

CHAPTER 1

STRUCTURE OF THE JAPANESE TAX SYSTEM

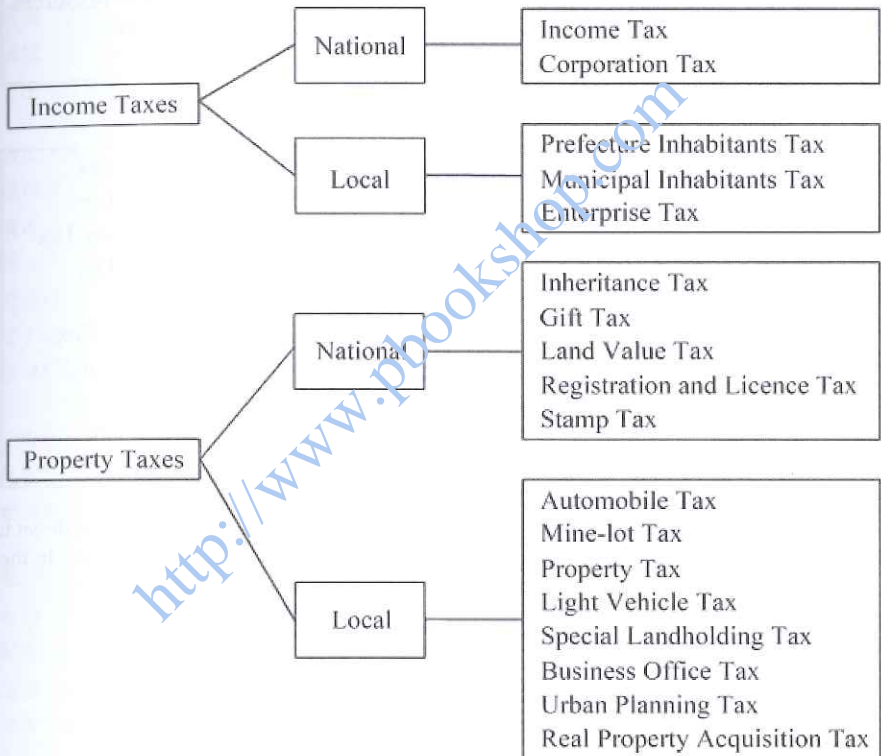
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OVERVIEW OF THE JAPANESE TAX SYSTEM

¶1-100 Overview of the Japanese tax system

The modern Japanese tax system dates from 1950 when the Japanese Diet enacted a series of tax reform ideas advanced by Dr Carl Shoup. The Shoup plan was noteworthy for its comprehensiveness. It replaced a system based on indirect taxes with one which is now centred around direct corporate and individual income taxes, supplemented by indirect taxes on consumption, customs, property and environmental levies.

Diagram 1: Major taxes in the Japanese tax system



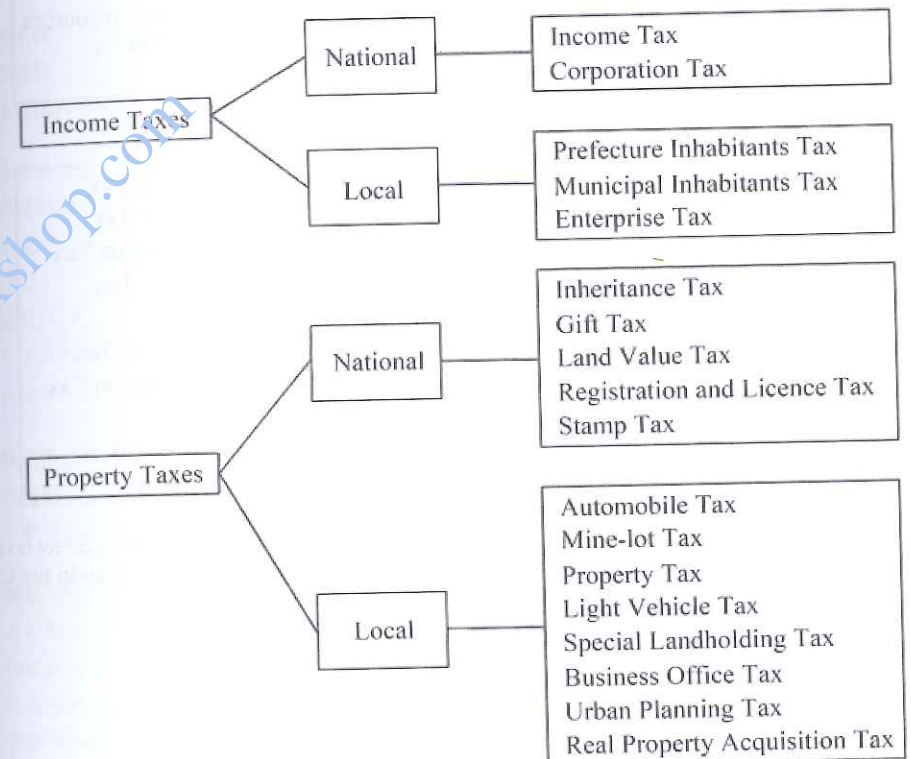
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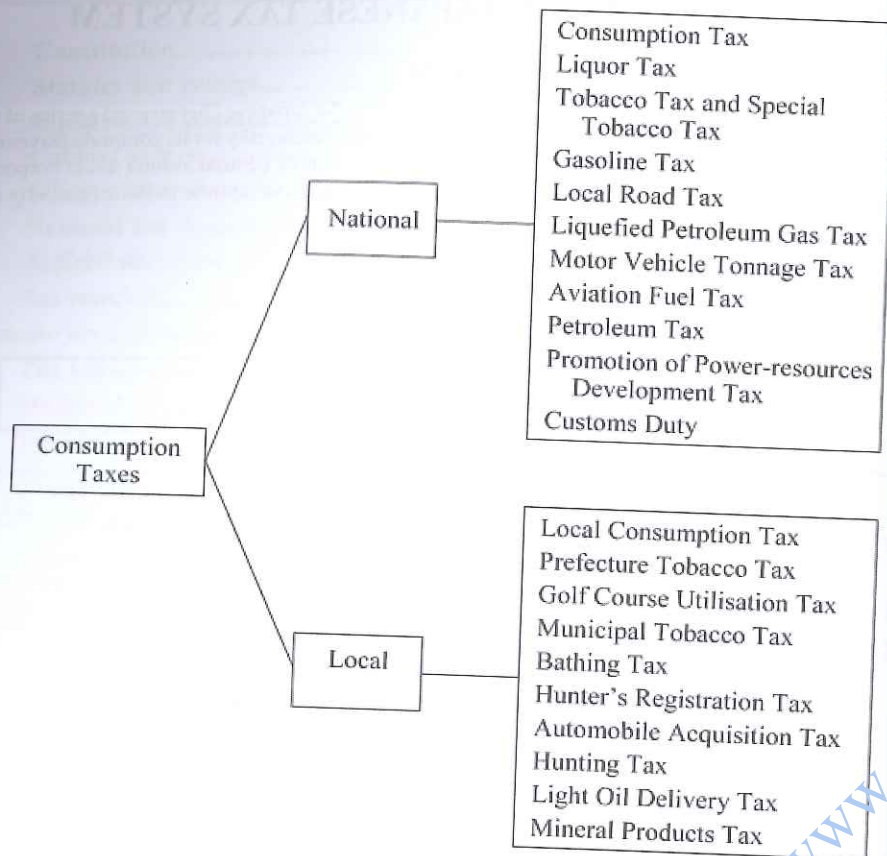
OVERVIEW OF THE JAPANESE TAX SYSTEM

¶1-100 Overview of the Japanese tax system

The modern Japanese tax system dates from 1950 when the Japanese Diet enacted a series of tax reform ideas advanced by Dr Carl Shoup. The Shoup plan was noteworthy for its comprehensiveness. It replaced a system based on indirect taxes with one which is now centred around direct corporate and individual income taxes, supplemented by indirect taxes on consumption, customs, property and environmental levies.

Diagram 1: Major taxes in the Japanese tax system





As the following tables indicate, the percentage of national revenue represented by direct taxes in Japan is about 55%, which is about the same as in the UK but considerably less than in the US where over 90% of federal tax revenues are derived from direct taxes.

Table 1: Japanese direct and indirect taxes (all yen amounts in ¥ billion)

		FY 2015		FY 2016	
		Budget amount	% of total	Budget amount	% of total
直接税	Direct tax	32,116	55.23%	35,024	57.23%
所得税	Income Tax	16,786	28.87%	18,352	29.99%
源泉分	- Withholding Tax	13,701	23.56%	15,059	24.61%
	- Self-assessed Tax	2,741	4.71%	2,916	4.76%
	- Special Restoration Tax	344	0.59%	377	0.62%
法人税	Corporation Tax	10,990	18.90%	12,233	19.99%
相続税	Inheritance Tax	1,761	3.03%	1,921	3.14%
地方法人特別税	Local Corporate Special Tax	2,102	3.62%	1,881	3.07%
地方法人税	Local Corporation Tax	477	0.82%	637	1.04%
間接税等	Indirect tax	26,030	44.77%	26,173	42.77%
消費税	Consumption Tax	17,112	29.43%	17,185	28.08%
酒税	Liquor Tax	1,308	2.25%	1,359	2.22%
揮発油税	Gasoline Tax	2,466	4.24%	2,386	3.90%
たばこ税	Tobacco Tax	906	1.56%	923	1.51%
石油ガス税	Liquefied Petroleum Gas Tax	10	0.02%	9	0.01%
航空機燃料税	Aviation Fuel Tax	51	0.09%	52	0.08%
石油税	Petroleum Tax	628	1.08%	688	1.12%
自動車重量税	Motor Vehicle Tonnage Tax	374	0.64%	385	0.63%
関税	Custom duty	1,117	1.92%	1,106	1.81%
とん税	Tonnage Tax	10	0.02%	10	0.02%
印紙収入	Stamp duty revenue	1,027	1.77%	1,052	1.72%
地方揮発油税	Local Gasoline Tax	264	0.45%	255	0.42%
石油ガス税(譲与分)(特)	Liquefied Petroleum Gas Tax (SA)	10	0.02%	9	0.01%
航空機燃料税(譲与分)(特)	Aviation Fuel Tax (SA)	15	0.03%	15	0.02%
自動車重量税(譲与分)(特)	Motor Vehicle Tonnage Tax (SA)	257	0.44%	264	0.43%
特別とん税(特)	Special Tonnage Tax (SA)	12	0.02%	12	0.03%

		FY 2015		FY 2016	
		Budget amount	% of total	Budget amount	% of total
電源開発促進税(特)	Promotion of Power-resources Development Tax (SA)	323	0.56%	320	0.52%
たばこ特別税(特)	Special tobacco surtax	140	0.24%	143	0.24%
総計	Total	58,146	100.00%	61,197	100%

SA: Special account revenue not included in the general revenue.

(Derived from MOF figures)

Table 2: Comparison of composition of national revenue among G6 countries (direct tax, indirect tax)

Fiscal Year	Japan		US		UK	
	Direct	Indirect	Direct	Indirect	Direct	Indirect
1991	73.3	26.7	90.8	9.2	56.9	43.1
1992	70.7	29.3	90.3	9.7	55.9	44.1
1993	69.4	30.6	90.5	9.5	54.1	45.9
1994	66.6	33.4	90.3	9.7	54.0	46.0
1995	66.1	33.9	90.8	9.2	54.9	45.1
1996	65.3	34.7	92.1	7.9	54.7	45.3
1997	63.4	36.6	92.6	7.4	56.8	43.2
1998	59.3	40.7	93.2	6.8	57.4	42.6
1999	57.2	42.8	92.5	7.5	57.3	42.7
2000	61.3	38.7	93.3	6.7	58.2	41.8
2001	59.5	40.5	93.2	6.8	58.3	41.7
2002	56.3	43.7	92.3	7.7	57.2	42.8
2003	56.1	43.9	91.6	8.4	56.2	43.8
2004	58.2	41.8	91.8	8.2	57.1	42.9
2005	60.3	39.7	92.7	7.3	59.1	40.9
2006	61.9	38.1	93.5	6.5	60.0	40.0
2007	61.4	38.6	94.5	5.5	59.6	40.4
2008	57.7	42.3	94.0	6.0	61.2	38.8
2009	52.9	47.1	92.7	7.3	59.7	40.3
2010	56.3	43.7	92.3	7.7	58.5	41.5
2011	57.2	42.8	92.6	7.4	56.3	43.7
2012	58.7	41.3	92.7	7.3	56.1	43.9

Fiscal Year	Japan		US		UK	
	Direct	Indirect	Direct	Indirect	Direct	Indirect
2013	60.8	39.2	93.3	6.7	54.1	45.9
2014	56.8	43.2	N/A	N/A	N/A	N/A
2015	56.8	43.2	N/A	N/A	N/A	N/A
2016	57.2	42.8	N/A	N/A	N/A	N/A

Fiscal Year	Germany		France		Italy	
	Direct	Indirect	Direct	Indirect	Direct	Indirect
1991	49.6	50.4	40.6	59.4	55.6	44.4
1992	49.8	50.2	39.7	60.3	58.5	41.5
1993	47.6	52.4	40.2	59.8	59.4	40.6
1994	45.8	54.2	39.3	60.7	54.2	45.8
1995	47.9	52.1	39.6	60.4	54.8	45.2
1996	46.0	54.0	39.2	60.8	55.4	44.6
1997	45.8	54.2	39.6	60.4	56.7	43.3
1998	45.4	54.6	39.6	60.4	52.4	47.6
1999	46.9	53.1	41.5	58.5	53.6	46.4
2000	47.4	52.6	43.3	56.7	52.1	47.9
2001	43.9	56.1	44.7	55.3	54.4	45.6
2002	42.3	57.7	43.1	56.9	52.9	47.1
2003	41.7	58.3	42.8	57.2	51.5	48.5
2004	41.2	58.8	41.2	58.8	50.6	49.4
2005	41.4	58.6	53.0	47.0	50.7	49.3
2006	43.4	56.6	41.9	58.1	52.2	47.8
2007	43.7	56.3	42.0	58.0	53.6	46.4
2008	44.9	55.1	42.4	57.6	55.1	44.9
2009	41.6	58.4	40.6	59.4	55.0	45.0
2010	41.3	58.7	43.0	57.0	53.4	46.6
2011	42.4	57.6	41.1	58.9	52.5	47.5
2012	43.9	56.1	42.6	57.4	N/A	N/A
2013	45.0	55.0	43.9	56.1	N/A	N/A

Source: Japan Ministry of Finance

As the table indicates, Japan underwent a significant shift from reliance on direct taxes to indirect taxes from 1991 to 2016. For the period for which comparable data is available for most of the G6 countries — 1991 through 2013 — in Japan, the contribution of indirect taxes to national revenue rose from 26.7% to 39.2%, an increase of 12.5 percentage points. During the same time, the percentage contribution of indirect taxes increased by 4.6% in Germany, 2.8% in the UK and 3.1% in Italy (through 2011), while decreasing by 2.5% in the US and 3.3% in France.

¶1-110 Japanese Government finance

Japanese national revenues have been increasing at an average rate of 2.06% a year from 1991 to 2013, while tax revenues have been shrinking at a rate of 0.98% a year.

Table 3: Ratio of tax revenues to total Japanese national account revenues (¥100m)

Year	General account revenue	Revenue from taxes and stamps	% of revenue from taxes and stamps
1991	729,906	598,204	82
1992	714,660	544,453	76
1993	777,312	541,262	70
1994	763,390	510,300	67
1995	805,572	519,308	65
1996	818,090	520,601	64
1997	801,704	539,415	67
1998	897,827	494,319	55
1999	943,763	472,345	50
2000	933,610	507,125	54
2001	869,030	479,481	55
2002	872,890	438,332	50
2003	856,228	432,824	51
2004	888,975	455,890	51
2005	890,003	490,654	55
2006	844,127	490,691	58
2007	845,535	510,182	60
2008	892,082	442,673	50
2009	1,071,142	387,331	36
2010	1,005,346	414,868	41
2011	1,099,795	428,326	39
2012	1,077,620	439,314	41
2013	1,060,447	469,529	44

Source: Japan Ministry of Finance

The widening gap between general revenues and tax revenues has been financed primarily by issuing deficit bonds. In 1990, newly-issued Japan Government Bonds totalled ¥7.312 trillion, about 10% of general revenues. These were primarily construction bonds, used to finance public works projects. In 2016, ¥34.4 trillion worth of bonds were included in the national budget, constituting 35.6% of total expenditures, compared to ¥25.35 trillion and 37.6% in 2009. This represents a substantial decrease in bond dependence from 2014 (¥41.25 trillion of bonds making up 43.02% of

total expenditures). For 2016, only ¥6 trillion was earmarked for public works, the balance to be used to cover operating and pension related deficits. No country in the G6 other than Japan derived less than 80% of its national revenues from taxes during the 2013 fiscal year.

Table 4: Comparison of composition of national revenue derived from taxes among G6 countries (% for fiscal year 2013)

Country	% of national expenditures funded by taxes	% of national revenues from taxes
France	80.0	95.6
Germany	91.5	91.5
Italy	74.9	88.4
United Kingdom	74.3	85.9
United States	49.9	94.4
Japan	46.9	44.3

Source: Japan Ministry of Finance

The tax burden in Japan, computed as the ratio of tax revenues to national income, has decreased from 26.6% in 1991 to 22.7% in 2012. As of 2008, at 24.1%, it was the lowest of the G6 countries, except for the United States where the burden had dropped from 26.4% in 2007 to 24.0% in 2008.

Table 5A: Percentage of tax burden to national income

Country	National and local taxes	Taxes and social security contributions
France (2011)	37.0	62.1
Germany (2011)	29.5	51.2
Sweden (2011)	47.5	58.2
United Kingdom (2011)	36.7	47.4
United States (2011)	23.3	30.8
Japan (1995)	24.0	36.7
Japan (2000)	23.7	37.3
Japan (2005)	23.3	37.6
Japan (2008)	24.1	40.3
Japan (2010)	22.3	38.8
Japan (2011)	22.9	40.1
Japan (2012)	22.7	39.9
Japan (2013)	22.7	40.0
Japan (2014)	24.1	41.6
Japan (2015)	25.6	43.4

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PERSONS TAXABLE UNDER THE JAPANESE TAX SYSTEM

¶2-100 Persons taxable under the Japanese tax system

The Japanese tax system contains separate laws for individuals (the *Income Tax Law*) and corporations (the *Corporation Tax Law*). Before 2015, individuals were subject to graduated tax rates under the *Income Tax Law* with a maximum rate of 40%. The maximum rate increased to 45% under 2013 tax legislation effective 1 January 2015 (*Law to Partially Revise the Income Tax Law, etc.*, Law No 5 of 2013, 30 March 2013, Art 1 — 所得税法等の一部を改正する法律). From 1 January 2013 through 31 December 2037, a surtax known as the Special Reconstruction Income Tax, computed as 2.1% of the standard Income Tax amount, applies to domestic and foreign individuals and companies subject to Japanese Income Tax, either by assessment or through withholding. Corporations are generally subject to a Corporation Tax rate of 23.4% (23.2% for tax years beginning after 31 March 2018) with reduced rates for the first ¥8m of corporation income for medium- and small-sized corporations and other reduced rates for other specified organisations. A 10% surtax of the corporation tax, known as the Special Reconstruction Corporation Tax, is added to the corporation tax for tax years beginning from 1 April 2012 through 31 March 2014. Individuals and corporations may also be taxed differently depending on whether they are considered to be residents of Japan for tax purposes. Additionally, various types of Japanese corporate entities are subject to different tax regimes under the *Corporation Tax Law*.

This chapter provides a description of the classifications of persons subject to Japanese tax under the *Income Tax Law*, *Corporation Tax Law*, *Inheritance Tax Law*, *Gift Tax Law* and *Local Tax Law*. In recent years, substantial changes have occurred in the make-up of Japanese business and investment entities. This chapter includes descriptions of the tax rules applicable to entities resulting from the enactment of the *Special Purpose Companies Law* in 1998 and changes to the *Investment Trust Law* in 2000. Specific attention is also given to the tax treatment of business entities under the *Company Law (Kaisha Ho)* enacted on 29 June 2005, which came into effect on 1 May 2006, and related regulations issued on 7 February 2006 that also became effective on 1 May 2006.

Law: *Company Law*; *Corporation Tax Law*; *Gift Tax Law*; *Income Tax Law*; *Inheritance Tax Law*; *Investment Trust Law*; *Local Tax Law*; *Special Purpose Companies Law*

INDIVIDUAL TAXPAYERS (*KOJIN* — 個人)

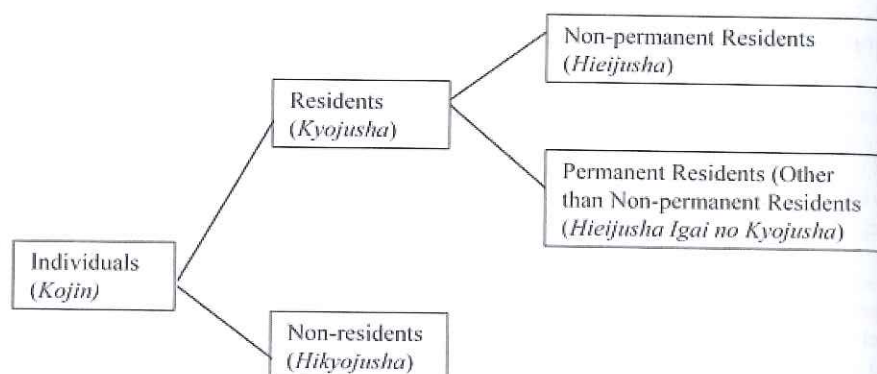
¶2-200 Individual taxpayers (*Kojin* — 個人)

The *Income Tax Law* classifies individuals into three classes of taxpayers:

- (1) permanent residents of Japan
- (2) non-permanent residents of Japan, and
- (3) non-residents (ITL Art 2(1)(iii), Art 2(1)(iv), Art 2(1)(v)).

(In the Japanese tax rules, permanent residents are usually referred to as “residents other than non-permanent residents”.)

Diagram 1: Classes of individual taxpayers



Law: Art 2(1)(iii), Art 2(1)(iv) and Art 2(1)(v) of the *Income Tax Law*

¶2-201 Classification of individuals in Japan under the immigration law (*Zairyu Shikaku* — 在留資格)

Table 1: Classification of individuals in Japan

Status of residence	Activities authorised to engage in	Period of residence
Diplomat	Activities by members of diplomatic missions or consular offices and their family	During period of diplomatic mission
Official	Activities by persons engaged in the official business of foreign governments or international organisations and activities by their family members	During the period of official business
Professor	Activities for research, direction of research or education at colleges or equivalent educational institutions	Three years or one year
Artist	Income producing activities for the arts other than by entertainers	Three years or one year
Religious activities	Religious activities conducted by persons sent to Japan by foreign religious organisations	Three years or one year
Journalist	Journalistic activities by persons under contract with a foreign journalistic organisation	Three years or one year

Status of residence	Activities authorised to engage in	Period of residence
Investor/business manager	Investment, international trade or other businesses	Three years or one year
Legal/accounting services	Legal or accounting services performed by legally qualified persons	Three years or one year
Medical services	Medical or dental services performed by legally qualified persons	Three years or one year
Researcher	Research with an organisation in Japan	Three years or one year
Instructor	Language instruction and other educational activities at pre-college schools and vocational schools	Three years or one year
Engineer	Technical services for an organisation in Japan	Three years or one year
Specialist in humanities, international services	Services requiring knowledge of jurisprudence, economics, sociology or other human science fields or involving knowledge of foreign cultures performed for an organisation in Japan	Three years or one year
Intra-company transferee	Services by persons transferred to business offices in Japan for a limited period of time	Three years or one year
Entertainer	Theatrical performances, musical performances, sports or any other show business activities	One year, six months or three months
Skilled labour	Services requiring specialised industrial techniques or skills performed for an organisation in Japan	Three years or one year
Cultural activities	Non-compensated academic or artistic activities, including studies of Japanese culture or arts	One year or six months
Temporary visitor	Sightseeing, business, etc, during a short period of stay in Japan	90 days, 30 days or 15 days
College student	Education at colleges or equivalent educational institutions and advanced vocational schools	Two years or one year
Pre-college student	Education at high schools or vocational schools	One year or six months
Trainee	Acquisition of technology, skills or knowledge at an organisation in Japan	One year or six months

Status of residence	Activities authorised to engage in	Period of residence
Dependant	Activities by the spouse or unmarried minor child of persons with residence status in Japan	Three years, two years, one year, six months or three months
Designated activities	Activities specifically designated by the Minister of Justice	Three years, one year or six months
Permanent resident	A person permitted permanent residence by the Minister of Justice	No time limit
Spouse or child of Japanese national	The spouse or child of a Japanese national	Three years or one year
Spouse or child of permanent resident	The spouse or child of a permanent resident of Japan	Three years or one year

Source: Japan Immigration Bureau, Ministry of Justice; *Immigration Control and Refugee Recognition Act* (Cabinet Order No 319 of 1951) as amended by Law No 43 of 2006

¶2-210 Scope of taxation of individuals

The following table summarises the basic rules of the tax base of individuals under the Japanese *Income Tax Law*.

Table 2: Tax base of individuals

Residency classification	Japanese source income	Non-Japanese source income paid in or remitted to Japan	Non-Japanese source income paid outside of Japan
Non-resident	Taxed	Not taxed	
Non-permanent resident	Taxed		Not taxed
Permanent resident	Taxed		

⇒ The scope of taxation of individuals is discussed in detail in Chapter 9 (Non-residents and Foreign Corporations) and Chapter 3 (Income Taxation).

¶2-220 Resident of Japan (*Kyojusha* — 居住者)

A resident of Japan is an individual with a domicile (*jusho*) located in Japan or who has maintained a residence (*kyosho*) in Japan continuously for one year or more up to the current date (ITL Art 2(1)(iii)). "Japan" is defined as any place within the jurisdiction of the *Income Tax Law* (ITL Art 2(1)(i)). A permanent resident is a resident of Japan other than a non-permanent resident (see ¶2-230).

¶2-210

Trips outside of Japan

Time spent outside of Japan by a person with a residence in Japan may be considered as time during which a residence was continuously maintained in Japan if it appears that the absence from Japan was intended to be temporary. Indications that a trip is intended to be temporary include the presence of family members in Japan, keeping a home or hotel room in Japan, or leaving personal effects in Japan (ITL Basic Circular 2-2).

Domicile (*jusho*)

A domicile is defined by the Japanese Civil Code as the base of one's living (*seikatsu no honkyo*) (Civil Code Art 21). An individual's domicile is to be determined by the objective facts and no one individual is deemed to maintain two domiciles simultaneously (ITL Basic Circular 2-1). If the domicile cannot be determined, the person's residence is treated as the domicile. A dual national of Japan and another country will be presumed not to have the intention to reside permanently in Japan if the person expresses the intention not to reside permanently in Japan to the tax office (ITL-EO Art 16(1)(ii)).

The following persons are usually presumed to have a domicile in Japan:

- a person whose occupation is such that he or she is normally required to live continuously in Japan for more than one year (ITL-EO Art 14(1)(i))
- a person of Japanese nationality (ITL-EO Art 14(1)(ii))
- a person who has been granted permanent residency in Japan under Japanese immigration law and regarding whom there are other relevant facts, such as the person's family being in Japan, property of the person in Japan, the nature of the individual's employment or actual residence in Japan for more than one year (ITL-EO Art 14(1)(ii)).

Example 1: Resident or non-resident

Ms A, a Japanese national, is employed by a company in Japan. Ms A has been assigned to work at the company's branch in Thailand for three years and is going to bring her family with her. Because she will have neither a residence nor domicile in Japan, she will be treated as a non-resident of Japan during the three years she is outside of Japan.

Example 2: Resident or non-resident

Mr B, an Australian college student, comes to Japan for the two-month summer break to teach English at a language school. At the end of the summer, the owner of the school offers Mr B a two-year contract and Mr B decides to stay in Japan. Mr B is not considered a resident of Japan during the summer. However, Mr B becomes a Japanese resident from the time he enters into the two-year long-term contract.

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Example 3: Resident or non-resident

Ms C, a Japanese national, is sent from Japan to work in the US branch of her company for three months. However, at the end of the first month, it is decided that local conditions in the US require her presence at the US branch for two more years. Ms C is a resident of Japan for the initial one month, but becomes a non-resident of Japan at the end of that month when the two-year long-term stay begins.

Under the *Bilateral Status of Forces Agreement* between Japan and the United States, members of the US military and their families are not considered to have acquired domiciles or residences in Japan (*Japan - US Bilateral Status of Forces Agreement*, 23 June 1960, Art 9(2)).

Law: Art 21 of the Civil Code; Art 2(1)(i) and Art 2(1)(iii) of the *Income Tax Law*; Art 14(1)(i), Art 14(1)(ii) and Art 16(1)(ii) of the *Income Tax Law Enforcement Order*

¶2-230 Non-permanent resident of Japan (Hiejusha — 非永住者)

A non-permanent resident of Japan is an individual who does not have Japanese nationality or citizenship and who has not been a resident of Japan or maintained a domicile in Japan for more than five years during the most recent ten-year period (ITL Art 2(1)(iv)). Before 1 April 2006, a non-permanent resident of Japan was defined as a resident of Japan who did not intend to permanently reside in Japan and who has not continuously resided in or maintained a domicile in Japan for more than five years up to the present time (ITL Art 2(1)(iv), before revision in 2006).

Beginning 2006, a person claiming status as a non-permanent resident must include the following information on the tax return (ITL Art 122(3), 123(3), 125(4), 127(4)):

- name, nationality, and residence or domicile
- dates during the last ten years when a residence or domicile was maintained in Japan and when a residence or domicile was not maintained in Japan
- period during the year when the person was a resident or non-resident of Japan
- income arising during the year while the person was a non-permanent resident of Japan, that is:
 - (a) Japanese source income, or
 - (b) non-Japanese source income paid in or remitted to Japan.

A person who was treated as a non-permanent resident of Japan before 2006, but who is classified as a permanent resident under the new definition enacted in 2006 (as in the case of a Japanese national who has not maintained a residence or domicile in Japan for five years up to the present time but has done so during the most recent ten-year period), will be subject to Japanese tax as a non-permanent resident on income arising on or before 31 March 2006 and as a permanent resident on income arising after that date.

Japanese nationals

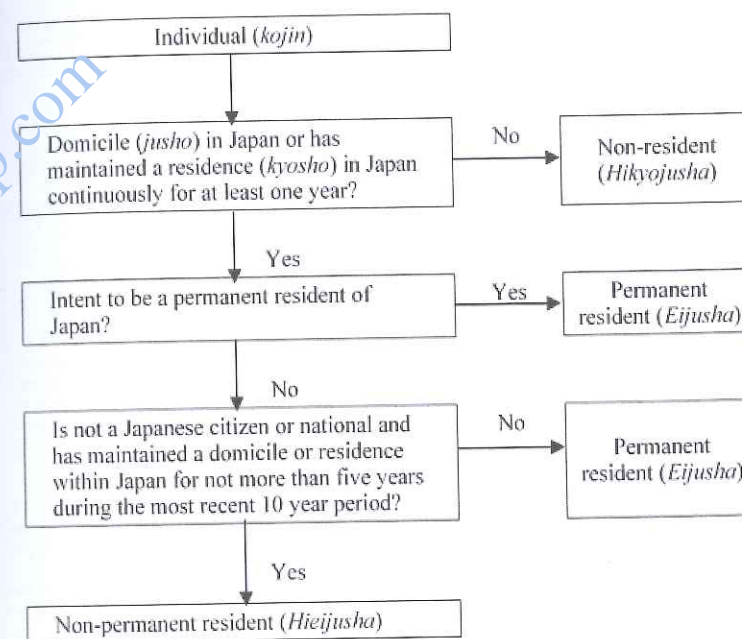
Japanese nationals employed in Japanese national or local civil service positions are deemed to have been domiciled in Japan for periods when they are outside of Japan (ITL Art 3(1)). This rule does not apply to civil service personnel who are:

- (1) not Japanese nationals, or

- (2) Japanese nationals, but who maintain a residence outside of Japan and are considered permanent residents of the other country (ITL Art 3(1); ITL-EO Art 13).

Example 4: Non-permanent resident

Mr D, a Chinese national employed by a company in Hong Kong, is assigned to work at the company's branch in Japan for three years. Mr D becomes a resident of Japan during the three-year period but does not become a permanent resident of Japan during the three-year assignment.

Diagram 2: Individual taxpayer classification rules**Confirmation of the type of resident status**

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INTRODUCTION

¶4-100 Introduction

The Japanese corporation tax is a direct tax on the income of entities classified as corporations under the *Corporation Tax Law* (CTL) (see ¶2-310). The following table summarises the Japanese tax scheme applicable to corporations.

Table 1: Taxation of Japanese domestic corporations

Type	Annual income	Income during liquidation	Liquidation income
Ordinary corporation (<i>futsu hojin</i> — 普通法人)	All income are taxed at regular rates (CTL Art 5, Art 66). A surtax known as the Special Reconstruction Corporation Tax equal to 10% of the standard corporation tax, applies for tax years beginning during the period from 1 April 2012 through 31 March 2014 (<i>Restoration Funding Act</i> , Law No 117, 2 Dec 2011, Art 48)	Effective for corporate dissolutions occurring on or after 1 October 2010, the tax on liquidation income is repealed. A corporation or co-operative is taxable during the period of liquidation under the regular corporation tax rules (CTL Art 5) Prior to 1 October 2010, income during liquidation was not taxed (former CTL Art 6)	Prior to 1 October 2010, taxed at special rates (former CTL Art 5, Art 99(1))
Public interest corporation (<i>koeki hojin</i> — 公益法人)	Taxed at reduced rates on income from profit-making businesses (CTL Art 4(1), Art 7, Art 66(3))		
Public corporation (<i>kokyo hojin</i> — 公共法人)	Not taxed (CTL Art 4(2))		
Co-operative (<i>kyodo kumiai</i> — 共同組合)	Taxed at reduced rates (CTL Art 5, Art 66(3))		
Non-juridical organisation (<i>jinkaku no nai shadan</i> — 人格のない社団)	Taxed at regular rates on income from profit-making businesses (CTL Art 4(1), Art 7, Art 66(1), Art 66(2))		
NPO	Taxed at reduced rates on income from profit-making businesses (CTL Art 7, Art 9(3))		Not taxed
Mutual benefit non-profit corporations	Taxed at regular rates on income from profit-making businesses (CTL Art 5, Art 66; <i>Tax Reduction Law</i> Art 16(1))	Not taxed (CTL Art 6)	Taxed at regular rates (CTL Art 5, Art 99(1))

Table 2: Japanese corporation taxation of foreign corporations (see ¶9-100)

Ordinary corporation (<i>futsu hojin</i> — 普通法人)	Taxed at regular rates on specified income from sources within Japan (CTL Art 4(3), Art 9(1), Art 141, Art 143(1))
Public interest corporation (<i>koeki hojin</i> — 公共法人)	Taxed at reduced rates on Japanese source income from profit-making businesses (CTL Art 4(3), Art 9(2), Art 143)
Non-juridical organisation (<i>jinkaku no nai shadan</i> — 人格のない社団)	Taxed at regular rates on Japanese source income from profit-making businesses (CTL Art 4(3), Art 9(2), Art 143)

Law: Art 4(1), Art 4(2), Art 4(3), Art 5, former Art 5, Art 6, former Art 6, Art 7, Art 9, Art 9(1), Art 9(2), Art 9(3), Art 10, Art 66, Art 66(1), Art 66(2), Art 66(3), Art 99(1), former Art 99(1), Art 99(2), Art 141, Art 143, Art 143(1) and Art 143(3) of the *Corporation Tax Law*; Art 16(1) of the *Tax Reduction Law*; Art 48 of the *Restoration Funding Act*

¶4-101 Medium- and small-sized companies (*Chushokigyo* — 中小企業)

Medium- and small-sized enterprises are eligible for numerous benefits under the *Corporation Tax Law*, including:

- Reduced tax rates (CTL Art 66(2)) (¶4-610)
- Carry back and carry-over of losses (STML Art 66-13) (¶4-460)
- Reserve for bad debts (STML Art 57-10) (¶4-471).

A medium- or small-sized company is generally a company with capital stock (*shonkin*) or invested capital (*shushikin*) of not more than ¥100m. However, for purposes of reduced tax rates, a company may not be treated as a medium- or small-sized company if it is owned 100% by a large-sized company with capital stock or invested capital of ¥500m or more (CTL Art 66(6)(ii)). Under the 2011 legislation, a company may not be treated as a medium- or small-sized company for purposes of the reduced tax rates applicable to medium- or small-sized companies and for purposes of exemption from the tax on excess retained earnings of family corporations (see ¶4-611) if it is owned 100% by more than one large-sized company within a 100% corporate group (see ¶4-650) (CTL Art 66(6)(iii); *Law to Revise the Income Tax, etc.*, 22 June 2011, Art 2).

Law: Art 66(2), Art 66(6)(ii) and Art 66(6)(iii) of the *Corporation Tax Law*; Art 2 of the *Law to Revise the Income Tax, etc.*; Art 57-10 and Art 66-13 of the *Special Taxation Measures Law*

¶4-110 Place of payment of taxes (*Nozeichi* — 納税地)

The place of payment of taxes for a domestic Japanese corporation is usually the place where its head office or principal office is located (CTL Art 16). The tax office with jurisdiction over the place of tax payment is where the corporation will not only pay tax, but also file various notifications and requests for approval regarding tax matters. The corporation must notify the tax office with jurisdiction within two months of incorporating and before moving from the jurisdiction (CTL Art 20, Art 148, Art 150). The National Tax Agency (NTA) may specify a different tax payment place if circumstances dictate. For example, if a corporation's headquarters is nominally in one jurisdiction,

¶4-101

but the centre of its business activity is in a distant branch, the NTA may treat the branch as the actual headquarters where taxes are paid (CTL Art 18).

Law: Art 16, Art 18, Art 20, Art 148 and Art 150 of the *Corporation Tax Law*

¶4-120 Final tax return (*Kakutei Shinkoku* — 確定申告)

The amount of a corporation's tax obligation is reported on a final tax return filed with the tax office with jurisdiction within two months after the end of the corporation's tax year even if there is no tax due, as in the case of a loss for the year (CTL Art 74). In the event that the tax return is not ready by the due date because of a disaster or audit by a Certified Public Accountant (CPA) or similar reason, the corporation may file a request for an extension of time to file the return within 45 days of the end of the tax year in the case of a disaster, etc., or by the last day of the tax year in the case of an audit (CTL Art 75, Art 75-2).

The following information is reported on the corporation tax return on various schedules numbered from 1(1) through 16-4 (CTL Art 74, Art 151; CTL-ER Art 34):

- corporation name
- place of payment of tax
- representative's name
- tax year
- amount of income or loss
- amount of Corporation Tax
- amount of Income Tax refund
- interim tax payment deduction amount
- interim tax payment refund amount
- other reference matters.

Attachments

The following items must be attached to the final tax return (CTL Art 74(2); CTL-ER Art 35):

- balance sheet
- profit and loss statement
- schedule of disposal of profit or loss
- detailed schedules supporting the balance sheet and profit and loss statement
- detailed schedule of changes in capital surplus.

Law: Art 74, Art 74(2); Art 75, Art 75-2 and Art 151 of the *Corporation Tax Law*; Art 34 and Art 35 of the *Corporation Tax Law Enforcement Regulations*

¶4-130 Interim tax return (*Chukan Shinkoku* — 中間申告)

Interim tax returns are used to pay Corporation Tax during the tax year. A corporation should file an interim tax return within two months from the end of the sixth month of the tax year (CTL Art 71). The interim tax payment is usually based on the tax for the prior year pro-rated by months, but

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an estimate of taxes may also be based on an interim closing of the books for the first six months of the year. If the tax for the prior year on a six month basis was ¥100,000 or less, no interim tax return is required.

Law: Art 71 of the *Corporation Tax Law*

¶4-140 Blue tax return (*Aoiro Shinkoku* — 青色申告)

The “blue tax return” system (named for the colour of the tax form) was initiated following a recommendation by the Shoup Mission in 1950 in order to promote the use of modern accounting methods by taxpayers. Substantial privileges are accorded to individuals and corporations who meet the accounting requirements and who receive permission to file interim and final blue tax returns.

To receive permission to file a blue tax return, a corporation must:

- record transactions in books and maintain and preserve those books and records (CTL Art 126), and
- submit an Application for Approval to File a Blue Tax Return (see Form 4 at ¶2-700) with the head of the tax office before the beginning of the tax year for which the blue tax return is to be filed (CTL Art 122). In the case of a newly incorporated company wishing to file a blue tax return for its first tax year, the due date for the application is the earlier of the last day of the first tax year or the day after three months from the date of incorporation.

E-Commerce records

Under the legislation effective for transactions on or after 1 April 2005, permission to file a blue tax return will be revoked if the methods used to retain records of electronic transactions (e-commerce) do not comply with the requirements of Japan’s electronic bookkeeping law relating to national taxes (*Special Rules for Methods of Preservation of Electronic Bookkeeping Records in Connection with National Taxes*, Law No 25, 1998, Art 11 — 電子計算機を使用して作成する国税関係帳簿書類の保存方法等の特例に関する法律).

Privileges accorded to filers of blue tax returns

- Ability to carry over losses for seven years (CTL Art 57).
- Ability to claim tax refunds by carrying back net losses (CTL Art 80). This provision has been suspended for tax years ending between 1 April 1992 and 31 March 2012 (STML Art 66-13). Subsequent legislation extends the suspension to 31 March 2018. However, medium- and small-sized companies with capital not exceeding ¥100m are not subject to the rule of suspension and may carry back losses under the regular rule.
- Prohibition of the tax office from making corrections to the corporation’s tax return not based on an investigation of the books and records (CTL Art 130(1)).
- The tax office is required to provide a written explanation of any corrections made to the tax return (CTL Art 130(2)).
- The tax office may not make a correction to the tax return based on estimates (CTL Art 131).
- Allowance of specially recognised depreciation (STML Art 42-5 to Art 52-3).
- Ability to expense amounts accumulated in various reserve funds (STML Art 55 to Art 57-9, Art 58, Art 61-2).
- Special deduction for expenditures in prospecting for new mineral deposits (STML Art 59).

- Special tax deductions for corporations in Okinawa (STML Art 60).
- Special tax deductions for corporations engaged in experimentation and research (STML Art 42-4).
- Special tax credits for corporations promoting the reform of the energy supply structure (STML Art 42-5(2)).
- Special tax credits for corporations acquiring facilities promoting the reduction of environmental impact of energy usage (STML Art 42-5-2(2)).
- Special tax credits for medium- and small-sized companies that acquire machinery, etc (STML Art 42-6(2)).
- Special tax credits for corporations acquiring machinery for industrial use in specified districts of Okinawa (STML Art 42-9).
- Special tax credits for specified medium- and small-sized companies in Okinawa that acquire management innovating equipment (STML Art 42-10(2)).
- Special tax credits for corporations acquiring equipment for use in special comprehensive strategic global zones (STML Art 42-11(2)).
- Special tax deductions for corporations increasing the number of employees (STML Art 42-12).
- Special taxation of revenues for Japanese vessels operating outside of Japan (STML Art 59-2).
- Special taxation of designated companies in special comprehensive strategic global zones (STML Art 60-2).
- Special taxation of companies carrying out authorised research and development (STML Art 60-3).
- Special taxation of acquisition of agricultural land (STML Art 61-3).
- Special taxation of technological research associations (STML Art 66-10).
- Special provision excluding receipts of dividends from casualty insurance companies (STML Art 67-7).

Law: Art 57, Art 80, Art 122, Art 126, Art 130(1), Art 130(2) and Art 131 of the *Corporation Tax Law*; Art 42-4 to Art 42-12, Art 42-4, Art 42-5 to Art 52-3, Art 55 to Art 57-9, Art 58, Art 58-3, Art 59, Art 59-2, Art 60, Art 60-2, Art 60-3, Art 61-2, Art 61-3, Art 66-10, Art 66-13 and Art 67-7 of the *Special Taxation Measures Law*; Art 11 of the *Special Rules for Methods of Preservation of Electronic Bookkeeping Records in Connection with National Taxes* (Law No 25, 1998)

¶4-150 Payment and refund of tax (*Nofu To Kanpu* — 納付と還付)

Tax reported on interim and final tax returns is paid by the due date for filing those returns (CTL Art 76, Art 77). Late payments of tax carry a penalty (*entaizei*) at a rate of 14.6% per annum (7.3% for the first two months the payment is overdue) (*General Law of National Tax* Art 60).

Excess tax payments may be either refunded or applied to unpaid national taxes:

- *Refund of Income Tax or foreign taxes.* If the amount of Japanese Income Tax or foreign taxes allowed as deductions from tax exceeds the amount of tax, the balance is refunded (CTL Art 78).
- *Refunds of interim tax payments.* If the final tax return shows an overpayment of tax from interim tax payments, the balance will be refunded to the corporation, including interest on the overpayment from the date of the interim payment (CTL Art 79).

- *Refund from loss carryback.* Net losses from the current year may be carried back for one year to reduce income in that prior year (CTL Art 80). This provision has been suspended for tax years ending between 1 April 1992 and 31 March 2012 (STML Art 66-13). Subsequent legislation extends the suspension to 31 March 2018. However, medium- and small-sized companies with capital not exceeding ¥100m are not subject to the rule suspension and may carry back losses under the regular rule. Prior to 1 February 2009, the loss carryback of medium- and small-sized companies was limited to that arising during their first five years of existence. Any resulting decrease in the tax from that prior year is refunded according to the following formula:

$$\text{Refund} = \frac{\text{Loss carried back}}{\text{Carryback year income before loss carryback}} \times \text{Tax of the carry back year}$$

Example 1: Refund from loss carryback

A medium- or small-sized corporation records a profit in year 1 of ¥5m and pays tax (at a 22% rate) of ¥1.1m. In year 2, the corporation incurs a loss of ¥2m. It is eligible for a refund on the prior taxes paid of ¥440,000.

$$(\text{¥2m}/\text{¥5m}) \times \text{¥1.1m} = \text{¥440,000}$$

Law: Art 76, Art 77, Art 78, Art 79 and Art 80 of the *Corporation Tax Law*; Art 60 of the *General Law of National Tax*; Art 66-13 of the *Special Taxation Measures Law*

¶4-160 Tax year (*Jigyo Nendo* — 事業年度)

The tax year of a corporation is the year specified in its articles of incorporation or in laws or regulations (CTL Art 13). If the tax year is not so specified, the corporation may elect a tax year by notifying the tax office within two months of the date of incorporation. Once established, the tax year may be changed by notifying the tax office (CTL Art 15). A tax year of less than 12 months is possible, but not a tax year of more than 12 months (CTL Art 13(1)). Most large Japanese corporations have a 12-month tax year ending on 31 March. But, as the following table indicates, the tax years of smaller corporations tend to be distributed more evenly throughout the year.

Table 3: Tax years of corporations for years ending between 1 April 2012 and 31 March 2014

End of tax year	Number of corporations	Capital under ¥100m	%	Capital ¥100m or more	%
April	184,993	184,434	7%	559	2%
May	214,200	213,292	8%	908	3%
June	249,868	248,496	10%	1,372	4%
July	197,922	197,365	8%	557	2%
August	228,176	227,379	9%	797	3%
September	283,268	281,406	11%	1,862	6%

End of tax year	Number of corporations	Capital under ¥100m	%	Capital ¥100m or more	%
October	117,800	117,312	5%	488	2%
November	86,013	85,501	3%	512	2%
December	258,682	254,129	10%	4,553	15%
January	90,168	89,551	3%	617	2%
February	172,337	171,021	7%	1,316	4%
March	507,523	490,366	19%	17,157	56%
Total	2,590,950	2,560,252	100%	30,698	100%

Source: Japan National Tax Agency

Law: Art 13, Art 13(1) and Art 15 of the *Corporation Tax Law*

TAXABLE INCOME (*SHOTOKU NO KINGAKU* — 所得の金額)

¶4-200 Taxable income (*Shotoku No Kingaku* — 所得の金額)

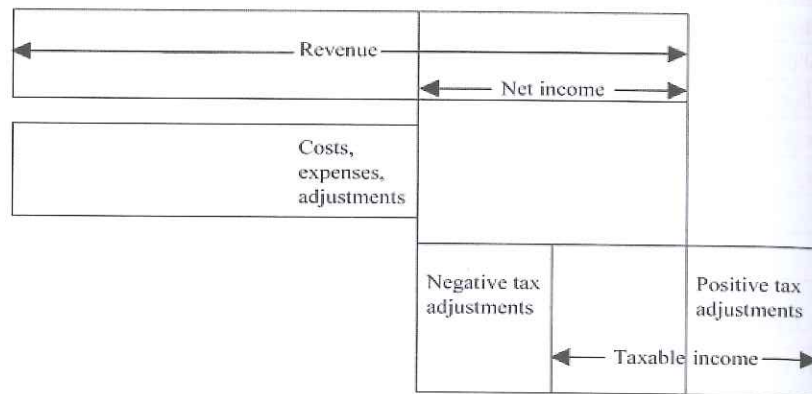
The basis of taxation for the Corporate Tax is the amount of taxable income, computed as the excess of the gross revenues (*ekikin no gaku* — 益金) over the deductible expenses (*sonkin no gaku* — 損金の額) for the taxable year (CTL Art 22(1)). Generally accepted accounting principles are used to determine the amounts of income and loss for tax purposes (CTL Art 22(4)).

Law: Art 22(1) and Art 22(4) of the *Corporation Tax Law*

¶4-210 Tax adjustments (*Zeimu Chosei* — 税務調整)

For tax purposes, both revenues and expenses must be determined based on generally accepted accounting principles (CTL Art 22(4)). But various adjustments to accounting income are required in order to determine taxable income.

Diagram 1: Tax adjustments



Tax adjustments occur in connection with closing of the accounts and from preparation of the tax return. Tax return adjustments may be voluntary or mandatory.

Table 4: Adjustments in closing accounts

Adjustments in closing accounts	Reference
Allowable depreciation expense	CTL Art 31
Allowable depreciation on deferred assets	CTL Art 32
Compensation of officers serving concurrently as employees	CTL Art 35(2)
Exclusion of excess retirement allowance for officers	CTL Art 36
Advanced depreciation on assets with reduced bases	CTL Art 42
Reserves for bad debts and returns	CTL Art 52, Art 53
Reserves for losses, etc	STML Art 52, etc
Accounting for long-term instalment sales	CTL Art 63

Table 5: Voluntary tax return adjustments

Voluntary tax return adjustments	Reference
Exclusion of dividends received	CTL Art 23(6)
Income Tax credit	CTL Art 68(3)

Table 6: Mandatory tax return adjustments

Mandatory tax return adjustments	Reference
Exclusion of appraisal gains from gross income	CTL Art 25
Exclusion of refunds from gross income	CTL Art 26
Exclusion of appraisal loss from expense	CTL Art 33(1)
Exclusion of excess compensation of officers from expense	CTL Art 34
Exclusion of officers' bonuses from expense	CTL Art 35
Exclusion of excess retirement allowance for officers from expense	CTL Art 36
Exclusion of excess compensation for employees from expense	CTL Art 36-2
Exclusion of excess retirement allowances for employees from expense	CTL Art 36-3
Exclusion of donations from expense	CTL Art 37
Exclusion of the amount of Corporation Tax from expense	CTL Art 38
Exclusion of the amount of Income Tax credited against Corporation Tax	CTL Art 40
The amount of reserves for bad debts included in gross income of the following period	CTL Art 52(9)
Net loss carry-overs	CTL Art 57
Excess depreciation, excess reserves and allowances, etc, not included in expense	CTL Art 31, etc
Exclusion of entertainment expenses from expenses	STML Art 61-4

Law: Art 22(4), Art 23(6), Art 25, Art 26, Art 31, Art 32, Art 33(1), Art 34, Art 35, Art 35(2), Art 36, Art 36-2, Art 36-3, Art 37, Art 38, Art 40, Art 42, Art 52, Art 52(9), Art 53, Art 57, Art 63 and Art 68(3) of the *Corporation Tax Law*; Art 52 and Art 61-4 of the *Special Taxation Measures Law*

¶4-220 **Credit for overpayment of tax due to disguised accounting** (*Kaso Keiri Nimotodzuku Kadai Shinkoku No Bai No Kosei Ni Tomonauhojin Zeigaku No Kojo* — 仮装経理に基づく過大申告の場合の更正に伴う法人税額の控除)

The *Corporation Tax Law* generally requires a company to record expenses for financial statement purposes if they are deducted on the tax return (CTL Art 22(4); see ¶4-210). Following a series of accounting scandals involving inflated earnings reports by companies seeking to maximise their share prices or secure bank financing in the mid-1960s, a provision was enacted which prevented companies that improperly inflated their earnings from obtaining an immediate refund of Corporation Tax when the accounts were adjusted to their proper levels by the tax authorities. Instead, the overpaid tax may be taken as credits against Corporation Tax for the year before the year that the correction is made and against Corporation Tax in the five-year period beginning in the year of the correction (CTL Art 70(1)).

Law: Art 22(4) and Art 70(1) of the *Corporation Tax Law*

GROSS REVENUES (*EKIKIN NO GAKU* — 益金の額)

¶4-300 Gross revenues (*Ekikin No Gaku* — 益金の額)

Gross revenues include income (*shueki*) from the following types of transactions (CTL Art 22(2)):

- (1) sales of property
- (2) transfers of property with or without compensation
- (3) provision of services with or without compensation
- (4) receipt of property without payment, and
- (5) other transactions, other than capital transactions.

Transfers without compensation or for low compensation

When a corporation transfers property to another party without compensation or for low compensation, the transfer is deemed to occur for fair market value; a gain and a contribution are recognised (CTL Art 22(2)).

Diagram 2: Journal entries — transfer without consideration

<i>Transferor</i>			
Property transferred — cost	XXX		
Gift expense	YYY		
Book value of property transferred		XXX	
Gain on transfer		YYY	
<i>Transferee</i>			
Value of property received	YYY		
Gift income			YYY

Example 2: Transfer without compensation and receipt without payment

A corporation transfers real property to a related corporation without compensation. The property has a basis to the corporation of ¥5m and a market value of ¥50m. The corporation has a gain on the transaction of ¥45m (¥50m property transfer income less ¥5m cost) and a contribution of ¥50m. The related corporation reports income from the receipt of property without payment in the amount of ¥50m and records the property on its books with a value of ¥50m.

Transactions increasing capital surplus

Capital transactions resulting in an increase or decrease in the capital, capital surplus or reserve accounts and distributions of profit or surplus (CTL Art 22(5)) are not included in income. The following amounts increase capital surplus and do not result in taxable income (CTL Art 2(17)):

- amounts in excess of the stated capital amount received on issue of stock
- gains on treasury stock
- fees received by a cooperative for admission of new members
- in the case of a merger, separation or subsidiary-type corporate division, or a qualified contribution-in-kind incorporation, the excess of the assets net of liabilities received over the increase in the capital account
- recognised book value adjustment gain resulting from a qualified subsequent contribution-in-kind incorporation
- in the case of an incorporation of a wholly-owned subsidiary, the excess of the value of the subsidiary stock received over the amount of increase in the capital account
- amounts transferred to capital surplus pursuant to a capital reduction (recapitalisation)
- amounts transferred to revaluation reserve funds or capital reserves, and
- value of money or property net of gift or inheritance tax contributed or bequeathed to the establishment of a medical foundation.

Law: Art 2(17), Art 22(2) and Art 22(5) of the *Corporation Tax Law*

¶4-310 Timing of income

Generally, Japanese corporate taxation follows a realisation principle which is based on the accrual basis of accounting (CTL Art 22).

Sales of inventory

Income from sales of inventory is generally recognised at the time of transfer, which is typically the date the goods are shipped or handed over to the buyer (CTL Basic Circular 2-1-1). If it is unclear when the goods are transferred, either of the following dates may be used (CTL Basic Circular 2-1-2):

- when most (ie 50% or more) of the sales proceeds are received, or
- the date of application for transfer of title.

Sales discounts and rebates

A discount is treated as a reduction in the sales price and is recognised at the time of sale. A rebate is a payment back to the buyer based on the amount or quantity purchased. If the method of determining the rebate is predetermined and communicated to the buyer beforehand, the rebate is accounted for by the buyer as of the date of the sale. Otherwise, the rebate is accounted for as of the time the buyer is informed of the rebate or, if the buyer is not informed, as of the date of payment (CTL Basic Circular 2-4-1).

Consignment sales

Income from consignment sales is recognised in the tax year when the consignee sells the item (CTL Basic Circular 2-1-3). However, if statement of consignment sales is prepared, the income may be recognised in the tax year the statement is received.

Income from contracts

Income from contracts where something is to be transferred to the other party is recognised at the time of transfer. If the contract is for performance of work or services, income is recognised at the time the performance is completed (CTL Basic Circular 2-1-5).

Transfers of fixed assets

Income from transfers of fixed assets is generally recognised in the year of transfer. But income from transfers of land and buildings is recognised as of the effective date of the contract of transfer (CTL Basic Circular 2-1-14).

Law: Art 22 of the *Corporation Tax Law*; CTL Basic Circulars 2-1-1, 2-1-2, 2-1-3, 2-1-5, 2-1-14 and 2-4-1

¶4-320 Instalment sales

Corporations may report income from sales, services, or construction projects (other than long-term construction projects subject to CTL Art 64) on instalment basis if:

- (1) the payments are to be received in three or more instalments
- (2) the last payment is to be received at least two years after the completion of the transaction giving rise to the payment, and
- (3) no more than two-thirds of the payments have been received by the time the transaction has been completed by the transfer of the item sold, etc (CTL Art 63, CTL-EO Art 126)

Income under the instalment method is determined as follows (CTL-EO Art 124):

Income currently recognised = Net sales price × instalment ratio

The net sales price is the sales price less cost of goods sold and sales commissions, etc (CTL-EO Art 124).

$$\text{Instalment ratio} = \frac{\text{Amount of denominator due or paid in the current period}}{\text{Instalment sale amount}}$$

Law: Art 63 and Art 64 of the *Corporation Tax Law*; Art 124 and Art 126 of the *Corporation Tax Law Enforcement Order*

¶4-330 Construction contracts

Income from construction contracts, other than long-term large-scale construction contracts, may generally be reported using either the completed contract method or the percentage of completion method. Long-term large-scale construction contracts are reported on the percentage of

completion method only. A long-term large-scale construction contract is one with a construction period of more than one year (two years before the change implemented by the 2008 legislation) (CTL Art 64(1); CTL-EO Art 129(1)) and a contract price of more than the minimum amount indicated in the following table. The percentage of completion method is not applicable if the project is expected to result in a loss (CTL Art 64(2)) or if the contract provides that half or more of the consideration is to be paid beyond one year from the date of the delivery of the constructed item (CTL-EO Art 129(2)). Under the 2008 legislation effective for tax years beginning on or after 1 April 2008, the percentage of completion method may be used when a loss is expected on a project that does not otherwise qualify as a long-term construction project and for software development projects (CTL Art 64(2)).

Table 7: Long-term large-scale construction contract

Date contract entered into	Minimum contract price
On or after 1 April 2008	¥1 billion
Before 1 April 1998 or between 1 April 2004 and 31 March 2008	¥5 billion
Between 1 April 1998 and 31 March 2001	¥15 billion
Between 1 April 2001 and 31 March 2004	¥10 billion

Law: Art 64(1) and Art 64(2) of the *Corporation Tax Law*; Art 129(1) and Art 129(2) of the *Corporation Tax Law Enforcement Order*

¶4-340 Dividends received (Uketorihaito — 受取配当)

Dividends received by a domestic Japanese corporation from other Japanese domestic corporations (other than public interest corporations or non-juridical persons) are eligible for a dividend exclusion:

- *100% group members.* Effective for dividends declared during tax years beginning on or after 1 April 2010, dividends paid and received between members of a 100% corporate group (see ¶4-650) are treated similarly to dividends on stock of a consolidated corporation; they are excluded from income of the recipient and no reduction by the amount of allocable interest expense is required. (CTL Art 23(1), (4)(i), Art 81-4(1), (4)).
- *Other related corporations.* Dividends on stock of a corporation other than a consolidated corporation or a 100% group member owned at least 25% by the recipient corporation are excluded from income after reducing the amount by the amount of the recipient's interest expense allocated to the dividends (CTL Art 23(1), (4)(ii)).
- *Consolidated corporations.* Dividends on stock of a consolidated corporation that is not a 100% group member or another related corporation, as described above, are excluded from the income of the recipient to the extent of 50% of the amount of the dividend less the amount of the recipient's interest expense allocated to the dividends (CTL Art 81-4).
- *Other corporations.* Dividends on stock of a corporation other than a 100% group member or a related corporation are excluded from income to the extent of 50% of the amount of the dividend less the amount of the recipient's interest expense allocated to the dividends (CTL Art 23(1), (4)(iii)).

¶6-620 Special rules for valuation of property used by specified businesses (Tokutei Jigyō Yo Shisan No Tokurei — 特定事業用資産の特例)

If specified unlisted stocks are received by inheritance or bequest, the heir may elect to include only 90% of their value in the tax base for the Inheritance Tax. No more than two-thirds of the outstanding stock of a corporation, and not more than ¥300m of value, may qualify for this special treatment. Specified unlisted stocks are stocks not listed on a stock exchange that satisfy certain conditions, including the following (STML Art 69-4):

- The value of all the issued stock of the corporation must be less than ¥2 billion.
- The decedent and persons related to the decedent must have owned more than one-half of the stock of the corporation.
- The heir must be a relative of the decedent and a person described in *Corporation Tax Law* Art 2(1)(xv) as a director, auditor, trustee, etc., of the corporation.

Law: Art 2(1)(xv) of the *Corporation Tax Law*; Art 69-4 of the *Special Taxation Measures Law*

CHAPTER 7 CONSUMPTION TAX

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INTRODUCTION

¶7-100 Introduction

In Japan, indirect taxes make up a little over a third of national and local tax revenues, which is less than is commonly seen in Europe, but considerably more than in the United States.

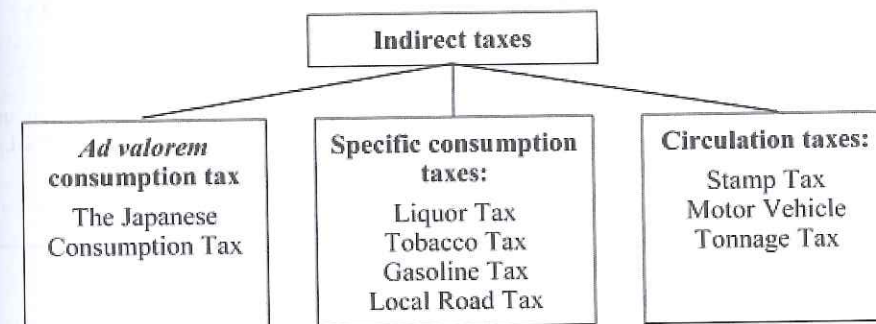
Table 1: International comparison of composition of national revenue ratio of direct taxes to indirect taxes (figures for Japan are estimates for 2015 and final figures for 2012; figures for the other countries are based on OECD data for 2013)

Country	Ratio of direct taxes to indirect taxes (national and local)
Japan (2013)	66:34
Japan (2010)	70:30
US	77:23
UK	57:43
Germany	52:48
France	54:46

Source: Japan Ministry of Finance

Japanese indirect taxes are of three general kinds: *ad valorem* Consumption Tax, specific consumption taxes based on units and circulation taxes on transactions and acts.

Diagram 1: Types of Japanese indirect taxes



The *ad valorem* Consumption Tax accounts for over half of the indirect tax revenues in Japan.

Table 2: Composition of Japanese indirect tax revenues 2015–2016

Indirect tax	Indirect tax revenues (¥1m)		% of indirect tax revenues	
	2015	2016	2015	2016
Consumption Tax	171,120	171,850	68%	67%
Gasoline Tax	24,660	23,860	10%	9%
Liquor Tax	13,080	13,590	5%	5%
Stamp duty revenue	10,270	10,520	4%	4%
Tobacco Tax	9,060	9,230	4%	4%
Customs duty	11,170	11,060	4%	4%
Other	13,960	14,640	6%	6%
Total indirect taxes	253,320	254,750	100%	100%

Although politically unpopular, indirect taxes are projected to become an increasingly important component of the Japanese tax system in the future due to a “hollowing out” of the tax base for the Income Tax as the population ages. Most of this increased burden is expected to be taken up by increases in the Consumption Tax rate, which increased from 5% to 8% in 2014 and will increase to 10% beginning on 1 April 2017 (on 1 June 2016, Prime Minister Abe announced that he will seek legislation to postpone the increase to a rate of 10% and measures associated with that increase until 1 October 2019). The Tax Commission, Japan’s tax policymaking panel, believes that an increase in the Consumption Tax rate to 20% will be needed to handle Japan’s fiscal needs.

THE CONSUMPTION TAX (*SHOHIZEI* — 消費税)

17-200 The Consumption Tax (*Shohizei* — 消費税)

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

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

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

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

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

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

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

Delay in increase of rate to 10%. On 1 June 2016, Prime Minister Abe announced that he will seek legislation to postpone the increase in the Consumption Tax to a rate of 10% and measures associated with that increase until 1 October 2019.

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

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

- Alcohol described in the Liquor Tax Law.
- “Dining out” (*gaishoku* — 外食) — meals consumed in restaurants, cafes, etc. But food eligible for the reduced tax rate includes:
 - “Take out” food put in a container or packaging for off the premise consumption
 - Food provided at an elderly care facility
 - Food provided to students at kindergarten, elementary and middle schools, etc.

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

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

- (1) The transfer of property or the provision of services in Japan by an enterprise in return for payment (*Consumption Tax Law* Art 2(1)(viii), Art 4(1)).
- (2) The removal of foreign goods from a bonded area (*Consumption Tax Law* Art 4(2)).
 - “Japan” refers to the enforcement area of the Consumption Tax (*Consumption Tax Law* Art 2(1)(i)).
 - “Enterprise” means either a sole proprietorship (operated by a natural person) or a corporation (*Consumption Tax Law* Art 2(1)(iii), (iv)). For this purpose, a business conducted by a local public body or a non-juridical organisation is considered to be a corporation (*Consumption Tax Law* Art 3, Art 60).
 - “Property” includes not only inventory and fixed assets but also intangible property rights (*Consumption Tax Law* Basic Circular 5-1-3).
 - “Bonded area” includes a specific bonded area, a bonded warehouse, bonded factory, bonded exhibiting area and comprehensive bonded area (*Consumption Tax Law* Art 2(1)(ii); *Customs Law* (*Kanzeiho*) Art 29).
 - The supply of property or services not involving an enterprise within Japan is not subject to Consumption Tax, but the importing of goods by a person other than an enterprise is subject to Consumption Tax.
 - Sale of personal assets, such as sale of a personal residence, is not subject to Consumption Tax.

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

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

Provision of services

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

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

Transfers or leases of property

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

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

¶7-210

Transfers for payment

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

Deemed transfers and other transactions subject to Consumption Tax

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

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

Imports

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

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

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

In order to provide equitable treatment to domestic and foreign — companies, beginning 1 October 2015, Consumption Tax will apply to electronic commerce such as the delivery of an electronic book, music, advertisements, or cloud services that an overseas company performs outside of Japan (*Consumption Tax Law* Art 2, Art 4 as amended by Law No 9, 1 April 2015). This rule overrides the general rule that services are considered domestic transactions if the services are provided within Japan (see ¶7-211). The method of tax collection differs depending whether the recipient of the services is a business or consumer. Foreign businesses with taxable sales less than ¥10m during the base period (generally the second year before the current year) may qualify for tax-exempt status (see ¶7-310). Other foreign companies with a business establishment in Japan related to the services or which have a tax representative in Japan may apply to the tax office to be “registered overseas business” eligible for the credit for taxable purchases (see ¶7-600).

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

services received by a Japanese permanent establishment of a foreign business for purposes of sales in Japan will be treated as Japanese domestic transactions subject to the reverse charge rules.

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

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

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

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

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

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

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

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

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

- (4) *Sales of postage stamps and document stamps.* Government postage stamps and stamps used for the Stamp Tax are not subject to Consumption Tax. Other mail-related items sold by the post office are also non-taxable, including postcards, cash envelopes, prepayment cards and parcel post wrapping materials (*Consumption Tax Law Basic Circular* 6-4-2). However, sales of collectible stamps are subject to tax.
- (5) *Merchandise and service cards.* Transfers (including sales from vending machines) of prepaid telephone cards, prepaid railway fare cards, book cards, gift certificates, etc, are not subject to Consumption Tax.
- (6) *Government fees.* Fees collected by the national or local governments or public bodies for permits, registration fees, document fees, etc, are not subject to Consumption Tax.
- (7) *International money orders and foreign exchange.* International postal money orders, traveller's cheques, letters of credit and foreign exchange transaction fees are not subject to Consumption Tax.
- (8) *Medical services received under public medical security laws.* Medical services received under public laws regarding health are not subject to Consumption Tax, including the *Health Insurance Act*, the *Seaman's Insurance Law*, the *Elderly Persons' Health Protection Act*, the *Physically Handicapped Person's Welfare Law*, the *Compensation to Victims of Damage to Health from Pollution Law*, the *Livelihood Protection Act*, the *Workers' Injury Compensation Insurance Act*, etc, (*Consumption Tax Law Basic Circular* 6-6-1).
- (9) *Nursing care services provided under the Nursing Care Insurance Act* (*Consumption Tax Law Basic Circular* 6-7-1).
- (10) *Social welfare services.* Various enterprises provide goods and services under the provision of the social welfare laws (*Consumption Tax Law Basic Circular* 6-7-5). Examples include:
- enterprises providing relief facilities under the *Livelihood Protection Law*
 - day care centres, infant and mother support facilities, and nursing homes under the *Child Welfare Act*
 - homes for the aged under the *Elderly Persons Welfare Act*
 - home services, day services, and short stay facilities provided under various welfare laws for children, the elderly and handicapped persons.
- (11) *Property transferred in connection with medical and midwife services for childbirth* (*Consumption Tax Law Basic Circular* 6-8-1).
- (12) *Burial and cremation fees.* However, funeral expenses are taxable (*Consumption Tax Law Basic Circular* 6-9-1).
- (13) *Transfers and leases of special items for the handicapped.* Tax-exempt items include wheelchairs, safety canes, artificial eyes, Braille machines, and other equipment or structures with special facilities for the handicapped (*Consumption Tax Law Basic Circular* 6-10-1).
- (14) *School and education costs.* Tax-exempt education costs are those related to schools, Job Ability Development Schools and special training colleges specified under the *School Education Law*. Examples of tax-exempt costs include tuition, entrance fees, facilities fees and fees for proof of student status documents, etc, (*Consumption Tax Law Basic Circular* 6-11-1).

- (15) *Textbooks specified in the School Education Law* (Consumption Tax Law Basic Circular 6-12-1).
- (16) *Residential lease*. Tax exemption applies to leases of homes, apartments, dormitories, company housing, etc. Short-term leases for less than one month are generally taxable (Consumption Tax Law-EO Art 16). Costs of hotels, *ryokan*, or resorts are taxable even if for a period of greater than one month (Consumption Tax Law Basic Circular 6-13-1).
- (17) *Receipt of tax-exempt foreign goods from bonded areas*. Tax exemption applies to the receipt from bonded areas of foreign property of the types otherwise qualifying for exemption, including securities, postage stamps, special articles for the use of the disabled, textbooks, etc.

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

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

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

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

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

- (1) A transfer or lease of property that is an export from Japan (*Consumption Tax Law Art 7(1)(i)*):
 - This exemption applies only to enterprises involved directly in exporting. It does not apply to subcontractors who provide goods to exporters or others who sell products to enterprises engaged in exporting (Consumption Tax Law Basic Circular 7-2-2).
- (2) A transfer or lease of foreign goods (*Consumption Tax Law Art 7(1)(ii)*):
 - This exemption applies to goods that have entered a bonded area in Japan without undergoing import processing and is then shipped outside of Japan (Consumption Tax Law Basic Circular 7-2-3).
- (3) Transportation of passengers or goods or telecommunications between Japan and outside Japan (*Consumption Tax Law Art 7(1)(iii)*).
- (4) A transfer, lease, or repair of ships or aircraft used for the transport of passengers or goods between Japan and outside Japan (*Consumption Tax Law Art 7(1)(iv)*).
- (5) Similar transfers or services specified in regulations (*Consumption Tax Law Art 7(1)(v)*).

Examples

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

- transfer or lease of foreign freight

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

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

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

Non-residents of Japan may purchase items for personal use at specially designated "tax-free shops" without paying Consumption Tax on the purchase (*Consumption Tax Law Art 8*; *Consumption Tax*). Among the most visible of these shops are the duty-free shops found in international airports and in the Akihabara "Electric Town" neighbourhood of Tokyo. Prior to 1 October 2014, exempt purchases were limited to those over ¥10,000 and included only such items as electric goods, handbags and clothing (Consumption Tax Law-EO Art 18). Beginning 1 October 2014, exempt purchases will also include items used in consumable items used in daily life such as food, beverages, medicines, and cosmetics. The separate exemption for consumable items applies to purchases costing at least ¥5,000 but not more than ¥50,000 beginning 1 April 2015.

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

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

¶7-233 Special export exemptions

Special exemptions from the Consumption Tax are provided for:

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

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

TAXPAYERS (NOZEI GIMUSHA — 納税義務者)

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

For purposes of the Consumption Tax, taxpayers are either:

- (1) an enterprise which transfers property or provides services in Japan in return for payment (*Consumption Tax Law Art 5(1)*), or
- (2) any person who removes foreign goods from a bonded area (*Consumption Tax Law Art 5(2)*):
 - An enterprise includes a sole proprietorship or a corporation, including a business conducted by a local public body or a non-juridical organisation (*Consumption Tax Law Art 2(1)(iv)*, Art 3, Art 5, Art 60).
 - It is not necessary for a taxpayer to have a residence or domicile in Japan in order to be subject to the Consumption Tax.
 - The obligation to pay Consumption Tax is extended beyond enterprises to consumers in the case of imports in order to maintain the tax balance between domestic and imported goods.

Trusts

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

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

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

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

Election to be a taxable enterprise

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

Application of exemption

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

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

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

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

Newly established sole proprietorships

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

Newly established corporations

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

Restrictions on use of the exempt enterprise system

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

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

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

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

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

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

Sole proprietorships

The tax period for individuals is the calendar year.

Corporations

The tax period for corporations is their fiscal year.

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

Sole proprietorships

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

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

Corporations

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

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

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

Corporations with a short tax year

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

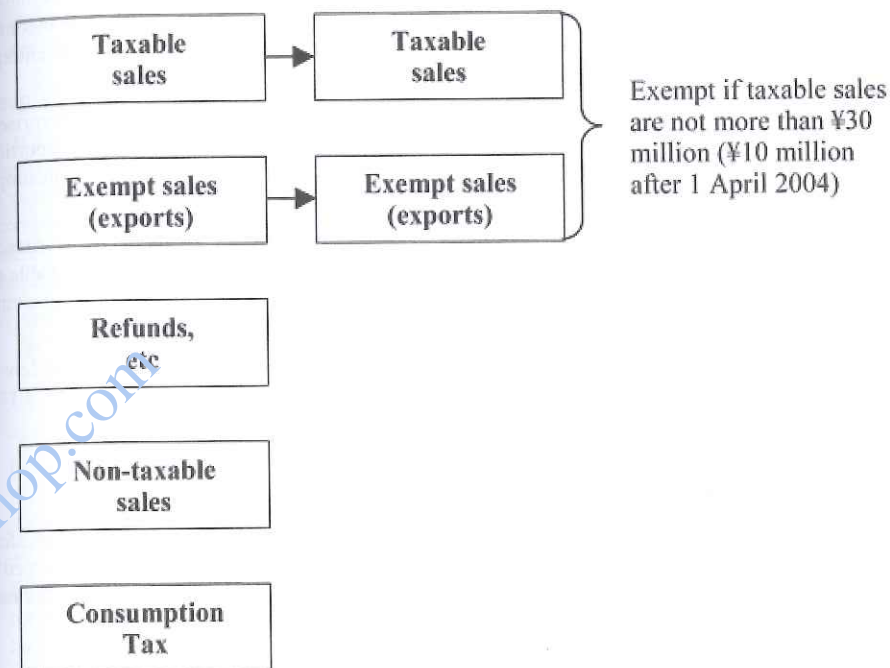
Deemed transactions and exempt transactions

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

Non-taxable transactions

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

Diagram 2: Exemption from Consumption Tax for Special Enterprises



Law: Art 2(1)(xiv), Art 9(2), Art 9(2)(ii), Art 9(4), Art 9(5), Art 9(6), Art 12-2 and Art 19-1 of the Consumption Tax Law; 2012 Draft of Law to Partially Revise the Consumption Tax Law in Order to Secure Stable Resources for Social Security

¶7-311 Special rules for exemption of inherited enterprises

If a sole proprietor inherits or succeeds to an enterprise, special rules are used to determine the amount of taxable sales during the base period:

- *In the year of inheritance or succession.* If the successor operates a sole proprietorship with less than ¥30m (¥10m after 1 April 2004) of taxable sales during the base period corresponding to the current year and the enterprise operated by the decedent has more than ¥30m (¥10m after 1 April 2004) of taxable sales in the base period, the enterprise in the hands of the successor is not exempt from Consumption Tax for the period beginning the day after the inheritance to the end of the year (*Consumption Tax Law Art 10(1)*).
- *In the first two years following the inheritance or succession.* If the taxable sales for the base period of the enterprise operated by the decedent and the taxable sales for the base period of a business operated by the successor together total more than ¥30m (¥10m after 1 April 2004), the enterprise in the hands of the successor is not exempt from Consumption Tax (*Consumption Tax Law Art 10(2)*).