licensing of intellectual property rights or the leasing of ships or aircraft, is not entitled to the exemption in any event.

First, a relevant foreign corporation which conducts wholesale, banking, trust, securities brokerage, insurance, water transportation or air transportation business, benefits from the exemption if:

(1) it has an office, shop, factory or other fixed facilities in the country or area where it has the head office or the principal place of business to operate its business,

(2) it manages, controls and operates its business in the country or area where it has the head office or the principal place of business, and

(3) it conducts more than 50% of its business with non-affiliated parties.

Second, a relevant foreign corporation which conducts any other business benefits from the exemption if:

(1) it has an office, shop, factory or other fixed facilities in the country or area where it has the head office or the principal place of business to operate its business,

(2) it manages, controls and operates its business in the country or area where it has the head office or the

principal place of business, and

(3) it conducts its business mainly in the country or area where it has the head office or the principal place of business.

[b] Transfer Pricing Rules n156

[i] Introduction. If a corporation conducts a transaction with its foreign affiliate at a price different from an arm's length price, the corporation is taxed as if it conducted the transaction at an arm's length price.

[ii] Foreign Affiliate. A foreign affiliate caught by these rules is a foreign corporation which has one of the following relationships with the corporation in question:

(1) One directly or indirectly owns 50% or more of the other's outstanding shares.

(2) A single individual or corporation directly or indirectly owns 50% or more of the outstanding shares of both.

(3) One can effectively control the other. For example, more than half of one's officers consist of the other's officers or employees, or substantial part of one's business is dependent upon the dealings with the others.

[iii] Relevant Transactions. Transactions caught by these rules include sale of assets, rendering of service, and any other transaction giving rise to profit or loss, but exclude gift of money and release from obligations.

These rules also apply to a transaction conducted between a corporation and a dummy party which is not a foreign affiliate, if the transaction in substance is conducted between the corporation and a foreign affiliate.

[iv] Arm's Length Price. An arm's length price is determined by one of the following methods:

(1) Comparable Uncontrolled Price Method (CUP)
The arm's length price is the price in a similar transaction in a similar situation between parties which are not affiliated.

(2) Resale Price Method (RP)
The arm's length price is obtained by deducting the normal make-up from a price in a transaction with a party which is not affiliated.

(3) Cost Plus Method (CP)
The arm's length price is obtained by adding the normal make-up to the cost of the goods in question.

(4) Others
Other methods stipulated by Cabinet Order as comparable to the above three methods.

[v] Correlative Adjustment. If an agreement on an arm's length price is reached between the Japanese tax authorities and a foreign tax authorities under a tax treaty, the Japanese tax authorities may adjust the amount of Corporation Tax already assessed.

[c] Thin Capitalization Rules n157

[i] Introduction. On April 1, 1992, Japan enacted new thin capitalization rules. Under these rules, a Japanese

corporation (or a foreign corporation running business in Japan) whose debt owed to its foreign controlling shareholder exceeds three times the equity held by such a shareholder, is prohibited from deducting from its taxable income such portion of interest payable to such a shareholder as accrues from the exceeding portion of the debt.

[ii] Foreign Controlling Shareholder. A foreign controlling shareholder ("FCS") means a non-resident or foreign corporation which has any of the following relationships with the corporation in question:

(1) The non-resident or foreign corporation (FCS) directly or indirectly owns 50% or more of the Japanese corporation's outstanding shares.

(2) A single individual or corporation directly or indirectly owns 50% or more of the outstanding shares of the foreign corporation (FCS) and the Japanese corporation.

(3) The non-resident or foreign corporation (FCS) can effectively control the Japanese corporation. For example, more than half of the Japanese corporation's officers consist of the non-resident's or foreign corporation's officers or employees, or substantial part of the Japanese corporation's business is dependent upon the dealings with the non-resident or foreign corporation.

[iii] Debt-Equity Ratio. A corporation whose debt owed to its FCS exceeds three times the equity held by the FCS is prohibited from deducting its taxable income such portion of interest payable to the FCS as accrues from the exceeding portion of the debt, except under certain circumstances.

Debt owed to an FCS means any debt owed to the FCS which bears interest. However, if the FCS has a permanent establishment in Japan and enjoys no relief (exemption or rate reduction as to interest) under a tax treaty, debt owed to such FCS is excluded.

Equity held by an FCS means the net assets (assets minus liabilities on the balance sheet) multiplied by the FCS's shareholding ratio.

[iv] Concession. As stated above, the thin capitalization rules apply if a corporation's debt-equity ratio to a specific FCS exceeds 3:1.

If, however, a corporation's total debt is three times or less of its total equity on the balance sheet, the thin capitalization rules will not apply.

Further, if the corporation establishes that, in the light of industry average or other situations, a ratio exceeding 3:1, for example 4:1, is justifiable, a concession is also given and the thin capitalization rules will not apply.

[25] Tax Returns

Corporations are required to file final tax returns with a tax office within two months after the end of each business year to report taxable income for the business year. n158

A foreign corporation which has Japan-source income subject to taxation by standard treatment n159 or which has a permanent establishment (activities within numbers one through three in the chart in § 2.23[o]3[c][o]a[c] *supra*) in Japan is required to file a final tax return in the same manner as applied to Japanese corporations. n160

A corporation which keeps proper accounting books may file a return on a blue form after obtaining approval of the chief of the tax office. n161 Such a tax return is called the "blue form return," and the ordinary tax return is called a "white form return."

The blue form return system was introduced as incentive to improve taxpayers' bookkeeping and encourage correct self-assessment. Therefore, several privileges are granted to a corporation which files a blue form return.

[26] Special Corporation Tax

As a temporary measure for business year ending between April 1, 1992 to March 31, 1994, Special Corporation Tax is levied on a corporation at the rate of 2.5% of the balance of the amount of Corporation Tax minus yen4,000,000.

FOOTNOTES:
(n1)Footnote 1. CTA, Art. 4.

(n2)Footnote 2. CTA, Art. 2, item 3.

(n3)Footnote 3. CTA, Art. 2, item 4.

(n4)Footnote 4. Schedules No. 1, 2 and 3 of CTA.

(n5)Footnote 5. CTA, Art. 2, item 13.

(n6)Footnote 6. CTA, Art. 3.

(n7)Footnote 7. CTA, Art. 2, item 8.

(n8)Footnote 8. CTA, Art. 2, item 9.

(n9)Footnote 9. CTA, Art. 4, paragraph 1.

(n10)Footnote 10. See, for further details of those legal entities, Ch. 7, §7.01, Chapter 1. Note that partnership companies in [o]B[c] are legal entities with unlimited liability.

(n11)Footnote 11. CTA Schedules 1(2) and 2(2).

(n12)Footnote 12. *Ibid*.

(n13)Footnote 13. CTA, Art. 4, para. 1; Art. 5.

On limited occasions, a one (1) percent flat rate Corporation Tax is imposed on pension funds accumulated by insurance companies or trust banks and held for trustor-companies. Since Income Tax will be levied on the pension payees when the funds are actually distributed later, this tax is a sort of interest payment for the deferral of the final Income Tax (CTA, Articles 8 and 87).

(n14)Footnote 14. Recent developments in the law regarding the tax treatment of associations and foundations with juridical person status are further discussed in the topic "Passage of Three Acts Reforming the Legal Framework Governing Public Interest Associations and Foundations with Juridical Person Status" in Ch. 1 §1.02[1] and Ch. 1 §1.03 *above*.

(n15)Footnote 15. CTA, Art. 4, para. 1.

(n16)Footnote 16. CTA, Art. 22 para. 1.

(n17)Footnote 17. CTA, Art. 22, para. 5.

(n18)Footnote 18. *Ibid*.

(n19)Footnote 19. CTA, Art. 22, para. 3.

(n20)Footnote 20. CTA, Art. 13, para. 1.

(n21)Footnote 21. CTA, Art. 13, para. 2.

(n22)Footnote 22. CTA, Art. 13, para. 3.

(n23)Footnote 23. CTA, Art. 22, para. 4.

(n24)Footnote 24. CTA, Art. 16.

(n25)Footnote 25. CTA, Art. 17, item 1.

(n26)Footnote 26. CTA, Art. 138, item 3.

(n27)Footnote 27. CTA, Art. 17, item 3.

(n28)Footnote 28. CTA, Art. 17, item 3; CTAEO (The Corporation Tax Act Enforcement Order), Art. 16.

(n29)Footnote 29. A similar provision is found in Art. 12 of the Income Tax Act.

(n30)Footnote 30. CTA, Art. 22, paras. 2 and 5; Art. 27.

(n31)Footnote 31. CTA, Art. 23.

(n32)Footnote 32. CTA, Art. 24.

(n33)Footnote 33. CTA, Art. 25.

(n34)Footnote 34. CTA, Art. 26.

(n35)Footnote 35. CTA, Arts. 42 through 44.

(n36)Footnote 36. CTA, Art. 45.

(n37)Footnote 37. CTA, Arts. 47 through 49.

(n38)Footnote 38. CTA, Art. 50.

(n39)Footnote 39. CTA, Art. 51.

(n40)Footnote 40. STMA (The Special Taxation Measures Act), Arts. 64 through 65-6.

(n41)Footnote 41. STMA, Art. 65-2, paras. 1 and 2.

(n42)Footnote 42. STMA, Arts. 65-7 through 65-9.

(n43)Footnote 43. CTABC (The Corporation Tax Act Basic Circular), 2-1-1, 2-1-2.

(n44)Footnote 44. CTABC, 2-1-5, 2-1-6.

(n45)Footnote 45. CTABC, 2-1-14.

(n46)Footnote 46. CTABC, 2-1-3.

(n47)Footnote 47. CTA, Art. 62.

(n48)Footnote 48. CTA, Art. 63.

(n49)Footnote 49. CTA, Art. 64.

(n50)Footnote 50. CTA, Art. 22, para. 3.

(n51)Footnote 51. CTA, Art. 2, item 11; CTAEO, Art. 10.

(n52)Footnote 52. The others are the moving average basis, straight average basis, lease-purchase-price basis, and retail basis.

(n53)Footnote 53. *Ibid*.

(n54)Footnote 54. CTA, Art. 29, para. 2; CTAEO, Art. 29 and Art. 186, item 2.

(n55)Footnote 55. CTA, Art. 29, para. 1; CTAEO, Art. 31, para. 1.

(n56)Footnote 56. CTAEO, Art. 30.

(n57)Footnote 57. CTA, Art. 30; CTAEO, Art. 34, para. 1.

(n58)Footnote 58. CTAEO, Art. 34, para. 1.

(n59)Footnote 59. CTAEO, Art. 34, paras. 1 and 3.

(n60)Footnote 60. CTAEO, Art. 38.

(n61)Footnote 61. CTAEO, Arts. 35, 36; Art. 186, item 2.

(n62)Footnote 62. CTA, Art. 2, item 24; CTAEO, Art. 13.

(n63)Footnote 63. CTA, Art. 31 para. 1.

(n64)Footnote 64. STMA, Arts. 42-5 through 52-3.

(n65)Footnote 65. CTAEO, Art. 132.

(n66)Footnote 66. CTA, Art. 2, item 25.

(n67)Footnote 67. CTAEO, Art. 14, para. 1.

(n68)Footnote 68. Commercial Code, Art. 291, para. 1.

(n69)Footnote 69. *Ibid*., Art. 287.

(n70)Footnote 70. A new tenant is typically required to pay the landlord a non-refundable sum additional to a refundable deposit and rent.

(n71)Footnote 71. CTABC, 8-2-1.

(n72)Footnote 72. CTAEO, Art. 134.

(n73)Footnote 73. CTA, Art. 33, para. 1.

(n74)Footnote 74. CTAEO, Art. 68, para. 1, item 1.

(n75)Footnote 75. CTAEO Art. 68, para. 1, item 3.

(n76)Footnote 76. CTAEO Art. 68, para. 1, item 2.

(n77)Footnote 77. CTA, Art. 22, para. 3.

(n78)Footnote 78. CTA, Art. 34, para. 3.

(n79)Footnote 79. *Ibid*.

(n80)Footnote 80. CTAEO, Art. 69, item 2.

(n81)Footnote 81. CTAEO, Art. 69, item 1.

(n82)Footnote 82. CTA, Art. 35, para. 1.

(n83)Footnote 83. CTA, Art. 37, para. 3, item 1.

(n84)Footnote 84. CTA, Art. 37, para. 3, items 2 and 3.

(n85)Footnote 85. CTAEO, Art. 73.

(n86)Footnote 86. CTA, Art. 37, para. 6.

(n87)Footnote 87. STMA, Art. 62.

(n88)Footnote 88. STMAEO, Art. 38-2.

(n89)Footnote 89. CTA, Article 38.

(n90)Footnote 90. CTA, Art. 60.

(n91)Footnote 91. Law No. 41, 1939.

(n92)Footnote 92. CTA, Art. 61.

(n93)Footnote 93. CTA, Art. 81.

The application of this provision is, however, suspended for business years ending between April 1, 1992 and March 31, 1994 (STMA, Art. 66-14).

(n94)Footnote 94. CTA, Art. 57.

(n95)Footnote 95. CTA, Art. 58.

(n96)Footnote 96. CTA, Art. 59.

(n97)Footnote 97. A "family corporation" is defined in Article 2, item 10 of the Corporation Tax Act as a corporation in which not less than 50 percent of all issued shares or investment is owned by three or fewer individual or corporate shareholders or shareholder groups defined by Cabinet Order. *See* § 2.21 *infra.*

Article 132 above is made applicable to foreign corporations by Article 147.

(n98)Footnote 98. Old CTABC, 355.

(n99)Footnote 99. Head of Omi Hachiman Tax Office v. Shimizuso K.K., Osaka High Court, 925 Hanrei Jiho 51, March 30, 1978.

(n100)Footnote 100. This provision is made applicable to foreign corporations by Art. 142.

(n101)Footnote 101. CTA, Art. 37, para. 6.

(n102)Footnote 102. CTA, Art. 66.

(n103)Footnote 103. Commercial Code, Art. 409.

(n104)Footnote 104. *Ibid*., Art. 410.

(n105)Footnote 105. Rules Concerning Balance Sheet and Profit and Loss Statement of Stock Corporation, Ministerial Ordinance, Ministry of Justice No. 31 of 1963 as amended.

(n106)Footnote 106. ITA, Art. 25.

(n107)Footnote 107. CTA, Art. 24.

(n108)Footnote 108. ITAEO, Art. 61, para. 2; CTAEO, Art. 23 para. 2; CTA, Art. 112, para. 2.

(n109)Footnote 109. CTA, Art. 112.

(n110)Footnote 110. CTA, Arts. 112 and 115; Local Tax Act, Arts. 23, 51, 292, 314-6.

(n111)Footnote 111. CTA, Art. 113.

(n112)Footnote 112. CTA, Art. 112, para. 3.

(n113)Footnote 113. CTA, Art. 112, para. 3.

(n114)Footnote 114. CTA, Art. 112, para. 3.

(n115)Footnote 115. CTA, Art. 112, item 19.

(n116)Footnote 116. CTA, Art. 2, item 17.

(n117)Footnote 117. CTA, Art. 51.

(n118)Footnote 118. CTAEO, Art. 93.

(n119)Footnote 119. CTSBC, Art. 10-7-1.

(n120)Footnote 120. STMA, Art. 66.

(n121)Footnote 121. CTA, Art. 2, item 10.

(n122)Footnote 122. CTABC, 1-3-2.

(n123)Footnote 123. Old CTABC, 49.

(n124)Footnote 124. CTABC, 1-3-1-2.

(n125)Footnote 125. CTA, Art. 2, item 10; CTAEO, Art. 4.

(n126)Footnote 126. Civil Code, Art. 725.

(n127)Footnote 127. Old CTABC, 44.

(n128)Footnote 128. CTABC, 1-3-3.

(n129)Footnote 129. CTABC, 1-3-4.

(n130)Footnote 130. CTA, Art. 2, item 10.

(n131)Footnote 131. Old CTABC, 50.

(n132)Footnote 132. CTA, Art. 67.

(n133)Footnote 133. CTA, Art. 67, para. 3.

(n134)Footnote 134. CTA, Art. 67, para. 1.

(n135)Footnote 135. See § 2.18, Intercompany Pricing, *supra*.

(n136)Footnote 136. Commercial Code, Art. 204.

(n137)Footnote 137. Commercial Code, Arts. 73 and 147; Limited Liability Company Act, Art. 19.

(n138)Footnote 138. NTCA (The National Tax Collection Act), Art. 35, para. 1.

(n139)Footnote 139. NTCA, Art. 36.

(n140)Footnote 140. CTA, Art. 68.

(n141)Footnote 141. CTA, Art. 69.

(n142)Footnote 142. CTA, Art. 69, para. 1.

(n143)Footnote 143. CTA, Art. 69, para. 2.

(n144)Footnote 144. CTA, Art. 4.

(n145)Footnote 145. For a discussion of rules for determination of status, see § 2.01 *supra*.

(n146)Footnote 146. CTA, Arts. 138 and 139.

(n147)Footnote 147. CTA, Art. 139.

(n148)Footnote 148. CTA, Art. 141.

(n149)Footnote 149. CTA, Art. 142.

(n150)Footnote 150. ITA, Art. 212, para. 1.

(n151)Footnote 151. ITA, Art. 212, para. 2.

(n152)Footnote 152. ITA, Art. 212, para. 1.

(n153)Footnote 153. ITA, Art. 213.

(n154)Footnote 154. ITA, Art. 214.

(n155)Footnote 155. STMA, Arts. 66-6 and 66-9.

(n156)Footnote 156. STMA, Art. 66-4.

(n157)Footnote 157. STMA, Art. 66-5.

(n158)Footnote 158. CTA, Art. 74.

(n159)Footnote 159. *See* § 2.23[o]3[c][o]a[c] *supra.*

(n160)Footnote 160. CTA, Art. 145.

(n161)Footnote 161. CTA, Art. 121.