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Doing Business in Japan

CHAPTER 10 Taxation

4-10 Doing Business in Japan § 10.01

§ 10.01 Taxation: An Overview

[1] Table of Abbreviations

The abbreviations used throughout this chapter include:

CTA:	Corporation Tax Act
CTABC:	Corporation Tax Act Basic Circulars
CTAEO:	Corporation Tax Act Enforcement Order
IhTA:	Inheritance Tax Act
IhTAEO:	Inheritance Tax Act Enforcement Order
IhTABC:	Inheritance Tax Act Basic Circulars
ITA:	Income Tax Act
ITABC:	Income Tax Act Basic Circulars
ITAEO:	Income Tax Act Enforcement Order
LTA:	Local Tax Act
LTAEO:	Local Tax Act Enforcement Order
MOA:	Ministry of Agriculture, Fishery and Forestry
MOF:	Ministry of Finance
STMA:	Special Taxation Measures Act
STMAEO:	Special Taxation Measures Act Enforcement Order

[2] Japan's Tax Structure

[a] Introduction. The Japanese national and local governments impose a variety of taxes upon individuals and corporations. Local taxes are levied at both the prefectural and municipal (i.e., ward, city, town, or village) levels. The national government collects approximately two-thirds, and local governments about one-third, of all taxes collected in Japan. n1

The tax structures of the national government, prefectural governments, and municipal governments are similar to each others. All three levels utilize income taxes and consumption taxes to generate revenue, while property taxes on immovables are imposed only by municipal governments. National and local income taxes are imposed on similar net income bases.

There is a substantial transfer of public funds, amounting to approximately thirty percent of all national tax revenues, from the national to the local governments. This intergovernmental transfer is made in the form of grants, subsidy or concessions by the national government to help finance both general and specific activities of local governments.

The problem of double taxation at both the central and local government levels is ameliorated to some extent by deduction of "enterprise taxes" from a national income tax. The enterprise tax is one of two major sources of tax revenue at the prefectural level.

[b] Tax Structure

There are both national and local taxes in Japan. A tax denoted "local" may be imposed by either a prefecture or a municipality based on a national law of "Local Tax Act". n2 Various Japanese taxes are listed in the following paragraphs.

[i] National Taxes.

(1) Taxes on income: Income Tax (for individuals); Corporation Tax, and Special Corporation Tax (for corporations, i.e., body corporate or legal persons)

(2) Taxes on inheritances and gifts: Inheritance Tax and Gift Tax

(3) Taxes on property: Land Value Tax; Automobile Weight Tax

(4) Taxes on consumption: Consumption Tax (national); Liquor Tax; Tobacco Tax; Gasoline Tax; Local Road Tax; Petroleum Gas Tax; Aircraft Fuel Tax; Petroleum Tax; Customs Duties

(5) Taxes on transactions: Stamp Duty; Registration and License Tax; Securities Transaction Tax; Bourse Transaction Tax

(6) Other miscellaneous taxes: Electric Power Resources: Development Promotion Tax

[ii] Prefectural Taxes.

(1) Taxes on income: Prefectural Inhabitants Tax; Enterprise Tax

(2) Taxes on property: Automobile Tax

(3) Taxes on consumption: Prefectural Tobacco Tax; Golf Course Tax; Special Local Consumption Tax; Light Oil Delivery Tax

(4) Taxes on transactions: Real Property Acquisition Tax; Automobile Acquisition Tax

(5) Other miscellaneous taxes: Mine-lot Tax; Hunters' License Tax; Hunting Tax

[iii] Municipal Taxes.

(1) Taxes on income: Municipal Inhabitants Tax

(2) Taxes on property: Fixed Assets Tax; Special Land Holding Tax; City Planning Tax; Light Automobile Tax; Enterprise Establishment Tax

(3) Taxes on consumption: Municipal Tobacco Tax; Bathing Tax

(4) Other miscellaneous taxes: Mineral Product Tax

[iv] Table of Taxes Imposed.

National	Local		
Category		Prefectural Level	Municipal Level
Income and Profits	Income (both withholding and assessment)	Prefectural inhabitant,	Municipal inhabitant
	Corporation	Enterprise	
Inheritances and gifts	Inheritance		
Property	Automobile weight	Automobile	Fixed assets
	Land value		City planning
			Special land holding
			Light automobile
			Enterprise establishment
Consumption	Consumption	Prefectural tobacco	Municipal tobacco
	Liquor, Local road,	Light oil delivery	Bathing
	Gasoline, Petroleum,		
	Petroleum Gas,		
	Aircraft fuel		
Transactions	Stamp	Real Property acquisition	
	Registration and license	Automobile acquisition	
	Securities transaction		
	Bourse		
	Power resources		
	Development promotion		
Miscellaneous		Mine-lot, Hunting,	Mineral Products,
		Hunters' license,	Other
		Other	

[3] Sources of Japanese Tax Law

[a] Constitution and Statutes

[i] In General. Article 84 of the Constitution reads as follows: "No new taxes shall be imposed or existing ones modified except by law or under such conditions as the law may prescribe."

This Constitutional principle is known as the "principle of taxation by law." There is no uniform tax act in Japan, and a large number of tax statutes have been enacted by the Parliament. The procedures by which tax are levied are explicitly provided for under these statues.

In addition to the tax statutes, a major body of tax law exists in the form of cabinet orders (which clarify the intent of the statutes and set forth more detailed rules) and ministerial ordinances from the Ministry of Finance (which establish procedures and forms for each tax statutes and cabinet order).

[ii] Table of Major Tax Statutes. The following table enumerates the major tax statutes. In most cases, they are supplemented by enforcement orders and ministerial ordinances. The following abbreviations are used in this table:

PMO: Prime Minister's Office
MOF: Ministry of Finance
MOHA: Ministry of Home Affairs

(1) National Tax Common Rules

(a) National Tax Common Rules Act (Law No. 66, 1962)

(b) National Tax Common Rules Act Enforcement Order (Cabinet Order No. 135, 1962)

(c) National Tax Common Rules Act Enforcement Ordinance (MOF Ordinance No. 28, 1962)

(2) National Tax Collection

(a) National Tax Collection Act (Law No. 147, 1959)

(b) National Tax Collection Act Enforcement Order (Cabinet Order No. 248, 1957)

(c) National Tax Collection Act Enforcement Ordinance (MOF Ordinance No. 31, 1962)

(d) Act Concerning Adjustment of Procedures Between Tax Collection and Civil Execution (Supreme Court Ordinance No. 12, 1957)

(e) Enforcement Order of Act Concerning Adjustment of Procedures Between Tax Collection and Civil Execution (Cabinet Order No. 248, 1957)

(f) Enforcement Ordinance of Act Concerning Adjustment of Procedures Between Tax Collection and Civil Execution (Supreme Court Ordinance No. 12, 1957)

(g) Saving-for-Tax Association Act (Law No. 145, 1951)

(h) Saving-for-Tax Association Act Enforcement Order (Cabinet Order No. 99, 1951)

(3) National Tax Offenses

(a) National Tax Violation Control Act (Law No. 67, 1900)

(b) National Tax Violation Control Act Enforcement Order (Imperial Order No. 52, 1900)

(4) Income Tax

(a) Income Tax Act (Law No. 33, 1965)

(b) Income Tax Enforcement Order (Cabinet Order No. 96, 1965)

(c) Income Tax Enforcement Ordinance (MOF Ordinance No. 11, 1965)

(5) Corporation Tax

(a) Corporation Tax Act (Law No. 34, 1965) n3

(b) Corporation Tax Act Enforcement Order (Cabinet Order No. 97, 1965)

(c) Corporation Tax Act Enforcement Ordinance (MOF Ordinance No. 12, 1965)

(d) Ministerial Ordinance Concerning Useful Lives, etc. of Depreciable Assets (MOF Ordinance No. 15, 1965)

(6) Special Corporation Tax

(a) Special Corporation Tax Act (Law No. 15, 1992)

(b) Special Corporation Tax Act Enforcement Order (Cabinet Order No. 89, 1992)

(c) Special Corporation Tax Act Enforcement Ordinance (MOF Ordinance No. 15, 1992)

(7) Inheritance and Gift Taxes

(a) Inheritance Tax Act (Law No. 73, 1950)

(b) Inheritance Tax Act Enforcement Order (Cabinet Order No. 71, 1950)

(c) Inheritance Tax Act Enforcement Ordinance (MOF Ordinance No. 17, 1950)

(8) Land Value Tax

(a) Land Value Tax Act (Law No. 89, 1971)

(b) Land Value Tax Act Enforcement Order (Cabinet Order No. 360, 1988)

(c) Land Value Tax Act Enforcement Ordinance (MOF Ordinance No. 31,1991)

(9) Automobile Weight Tax

(a) Automobile Weight Tax Act (Law No. 89, 1971)

(b) Automobile Weight Tax Act Enforcement Order (Cabinet Order No. 275, 1991)

(c) Automobile Weight Tax Act Enforcement Ordinance (MOF Ordinance No. 66, 1971)

(10) Consumption Tax

(a) Consumption Tax Act (Law No. 108, 1988)

(b) Consumption Tax Act Enforcement Order (Cabinet Order No. 360, 1988)

(c) Consumption Tax Act Enforcement Ordinance (MOF Ordinance No. 53, 1988)

(11) Liquor Tax

(a) Liquor Tax Act (Law No. 6, 1953)

(b) Liquor Tax Act Enforcement Order (Cabinet Order No. 97, 1962)

(c) Liquor Tax Act Enforcement Ordinance (MOF Ordinance No. 26, 1962)

(12) Tobacco Tax

(a) Tobacco Tax Act (Law No. 72, 1984)

(b) Tobacco Tax Act Enforcement Order (Cabinet Order No. 5, 1985)

(c) Tobacco Tax Act Enforcement Ordinance (MOF Ordinance No. 1, 1985

(13) Gasoline Tax

(a) Gasoline Tax (Law No. 55, 1957)

(b) Gasoline Tax Act Enforcement Order (Cabinet Order No. 57, 1957)

(c) Gasoline Tax Act Enforcement Ordinance (MOF Ordinance No. 30, 1962

(14) Local Road Tax

(a) Local Road Tax Act (Law No. 104, 1955)

(b) Local Road Tax Enforcement Order (Cabinet Order No. 151, 1955)

(15) Petroleum Gas Tax

(a) Petroleum Gas Tax Act (Law No. 156, 1965)

(b) Petroleum Gas Tax Act Enforcement Order (Cabinet Order No. 5, 1966)

(c) Petroleum Gas Tax Act Enforcement Ordinance (MOF Ordinance No. 4, 1966)

(16) Aircraft Fuel Tax

(a) Aircraft Fuel Tax Act (Law No. 7, 1972)

(b) Aircraft Fuel Tax Act Enforcement Order (Cabinet Order No. 57, 1972)

(17) Petroleum Tax

(a) Petroleum Tax Act (Law No. 25, 1978)

(b) Petroleum Tax Act Enforcement Order (Cabinet Order No. 132, 1978)

(18) Customs Duties

(a) Customs Duties Act (Law No. 61, 1954)

(b) Customs Duties Act Enforcement Order (Cabinet Order No. 150, 1954)

(c) Customs Duties Act Enforcement Ordinance (MOF Ordinance No. 55, 1966)

(19) Stamp Tax

(a) Stamp Tax Act (Law No. 23, 1967)

(b) Stamp Tax Act Enforcement Order (Cabinet Order No. 108, 1967)

(c) Stamp Tax Act Enforcement Ordinance (MOF Ordinance No. 19, 1967)

(20) Registration and License Tax

(a) Registration and License Tax Act (Law No. 35, 1967)

(b) Registration and License Tax Act Enforcement Order (Cabinet Order No. 146, 1967)

(c) Registration and License Tax Act Enforcement Ordinance (MOF Ordinance No. 37, 1967)

(21) Securities Transaction Tax

(a) Securities Transaction Tax Act (Law No. 102, 1953)

(b) Securities Transaction Tax Act Enforcement Order (Cabinet Order No. 138, 1953)

(c) Securities Transaction Tax Act Enforcement Ordinance (MOF Ordinance No. 43, 1953)

(22) Bourse Transaction Tax

(a) Bourse Transaction Tax Act (Law No. 22, 1990)

(b) Bourse Transaction Tax Act Enforcement Order (Cabinet Order No. 117, 1990)

(c) Bourse Transaction Tax Act Enforcement Ordinance (MOF Ordinance No. 23, 1990)

(23) Electric Power Resources Development Promotion Tax

(a) Electric Power Resources Development Promotion Tax Act (Law No. 79, 1974)

(b) Electric Power Resources Development Promotion Tax Act Enforcement Order (Cabinet Order No. 339, 1974)

(24) Special Taxation Measures

(a) Special Taxation Measures Act (Law No. 26, 1957)

(b) Special Taxation Measures Act Enforcement Order (Cabinet Order No. 43, 1957)

(c) Special Taxation Measures Act Enforcement Ordinance (MOF Ordinance No. 15, 1957)

(25) Special Reductions

(a) Act Concerning the Reduction of, Exemption from and Postponement of Collection of Taxes for Victims of Disaster (Law No. 175, 1947)

(b) Enforcement Order of Act Concerning the Reduction of, Exemption from and Postponement of Collection of Taxes for Victims of Disaster (Cabinet Order No. 268, 1947)

(26) Local Taxes

(a) Local Tax Act (Law No. 226, 1950)

(b) Local Tax Act Enforcement Order (Cabinet Order No. 245, 1950)

(c) Local Tax Act Enforcement Ordinance (PMO Ordinance No. 23, 1954)

(27) International Aspects

(a) Act Concerning Special Rules, etc., of Income Tax Act, Corporation Tax Act and Local Tax Act Incidental to Enforcement of Tax Treaties (Law No. 46, 1969)

(b) Enforcement Order of Act Concerning Special Rules, etc. of Income Tax Act, Corporation Tax Act and Local Tax Act Incidental to Enforcement of Tax Treaties (Cabinet Order No. 335, 1987)

(c) Enforcement Order of Act Concerning Special Rules, etc. of Income Tax Act,

Corporation Tax Act and Local Tax Act Incidental to Enforcement of Tax Treaties (MOF-MOHA Ordinance No. 1, 1969)

(d) Act Concerning Exemption from Income Tax, etc. by Reciprocity Principle on Income of International Transportation by Aliens, etc. (Law No. 144, 1962)

(e) Enforcement Order of Act Concerning Exemption from Income Tax, etc., by Reciprocity Principle on Income of International Transportation by Aliens, etc. (Cabinet Order No. 227, 1962)

Prefectures and municipalities enact their own ordinances to provide for the levy and collection of local taxes. Such ordinances tend to be simple and often cite the provisions of the Local Tax Act because they must comply with the Local Tax Act and the enforcement orders and regulations under it.

[b] Circulars (Rulings). The National Tax Administration issues written rulings that are called circulars (*tsutatsu*) for the purpose of interpretation and enforcement of the tax laws within tax administration itself. Circulars assure uniform enforcement of tax laws by all tax offices, because any lower level divisions/staffs within its organization must follow such circulars, although taxpayers (out of administration) need not follow such circulars. They are issued in the name of the Commissioner of the National Tax Administration.

Circulars are classified as either basic circulars or individual circulars. Basic and individual circulars do not differ in nature or effect. The principal difference is that basic circulars are arranged in the same order as the provisions of the tax laws, while individual circulars are issued on a case-by-case basis as the Tax Administration sees the need for them or when it judges that its answers to taxpayers' inquiries have general applicability. Individual circulars are sometimes incorporated into the basic circular system when that system is revised.

There is another type of circular, often called the "handling circular." This type of circular is issued at the time of enactment of a new tax law or amendment to an existing tax law. Handling circulars are issued to supplement the basic circulars.

The legal nature of a circular is that of an order issued by a higher division of the National Tax Administration to a lower division. Accordingly, it has legally binding force upon the lower divisions of the Administration to which it is directed, but it has no legally binding effect upon taxpayers or the judicial courts. Theoretically, Japanese courts may ignore the tax circulars; in practice, though the circulars are given much respect, *de fact*, and are seldom invalidated by the courts.

[c] Advance Tax Rulings. Japanese law does not have a system of mandatory advance rulings for tax purposes. However, unofficial advance rulings in written form are occasionally issued by relevant tax administration to taxpayers who request them. The issuing agency is the Ruling Office of the Taxation Department of the National Tax Administration.

There are no written rules as to what subjects these rulings can address or the length of time the issuance of such a ruling may take. Although there is no specific provision making the rulings binding on the tax administration, the taxpayer--depending on the factual situations involved--may be protected by the general principle of reliance upon an official statement of an administrative authority, if several of judicial requirements for this principle are met in a facts and circumstances under a specific case.

[4] Legislative Procedures

Tax Statutes are enacted by the Diet, which consists of the House of Representatives (Lower House) and the House of

Councilors (Upper House). Enforcement orders and ministerial ordinances are both drafted in the Ministry of Finance. Enforcement orders are adopted and promulgated by the Cabinet, and ministerial ordinances by the Ministry of Finance.

New tax legislation and amendments to existing tax laws are initiated by the Tax System Research Council, a consultative committee to the Ministerial Office of the Prime Minister, and is in close contact with the Tax Bureau of the Ministry of Finance.

The Tax System Research Council is composed of members from both the House of Representatives and House of Councilors, and its purpose is the research study and recommendation of desirable measures concerning tax policy. The Council makes its recommendations for amendments to tax statutes around November of each year. It also sometimes makes recommendations concerning the long-term policy on tax system in the form of "Reports".

At about the same time in the past, the corresponding Tax System Research Council of the ruling political party makes its own recommendations (The ruling party has been the Liberty Democratic Party -LDP- for 60 years after 1955, major part of post-war decades). The recommendations of the consultative Tax System Research Council often lay the ground for the discussions by the LDP Council. After change of administration in September 2009, Democratic Party -DP- does not establish its tax committee as its internal organization, and only the governmental Tax System Research Council provides proposals for annual tax amendments. The Cabinet chooses which tax bills to introduce to the Diet principally on the basis of the recommendations made by the governmental Tax Council.

After introduction of the tax bills to the floors of both Houses, they are referred to the respective Budget/Finance Committees of the two Houses. In the course of discussion of the bills, political compromises are sometimes worked out between the ruling and opposition parties that result in amendments of the original bills.

Tax bills are introduced immediately after the ordinary session of the Diet that starts in December each year and are adopted by the Diet ordinarily in March or, in exceptional cases, in April of the following year. The fiscal year of the Japanese Government starts on April 1. This is often the effective date of new tax legislation. Tax statutes, such as Income Tax Act, Corporate Tax Act (within limited cases), sometimes adopt calendar year as tax calculation periods. n4 Thus, new legislation in each year includes retroactive application of revised statutes to facts or transactions occurred before the enactment of new legislation.

[5] Administrative Procedures

[a] Tax Bureau. The Ministry of Finance (MOF) is responsible for the administration of the Japanese national tax system. Major roles of that Ministry are played by two MOF organizations; the Tax Bureau, which is an internal department of MOF, and the National Tax Administration (NTA), an external agency under the control of MOF. The Tax Bureau of the Ministry is in charge of the research, planning and drafting of the national tax legislations. The National Tax Administration is responsible for the execution or administration of national tax laws and collection of national taxes. In addition, the Customs and Tariff Bureau is in charge of policy and administration of customs duties, the tonnage tax and the special tonnage tax. Actual collection of such duties and taxes is decentralized and made by the nine Customs Houses (i.e., Tokyo, Yokohama, Kobe, Osaka, Nagoya, Moji, Nagasaki, Hakodate, and Okinawa).

The Tax Bureau is generally responsible for the research, planning, budgetary estimates and drafting of all laws relating to national taxes and consists of the following:

(1) the Coordination Division, responsible for the formulation of general tax policies, research, planning, and the drafting of laws concerning the tax accounting system and the estimation and accounting of tax revenues;

(2) the Research Division, responsible for research of matters that form the basis of tax policies, internal

and foreign tax systems, and estimates of tax revenues and for the production and analysis of statistics concerning taxes;

(3) the First Tax Division, responsible for the planning and drafting of laws concerning income and property taxes;

(4) the Second Tax Division, responsible for the planning and drafting of laws concerning indirect national taxes;

(5) the Third Tax Division, responsible for planning and drafting of laws concerning corporation taxes; and

(6) the Director of International Tax Policy Division, responsible for the planning and drafting of tax treaties, for foreign tax credits and for the taxation of nonresidents, nonpermanent residents, and foreign corporations under the Income Tax Act and the Corporation Tax Act.

[b] National Tax Administration

[i] In General. The National Tax Administration is in charge of administration, assessment and collection of national taxes. Its function is equivalent to that of the Internal Revenue Service of the United States or the Inland Revenue of the United Kingdom.

The National Tax Administration, headed by a Commissioner, consists of (1) the Commissioner's Secretariat, (2) the Taxation Department, (3) the Collection Department, and (4) the Audit and Inspection Department.

[ii] Three Departments. The Taxation Department is divided into six divisions: (1) Income Tax Division, (2) Property Tax Division, (3) Corporate Tax Division, (4) Consumption Tax Division, (5) Information and Research Division, and (6) Liquor Tax Division. The Ruling Office under the Income Tax Division is in charge of planning and drafting circulars and rulings in connection with the application of direct national tax laws and judicial litigation involving direct national taxes. The Collection Department consists of the Revenue Accounting Division and the Collection Division. The Collection Division is in charge of procedures for the compulsory collection of national taxes.

The Audit and Inspection Department consists of the Audit Division and the Inspection Division. The Audit Division supervises tax audits of large corporations, both domestic and foreign, and of nonresident individuals. The Inspection Division supervises investigation and inspection concerning evasion of national taxes.

[iii] Regional Tax Bureaus. There are eleven Regional Tax Bureaus and one Regional Tax Office under the supervision of the National Tax Administration. The function of each Regional Bureau and Regional Tax Office is to supervise, guide and control the tax offices, which constitute the field offices for each respective jurisdiction. Regional Tax Bureaus are located in Tokyo, Kanto-Shinetsu, Osaka, Sapporo, Sendai, Nagoya, Kanagawa, Hiroshima, Takamatsu, Fukuoka, and Kumamoto. The Regional Tax Office is located in Okinawa. There are a total of about 500 local tax offices nationwide.

Each prefectural and municipal government maintains tax departments for assessment and collection of their local taxes.

[6] Review Procedures

[a] National Tax

A three-step appeal procedure is available to the taxpayer dissatisfied with the determination of tax liability by his local tax office: (1) reinvestigation by the tax office concerned, (2) review by the National Tax Tribunal (a quasi-judicial

body), and (3) judicial review. Subject to certain exceptions, the exhaustion of each preceding step is a prerequisite to taking succeeding steps.

[i] Tax Office. A taxpayer may request reinvestigation of tax liability assessed (or revised) by his tax office within two months after he receives notice of assessment (or revision). If his tax liability has been investigated by any staff member of a Regional Tax Bureau or the National Tax Administration, he may directly request the Bureau or the Administration to reinvestigate the case. Taxpayers who have filed blue returns are allowed to skip this step and directly request the National Tax Tribunal to review the case.

[ii] National Tax Tribunal. A taxpayer may request the National Tax Tribunal to review his tax liability within one month after he receives a decision (dismissal) concerning his request for reinvestigation from a tax office, a Regional Tax Bureau or the National Tax Administration. The same applies if no decision has been made within three months after the filing of a request for reinvestigation with a tax office, a Regional Tax Bureau of the National Tax Administration.

The National Tax Tribunal was created in 1970 as a quasi-judicial administrative agency independent of the National Tax Administration. Prior to establishment of the Tribunal, a conference board performed similar functions, but it was under the supervision of the National Tax Administration.

The director of the National Tax Tribunal is appointed by the Commissioner of the National Tax Administration with the consent of the Minister of Finance. The "judges" of the National Tax Tribunal are appointed by the director. Tribunal judges may decide cases before them in accordance with their own interpretation of the tax law, except that they must obtain the consent of the Commissioner if their interpretations differ from interpretations found in circulars and rulings issued by the National Tax Administration. In deciding whether he should give such consent, the Commissioner is required to pay due consideration to the opinion of the National Tax Review Committee, which consists of persons of academic knowledge and professional experience.

[iii] Judicial Courts. A taxpayer who objects to the decision of the National Tax Tribunal may bring an action in a District Court (the court of general jurisdiction in Japan) for a remedy within three months of his receipt of notice of the decision from the National Tax Tribunal. The taxpayer is entitled to bring suit in the District Court in certain other cases as well, such as when the National Tax Tribunal makes no decision within three months after the filing of a request for review.

There is no court specially designed to hear tax disputes. Judicial review processes both for civil and criminal tax cases follow ordinary civil or criminal procedures for other field of laws. A High Court and the Supreme Court will hear tax cases on appeal from a District Court and a High Court, respectively.

[b] Local Taxes. The procedure described for national taxes also applies to local taxes, except that the National Tax Tribunal does not hear local tax cases, and there is no equivalent tribunal on the local level. Thus, on local tax matters, the taxpayer is free to file suit directly after reinvestigation by his tax office.

[7] National Income Tax

[a] Taxpayers. Taxpayers are individuals, classified into residents, non-permanent residents and nonresidents. A resident is taxed on his worldwide income. A nonresident is taxed only on income derived from sources in Japan.

An individual is considered a resident when he has his principal place of residence in Japan or has had a temporary domicile in Japan continuously for one year or more. Generally speaking, an individual is deemed to be a resident in Japan from the outset if he has an occupation that requires his stay in Japan for one year or more.

Residents are further classified into nonpermanent residents and permanent residents. A resident who does not qualify

as nonpermanent is classified as permanent. A nonpermanent resident means a resident who has no intention to stay permanently in Japan, and whose entire stay in Japan is five years or less. A nonpermanent resident will not be taxed on his foreign-source income unless it is paid in or remitted to Japan. A permanent resident is a resident who has an intention to stay permanently in Japan or who has lived in Japan for more than five years.

[b] Taxable Income. For purposes of the Income Tax, resident taxpayer follows world-wide income taxation and non-resident taxpayer follows domestic-source income taxation. There are ten types of individual income for a resident: interest income, dividend income, real estate income, business income, salary income, retirement income, timber income, transfer income, occasional income and miscellaneous income. Taxable income is computed on a calendar year basis. Unlike corporations, individual taxpayers are not allowed to elect any other fiscal periods.

For nonresident individuals, the following income from sources in Japan is taxable: n5

1. Income from business in Japan or from holding, operation or alienation of assets in Japan, excluding the income described in items 2 through 13.

2. Income from transfer of land located in Japan or rights to such land or to a building located in Japan or an annex to such a building.

3. Income from personal services performed in Japan, such as entertainers' performances and professionals' services.

4. Rent or other compensation for use of real property located in Japan and compensation for rental to a resident or a Japanese corporation of a vessel or aircraft.

5. Interest income from Japanese government bonds, debentures of Japanese corporations, and bank deposits in Japan.

6. Dividends received from domestic corporations.

7. Interest income from a loan made to a person conducting continuous activities in Japan with respect to such activities in Japan.

8. Royalties received from a person conducting continuous activities in Japan with respect to such activities in Japan for industrial property rights (including know-how), copyrights or specified equipment, and proceeds from the sale of industrial property rights (including know-how) or copyrights.

9. Salaries for personal services performed dependently in Japan.

10. Monetary awards for advertisements concerning business in Japan.

11. Payment from a life insurance or pension contract concluded through a place of business in Japan.

12. Profit from certain financial products.

13. Distribution of Revenues from a silent partnership (*Tokumei Kumiai*) concerning investment in business conducted in Japan.

The taxable income comprises taxable income of three types for a resident: taxable ordinary income, taxable timber income, and taxable retirement income. Taxes on retirement income and timber income are determined separately in

view of their special nature. Taxable ordinary income consists of eight original types of income. Generally speaking, the taxable income of each type is determined by subtracting necessary expenses or basis from gross receipts. For interest income, gross receipts constitute the taxable income. For dividends income, any interest payments for debt to acquire shares or assets that generate dividends income could be deductible from gross receipts of dividends distributions. In the case of salary income, a specified statutory deduction is allowed.

Before the tax reform of 1988, capital gains derived from a transfer of securities were not taxable unless the number and value of sales exceeded certain limits. The revised Income Tax Act provides that such capital gains arising from the sale of securities are now taxable either by a separate withholding method or by a separate return method. The taxpayer can elect which method to use. Under the first method, the taxable gain is deemed to be 5% of the sales value. The tax rate is 20% under both methods.

Long-term capital gains receive favorable treatment in that only from movable properties one-half of the taxable gain is taxed. If the asset transferred had been owned by the taxpayer for more than five years, the gain made from such transfer shall be deemed to be "long-term," otherwise the gain is deemed "short-term." A surtax is levied on the proceeds of a sale of real property.

For the determination of timing of income recognition, generally speaking, the accrual (realization) method is used in tax accounting. Income accrues when a taxpayer's right to receive it becomes determinative.

Generally accepted accounting principles (*GAAP*) must be followed in determining necessary expenses and other factors in calculating taxable income.

[c] Calculation of Tax. Statutory deductions and exemptions are allowed. They are deductions for casualty loss, medical expenses, specified insurance premiums and qualified contributions, as well as the basic exemption, spouse deduction, dependent deduction, and an additional deduction for a taxpayer who is sixty-five years old or more or physically handicapped (or has a handicapped spouse or dependent), or who is an employed student, a widow or a widower. The basic exemption or spouse/dependent deduction is 380,000 yen for each taxpayer, spouse, and dependent. A larger deduction is allowed for any of these persons who meet certain requirements. These allowances are first deducted from the ordinary income, and any remainder can be deducted from timber income, and then from retirement income.

After the tax base has been fixed with respect to ordinary income, retirement income, and/or timber income, the income tax amount can be calculated by applying the rates in the following table. The progressive rates vary from ten percent for the first 3,000,000 yen of net income to fifty percent for any amount above 20,000,000 yen.

[d] Tax Credits. Foreign Tax Credit: Foreign taxes which are paid by an individual taxpayer, and which are similar in nature to Japanese income tax, can be credited against income tax due in Japan, within certain statutory limitations. Sales tax paid in a foreign country does not qualify for this foreign tax credit of income taxation.

Dividends Received Credit: An amount equal to 2.5, 5 or 10 percent of dividend income from domestic corporations can be credited against national income tax. This is to avoid double taxation between individual income tax and the corporation tax because part of the taxable income of a corporation, i.e., that portion earmarked for distribution as dividends at a meeting of the board of directors or shareholders' general meeting, has already been taxed.

[e] Returns and Payment of Tax. Income Tax is paid on a calendar year basis. Final tax returns must be filed with the Tax Office during the period from February 16 to March 15 of each year for income accrued in the immediately preceding calendar year. However, a taxpayer whose annual income comprises salary income of 15,000,000 yen or less is not required to file a tax return, since income tax on salary income is withheld at the time of payment by the employer and tax amount on gross annual salary is readjusted on the latest payment of annual salary.

However, a taxpayer who receives salary income from two or more sources, or who has other income, must submit a tax return to relevant tax office. A tax return must be accompanied by payment of any tax due. An individual who satisfies certain bookkeeping requirements may file a special blue return (*aoiro shinkoku*) as opposed to an ordinary white return (*shiroiro shinkoku*). This blue return system encourages taxpayers to record all their transactions in a financial year, allowing them to enjoy certain advantages in both substantive and procedural tax law during that financial year. In order to enjoy these advantages, taxpayers must apply at their local tax office and then must keep books and accounts, record their transactions, and retain their accounting books for a certain period of time.

If individuals elect this option, when filing their tax returns, they must use a special blue form instead of an ordinary white one, which carries certain tax advantages.

[f] Nonresidents. Income tax rules are generally applicable to a nonresident taxpayer if he has a permanent establishment within Japan and has income from a Japanese source. If he has no permanent establishment within Japan but has income from sources in Japan of a prescribed kind, Income Tax, in most cases, is withheld at the source. The statutory withholding rate is from ten to twenty percent but if a tax treaty is applicable, it reduces the withholding rates for dividends, interest, and/or royalty income. Currently, interest accrued on debentures with a maturity of a certain period issued in foreign currencies by Japanese corporations is exempted from Japanese withholding tax under domestic tax statutes.

[8] Local Income Taxes

In addition to income tax, which is a national tax, prefectural and municipal inhabitants taxes are imposed on the income of individual taxpayers. The methods of calculation used for the national income tax are also generally followed for these local taxes. These taxes are payable in installments in the year succeeding the year in which income accrues. The combined prefectural and municipal tax rate ranges from five to twenty-two percent of the taxable income (as calculated for the national income tax). A per capita levy is also imposed, but the amount is minimal.

A local enterprise tax is also imposed on taxpayers carrying on specified types of business. It ranges from three to five percent of taxable income depending on the type of business.

[9] National Corporation Tax

[a] Taxpayers. There are two types of corporate taxpayers under Japanese tax law: domestic corporations (corporations which have their head office in Japan), and foreign corporations (any corporations other than domestic corporations).

A domestic corporation is subject to national corporate tax on its worldwide income. A foreign corporation having a permanent establishment in Japan is taxed only on its Japan-source income. A foreign corporation not having a permanent establishment in Japan is subject to Income Tax withholding on certain kinds of Japan-source income such as dividends, royalties, interest, and service fees, and subject to Corporation Tax on certain kinds of Japan-source income, such as income from the transfer of land located in Japan.

A family corporation, a corporation in which not more than three groups of closely related shareholders own fifty percent or more of the shares, may be subject to a denial and reconstruction of its transactions by the head of the tax office for the purposes of corporate taxation. n6

[b] Basic Principles of Income Determination. As mentioned above, the tax base or net income in each taxable year is determined by deducting necessary expenses and losses from the gross income of that period. Gross income includes receipts from the sale of assets, rendering of services, and other transactions excluding capital transactions. Capital transactions are transactions dealing with the capital of a corporation, such as payments in premiums, increases or decreases in capital, and the distribution of dividends.

Expenses include inventory acquisition costs, sales expenses, general administrative expenses, production costs, and other ordinary and necessary expenses incurred in carrying on business.

A taxable year is basically identical to the accounting period (business year) of the corporation set out in its articles of incorporation. Thus, a taxable year is not necessarily a calendar year, but it must not exceed one year. Accounting methods to be employed by a taxpayer corporation must conform to generally accepted accounting principles, although special accounting methods are provided in the tax law for certain cases. Computation of tax liability is always made on an accrual (realization) basis.

[c] Determination of Gross Income. As with individual income tax, the gross income of a corporation includes all its income. If a corporation receives property without giving counter-value or transfers its property to others without receiving counter-value, the fair market value of such property would constitute gross income. On the other hand, there are some items which are specifically excluded from gross income. Most important is the exclusion of dividends received from domestic or foreign corporations under a certain limitation. Before the 1988 tax amendments, the total dividends received, under this certain limitation, were subject to exclusion from gross income, now 80% of such dividend income can be excluded. This is to avoid economic double taxation of the same income. For dividends received from foreign subsidiaries, 2009 revision on Corporation Tax Act allows to exempt 95% of gross amount of dividends received from gross income of Japanese parent corporation.

[d] Determination of Necessary Expenses. As mentioned above, necessary expenses are deductible. Further explanation of some of the deductible items follows:

a. Inventory acquisition costs are deductible and are determined either by the "cost method" or by the "lower-of-cost-or-market-value method." A corporation must elect one of these two methods to use in evaluating its inventories.

A similar requirement is imposed for evaluation of securities held by a corporation.

b. For depreciation of tangible fixed assets, the straight-line method and the declining balance method are recognized. A corporation must elect one of these and give prior notification to the tax office. A ministerial ordinance from the Ministry of Finance provides for classes or categories of depreciable asset and the useful life of such assets. The Special Tax Measures Act provides for various special additional and accelerated depreciations for specified machines and equipments.

c. Salaries, bonuses, and retirement allowances paid to employees of a corporation are deductible.

d. Remuneration payable to directors, statutory auditors and other equivalent management personnel of a corporation is also classified into the three types mentioned above. Salaries or retirement allowances paid to directors and other management staff are deductible unless unreasonably high. Reasonableness is determined with regard to appropriateness for services actually rendered by the person, considering the scope of duties, amount of time spent, profit of the corporation, and other factors. Bonuses to directors and other management personnel are not deductible expenses. This is based on the notion that bonuses are extra remunerations that should be payable out of net profits.

e. Donations made by a corporation are deductible if they meet certain requirements. Gifts to governments, qualified public corporations, and entities established to promote public interests are fully deductible. Subject to a limit on the deductible amount based on amount of capital, income, etc., gratuitous transfers of cash or other property to natural persons or corporations and grants of economic benefits to natural persons or corporations made without receiving counter value or for unreasonably low

counter value are also deductible.

f. Deductibility of entertainment expenses (*kosaihi*) actually incurred is determined according to the size of a corporation, i.e., its stated capital; the larger the capital, the lower the amount of entertainment expenses allowed to be deduced. This is to prevent excessive entertainment expense deductions.

g. Taxes and public dues (except for the Corporation Tax, prefectural and municipal inhabitant taxes and penalty taxes, criminal fines or penalties) are deductible expenses.

h. Various reserves are granted tax-free status. Among them are reserves for bad debts, bonuses, sales returns, repairs, and overseas investment losses.

i. If a corporation obtains income from overseas transactions involving the transfer, licensing, and the like, of technological rights, a certain portion of such income is deductible from taxable income.

[e] Calculation of Tax. The Corporation Tax for each accounting period is determined by applying the tax rate to the tax base, which is the net income calculated by deducting expenses and losses from gross income. The basic tax rate is 37.5 percent. A lower rate used to be applied to that portion of income that is distributed as dividends, but the tax reform of 1988 removed this distinction. The rationale for the revision is that it is neither neutral nor fair to divide the profit of a corporation into two portions, the portion distributed and the portion retained, because that division results in a difference in the average tax burden depending on the pay-out ratio of the corporation.

Under present tax law, individuals receiving dividends from a corporation will be taxed again on the dividends even though the dividends were already taxed at the corporation at the same rate as the portion of taxable income retained within the corporation. To counteract double taxation, an individual receives tax credit for dividends on the individual's tax return.

[f] Tax Credits. Tax credits are available for income tax withheld on interest, dividends, or other income. Foreign taxes are creditable. Before the introduction of exemption of dividends from foreign subsidiaries, indirect tax credit is allowed for dividends received from eligible foreign subsidiaries. However, on the introduction of such foreign dividends exemption, such indirect foreign tax credit has been abolished.

The creditable foreign taxes are those taxes on income (including local taxes) that are the counterpart of the Japanese Corporation Tax. The Japanese foreign tax credit is limited to 90% of the foreign taxes paid. This means that a Japanese corporation will pay at least 10% of its corporate tax to the Japanese government. The carry-over period was reduced to three years from five years in 1989.

A special tax credit is allowed, for example, for qualified research and development expenses incurred by a corporation.

[g] Returns and Payment of Tax. Within two months (or three months if approval is obtained) after the end of each accounting period, a corporation must submit a final return accompanied by the corporation's balance sheet and other financial statements covering such period, all prepared for tax purposes. Subject to certain bookkeeping requirements, a special blue return can be submitted. Corporations permitted to use this blue form return are allowed certain tax preferences. Postponement of tax payment is allowed subject to prior approval.

[h] Foreign Corporations. The tax liability of a foreign corporation, a corporation having its head office outside of Japan, is determined on the basis of its having permanent establishment in Japan and the Japan-source income. In substance, the above comments regarding the taxation of nonresidents, apply here. Factors for determining taxable Japan-source income for nonresident individuals are the same for foreign corporations except for salaries. n7 A foreign corporation doing business through a permanent establishment in Japan is liable for Japanese corporation tax on its Japan-source income. Substantially the same rules are applicable to them as are applicable to domestic corporations. A

foreign corporation not having a permanent establishment in Japan is generally taxed at the source on its Japan-income from sources in Japan such as royalties, rentals, interest, dividends, and service fees. The basic withholding tax rate is from ten to twenty percent here as well, but when a tax treaty is applicable, the rate is generally reduced.

Scope of taxable income in the hand of the permanent establishment of foreign corporation is determined based on so-called "entire income" method. For foreign corporations with branch-type PE (subpara.1-PE) must recognize all types of domestic source income as taxable in Japan, although construction site-type PE(subpara.2 PE) and dependent agency PE (subpara.3 PE) recognizes income other than business income with "attributable income" method. Under income tax conventions, any income taxable in the hand of any type of PE is limited to those attributable to such PE.

[10] Local Corporate Taxes

In addition to the national corporate tax, there are two local taxes on the income of a corporation. One is the Enterprise Tax, which is six to twelve percent of the corporate net income, the rate depending on the amount of income. The other is the Inhabitant Tax imposed by the prefectures and municipalities, which consists of a nominal flat per capita tax plus about seventeen to twenty percent of the National Corporation Tax amount. These local taxes are also applied to a foreign corporation's taxable net income that is attributable to its permanent establishment in Japan. The rates may vary slightly depending on the prefecture and municipality.

In total, the statutory total corporate income tax burden amounts to a rate around fifty percent.

[11] Tax Treaties

Japan is a party to income tax treaties with the following countries:

Ireland, United States of America, n8 Sweden, Pakistan, Norway, Denmark, India, Singapore, Austria, United Kingdom, New Zealand, Thailand, Malaysia, Canada, France, Germany, Brazil, Sri Lanka, Belgium, Egypt, Australia, Italy, Zambia, Netherlands, Republic, of Korea, Switzerland, Finland, Ireland, Spain, Romania, Czech Republic, Philippines, Hungary, Indonesia, People's Republic of China, Commonwealth of Independent States, Bangladesh, Bulgaria, Israel Luxembourg, Vietnam, Mexico, South-Africa, Brunei.

Japan has also a tax treaty with the United States regarding the taxation of estates, inheritances, and gifts.

[12] Inheritance and Gift Taxes

[a] In General. Unlike estate tax in the United States, where the decedent's estate itself is taxed, inheritance tax in Japan is imposed on the individual who inherited and received property from the estate. Thus, Japanese inheritance tax could be characterized as a kind of supplemental income tax, levied on the increase of an individual's estate through inheritance or bequest. Gift tax is imposed to prevent the avoidance of inheritance tax by *inter vivos* transfer. The taxpayer in this case is the donee.

The beneficiaries of the income of a trust are also taxed. n9

[b] Inheritance Tax. An individual who has acquired property through inheritance or bequest is subject to inheritance tax on the entire amount of property received if he is a resident of Japan at the time of the acquisition of the property. The location of the property received is irrelevant. In the event that the individual is not a resident of Japan at the time of the acquisition of the property, he must pay inheritance tax only on property located within Japan.

If the deceased did not prepare a will, the heirs and their respective interests in the estate will be determined by the provisions of the Civil Code of Japan.

In calculating the inheritance tax, first the aggregate tax is determined after statutory deductions, applying the progressive tax rates from ten to seventy percent. Any liability of the deceased outstanding at the time of death is deductible. The aggregate tax amount is allocated to each individual who has received property through inheritance or bequest, pro rata to the amount of property he received. Further adjustments by addition or deduction are made, and the amount finally obtained is the inheritance tax due. A spouse, minor child, or a child with a physical handicap is allowed a special deduction. The tax liability of an individual other than a spouse, child, or parent of the deceased is increased by twenty percent.

Valuation of the property inherited or bequeathed is made on the basis of the market value at the time of the acquisition. Official circulars have been issued, containing guidelines for evaluating the property except where otherwise provided for in the tax law.

If the deceased donated his property to heirs or legatees within three years before his death, such property will be regarded as inherited. Any gift tax or any foreign inheritance or similar taxes paid can be credited against the inheritance tax.

An individual to whom inheritance tax liability accrued with respect to property obtained through inheritance or bequest must submit a return accompanied by required documents within six months after the death of the deceased.

[c] Gift Tax. Gift tax is calculated on a calendar year basis. Like the inheritance tax, the tax liability of an individual who obtained property by gift depends on whether he is a resident of Japan at the time of the property acquisition. All property obtained by gift in a calendar year is aggregated, and a basic exemption is allowed. The balance is subject to gift tax at the prescribed progressive rates of ten to seventy percent. Property donated by a corporation is subject not to gift tax but to income tax. A specified gift to a spouse who has been married to the donor for twenty years or more, or a gift to a trust of which a physically handicapped individual is the beneficiary, receives preferential tax treatment. Any foreign gift tax paid can be credited. A return must be filed by March 15 of the succeeding year by any individual to whom gift tax liability has accrued.

[13] Taxes on Property

The fixed assets tax, which is a local municipal tax imposed annually, appears to be one of the most important property taxes. Fixed assets tax is imposed on land, buildings, and specified depreciable assets. Not included are automobiles and light automobiles, which are taxed separately. The taxpayer is the owner of the fixed asset as of January 1 of each year. As a general rule, the tax base is market value. Especially concerning land, however, this rule is not strictly applied. Land is usually undervalued for purposes of this tax. The statutory basic rate is 1.4 percent, but the tax varies according to municipality.

Owners of certain land are subject to a special land holding tax. This tax covers both holding and purchase of land in a prescribed period. The rate is 1.4 percent or 3 percent, but fixed assets tax and real property acquisition tax paid covering the same land can be credited.

The enterprise establishment tax is applicable only in the larger cities. This tax is imposed on the owners of newly constructed buildings and on enterprises having a business space or number of employees larger than the prescribed amount. Small enterprises are exempt.

An automobile weight tax, an automobile tax, and a light automobile tax are imposed according to the weight or size of the automobile.

[14] Taxes on Consumption

The Consumption Tax is by far Japan's most important national tax on consumption. Any enterprise that, for monetary compensation, transfers or leases assets or provides services in Japan, and any person who imports foreign goods into Japan are subject to the Consumption Tax. A nonresident or a foreign corporation is also subject to the Consumption Tax as long as such party's activities fall within the above-mentioned categories.

Activities that are not taxed or that are otherwise exempted include the transfer of land or securities, the provision of certain medical or educational services, and the export of goods.

The rate of the tax is four percent (4%) of the price of the goods or any monetary compensation received. Any consumption tax paid to upstream parties is deductible from the tax amount. In other words, a manufacturer may deduct from the tax amount due on a good the tax amount imputed by its supplier. As a consequence, the end user ultimately bears the tax amount on the added value.

As a type of local tax, Local Consumption Tax is levied as surtax to national Consumption Tax. Tax rate of such Local Consumption Tax is 25% of national Consumption Tax (25%*4%=1%). Such tax is added to national Consumption Tax and collected when the seller of supplier of goods or services pays national Consumption Tax. Thus, such amount of tax is five percent (4%+25%*4%).

[15] Taxes on Transactions A stamp Duty is levied on persons who execute taxable documents. Payment of this duty is generally made by affixing a revenue stamp to the document. The stamp duty is imposed per document. Taxable documents are, inter alia, deeds covering real estate transactions, promissory notes, bills of exchange, share certificates, articles of incorporation, forms of contracts of prescribed kinds, bank passbooks, bills of lading and other negotiable instruments, letters of credit, insurance policies, and receipts. Some stamp tax amounts are determined on the basis of the size of the transaction covered by the taxable document. Otherwise, the tax amounts are generally fixed. Revenue stamps are available at post offices.

Registration and license taxes are imposed on registration, at the official registrar's office, of the following: acquisition, transfer, modification, or cancellation of rights concerning real estate, ships, aircraft, mortgages of various types, industrial property, mining rights, etc.; matters concerning corporations and other judicial entities, and of acquisition, etc.; qualifications and official licenses for professionals such as attorneys at law, certified public accountants, medical doctors; and, banks and other specified businesses for which licenses are required.

A real property acquisition tax is imposed on any person acquiring real property. The tax amount is four percent of the acquisition price. The burden of the real property acquisition tax is lessened by various preferential measures for an individual acquiring property to use as his own residence.

An automobile acquisition tax is applicable to the acquisition of automobiles. The tax base is the acquisition price. The statutory rate is three percent.

FOOTNOTES:

(n1)Footnote 1. Information in English is available from website of the Ministry of Finance. http://www.mof.go.jp/english/index.htm

(n2)Footnote 2. The Local Taxes Act is a kind of legislation that put legal framework on individual local legislation of taxes. Immediate legal authority for each cases are local legislation of "*Jorei*" enacted by the legislative body of local governments.

(n3)Footnote 3. See also Amendments to the Corporation Tax Act (Law No. 14, 2000), summarized at *Part 1 Chap. 3*(A); for a further discussion of the Act and other tax law developments, see the essay "Guide to Recent Developments in Tax Law," Ch. 1 § 1.02[10] *infra*.

(n4)Footnote 4. For most of business enterprises, calculation periods of tax is business year that is used for the determination of periodical profits/annual distribution of dividends for corporate law purposes.

(n5)Footnote 5. ITA Art.161.

(n6)Footnote 6. Corporation Tax Act Art.132.

(n7)Footnote 7. CTA Art.142.

(n8)Footnote 8. A new treaty between the United States and Japan strengthening provisions against double taxation and tax evasion, etc., was entered into on March 30, 2004; *see* New United States-Japan Income Tax Convention (Treaty of 2004, No. 2) at Ch. 1 §1.02[10] *supra*.

(n9)Footnote 9. Book 5 "Inheritance" of the Civil Code.