

corporation income tax surtax to finance reconstruction following the Great Eastern Japan Earthquake), but other important tax reform issues were deferred. Tax reform in 2012 will have to take into consideration the adequacy of taxation in light of the severe financial circumstances facing Japan. One such issue is the need to limit the maximum amount of employment income deduction. Tax reform in 2012 should also consider taxes that address the problem of global warming in order to promote a liveable environment for future generations.

2012 tax reform

Social security is the largest fiscal expenditure item in the Japanese budget (social security represents 29.2% of budgeted 2012 expenditures while debt service, the second largest expenditure item, constitutes 24% of the proposed budget) and is increasingly important due to anticipated growth in this expenditure due to further ageing of the population in the future. By establishing trust in the social security system, it will be possible to expand consumption by the people. However, it is not sustainable to continue shifting the burdens of the social security system to future generations.

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

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

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

General 2013 tax reform principles

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

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

Strengthening growth through the stimulation of private investment

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

Measures for employment and training

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

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

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

Comprehensive reform of the social security and tax systems

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

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

Coordination with the Consumption Tax increase

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

Tax	Time obligation arises
Motor Vehicle Tonnage Tax	Time of delivery of car inspection certificate
Stamp Tax	Time the taxable document is prepared
Registration and Licence Taxes	At the time of verification of the subject matter or the registration or licence

Law: Art 15(1) of the *National Taxes Common Provisions Law*

¶1-410 The self-assessment system (*Shinkoku Nozei* — 申告納税)

Under the self-assessment system, taxpayers determine the amounts of their taxable income, deductions, credits, etc, and report their tax liability and tax payment on a tax return filed with the District Tax Office (*General Law of National Tax Art 16(1)(i), Art 17*). The self-assessment system is used for most of the national taxes in Japan, including income tax, corporation tax, inheritance and gift taxes, and consumption tax. If the taxpayer does not submit a tax return, or files an incorrect return, the tax authorities will assess the tax under the official assessment system (*General Law of National Tax Art 24, Art 25, Art 26*). Although self-assessment is the basic method of assessment for national taxes, in practice, most salaried workers in Japan are able to satisfy their tax obligations through the tax withholding system and are not required to file tax returns.

Law: Art 16(1)(i), Art 17, Art 24, Art 25, and Art 26 of the *General Law of National Tax*

¶1-420 Withholding tax system (*Gensen Choshu Seido* — 源泉徴収制度)

The withholding tax system is used in Japan for income tax on certain types of income, primarily to facilitate collection. In 2001, about 84% of income taxes were collected from the withholding tax system and only 16% from the self-assessment system (see ¶1-100 — Table 1: Japanese direct and indirect taxes for fiscal year 2001). Under the withholding system, the taxpayer pays the tax to a third party, who is responsible for collecting the tax and paying it over to the Government. The Government's right to collect the tax then attaches to the third party rather than to the taxpayer. The recipient of income, from which tax has been withheld, includes that income with other income when submitting his or her final tax return under the aggregate assessment system; calculates the amount of tax using the progressive tax rates; and determines the balance of tax due after deducting a credit for the tax withheld (ITL Art 120(1)(v)).

Table 15: Withholding tax rates

Income subject to withholding	Withholding rate
Employment income and retirement income (ITL Art 183 to Art 203-6).	Per specified tables reflecting the amount of salary after deducting social insurance premiums and the number of dependants. (see ¶3-390)
Interest (including that accruing from quasi-financial products described in ITL Art 174(1)(iii) to (viii)) and income from securities investment trusts (ITL Art 181, Art 182(1)(i), Art 209-3, Art 213).	20% (15% national and 5% local rates) (This represents the final tax liability, and aggregate income taxation is not applicable. See ¶3-360, ¶3-370)

Income subject to withholding	Withholding rate
Dividend income (ITL Art 181, Art 182(1)(ii) and Art 213).	20% (10% combined national (7%) and local (3%) rates on listed stocks until 31 December 2011, legislation in 2011 extends the reduced rates through 31 December 2013)
Royalties and other consideration in connection with copyrights, industrial property rights, manuscripts, broadcasts, public entertainment, broadcasts, lectures, and dramatisations, stenography or instruction in sports. Fees or other consideration to lawyers, CPAs, accountants, licensed tax accountants, land surveyors, architects, real estate appraisers, business consultants, building agents, athletes (including lump sum payments received by professional baseball players for future services (ITL-EO Art 320(6)), and racers. Prizes for advertising purposes and those paid to race horse owners. (ITL Art 174, Art 212(3))	10% of a single payment up to ¥1m and 20% of any single payment in excess of ¥1m
Profits of a Japanese Civil Code anonymous association (<i>tokumei kumiai</i>) (ITL Art 210, Art 211)	20%

Table 16: Payments subject to 10% withholding on amount computed after specified allowable deductions (ITL-EO Art 322)

Payment to	Allowable deduction
Judicial scriveners, land and house inspectors, or marine agents	¥10,000 per payment
Medical doctors or dentists for treatments under the social insurance system	¥200,000 per month
Professional boxers, as remuneration	¥50,000 per payment
Sales people or electric meter readers	¥120,000 per month
Bar or nightclub hostesses	¥5,000 per day
Recipients of prizes for advertising purposes	¥500,000 per payment
Racehorse owners as prizes	¥600,000 per payment plus 20% of the value of the prize

Withholding from salaries

Income tax on employment income is withheld based on tax tables reflecting the amount of the taxpayer's income and personal deductions (ITL Separate Schedules 2 to 5). At the end of the year, employers make any necessary adjustments and pay any over-withheld or under-withheld amounts to the employee or Government. Employees who

Public corporation	Governing statute
Japan Sewage Works Agency	<i>Japan Sewage Works Agency Law</i> (Law No 41, 1972)
Japan Judiciary Support Center	<i>Comprehensive Legal Support Law</i> (Law No 74, 2004)
Development Bank of Japan	<i>Development Bank of Japan Law</i> (Law No 73, 1999)
Japan Racing Association	<i>Japan Racing Association Law</i> (Law No 205, 1954)
Japan Pension Service	<i>Japan Pension Service Act</i> (Law No 109, 2007)
Japan Broadcasting Corporation	<i>Broadcasting Law</i> (Law No 132, 1950)
Agriculture, Forestry and Fisheries Finance Corporation	<i>Agriculture, Forestry and Fisheries Finance Corporation Law</i> (Law No 355, 1952)

Law: Art 2(1)(v), Art 4(3) and Separate Sch 1 of the *Corporation Tax Law*; *Agriculture, Forestry and Fisheries Finance Corporation Law*; *Broadcasting Law*; *Development Bank of Japan Law*; *Flood Control Societies Law*; *Independent Administrative Agency Regulation Law*; *Japan Bank for International Cooperation Law*; *Japan Finance Corporation for Municipal Enterprises Law*; *Japan Racing Association Law*; *Japan Sewage Works Agency Law*; *Land Improvement Law*; *Land Readjustment Law*; *Local Autonomy Law*; *Local Housing Supply Corporation Law*; *Local Road Corporation Law*; *National Life Finance Corporation Law*; *National University Law*; *Okinawa Development Finance Corporation Law*; *Port Authority Law*; *Promotion of Expansion of Publicly Used Land Law*; *Small Business Finance Corporation Law*; *Social Insurance Medical Fee Payment Fund Law*; *Japan Finance Corporation for Small and Medium Enterprise Act*; *Japan Pension Service Act*; *Comprehensive Legal Support Law*

¶2-340] Public interest corporations (*Koeki Hojin* — 公益法人)

Public interest corporations (referred to in the *Standard Bilingual Dictionary* as “non-profit corporations”) were, before the enactment of the reform of the public interest corporation system in 2006, established under Art 34 of the Civil Code (*Minpo*, Law No 89, 1896) which provided that an association (*shadan*) or foundation (*zaidan*) relating to worship, religion, charity, science, art, etc, relating to public interest and not having a profit motive, may be established as a corporation upon receiving the permission of the competent authorities. Public interest corporations include bodies such as municipal corporations and local public entities listed in Separate Schedule 2 of the *Corporation Tax Law* (CTL Art 2(1)(vi)) (see Table 11 below).

Associations (*shadan*) are generally corporate juridical persons with fee paying members who manage the association for some public purpose through the decisions of the members’ general meeting. On the other hand, foundations (*zaidan*) generally manage assets according to the directions of the donor and do not have members.

Public interest corporations are subject to Corporation Tax only on income from their profit-making activities (including investment income) (CTL Art 7). If earnings or assets from a public interest corporation are transferred from its profit-making activity to its exempt activity, a deemed charitable gift is considered to have occurred and the

corporation may take a gift deduction of up to 20% of its profit (the greater of 50% of the profit or ¥2m in the case of a school or social welfare organisation) (CTL Art 37(4); CTL-EO Art 73(1)(iii)).

Reform of the public interest corporation system

On 2 June 2006, three new laws were enacted relating to *ippan shadan hojin* (general incorporated association) and *ippan zaidan hojin* (general incorporated foundation) entities (*Law Relating to Ippan Shadan Hojin and Ippan Zaidan Hojin*, Law No 48, 2006). The public interest corporation system was drastically changed when the laws came into force on 1 December 2008. A pre-existing *shadan hojin* or *zaidan hojin* incorporated under the former Civil Code Art 34 is treated as a Special Civil Code Corporation during the five-year transition period to the new system beginning 1 December 2008.

Table 11A: Taxation of public interest corporations (*Koeki Hojin* — 公益法人)

Corporate classification	Scope of taxation (CTL Art 2(1)(xiii), Art 5, 7; CTL-EO Art 5)	Deemed donation (CTL Art 37(5); STML Art 66-11-2)	Corporation tax rate (CTL Art 66; STML Art 42-3-2)
Public interest association (<i>koeki shadan hojin</i> — 公益社団法人) or public interest foundation (<i>koeki zaidan hojin</i> — 公益財団法人)	Taxed on profit-making activities; income from public interest activities is exempt	The greater of 50% of income or public interest disbursements	22% (19% for tax years beginning on or after 1 April 2012) (CTL Art 66(3)) Annual income not exceeding ¥8m: 18% (15% from 1 April 2012 to 31 March 2015)
Non-profit general incorporated association (<i>ippan shadan hojin</i> — 一般社団法人) or foundation (<i>ippan zaidan hojin</i> — 一般財団法人)	Taxed on profit-making activities	N/A	30% (25.5% for tax years beginning on or after 1 April 2012) Annual income not exceeding ¥8m: 22% (18% from 1 April 2009 to 31 March 2012, 15% from 1 April 2012 to 31 March 2015, 19% after 31 March 2015)

Transitional rules

During the five-year transitional period, beginning when the laws come into force (1 December 2008), existing public interest corporations must undertake procedures to convert to the new system.

Table 11B is a list of the public interest corporations currently included in Separate Schedule 2 of the CTL.

Tax-free exchanges of fixed assets (*kotei shisan no kokan* — 固定資産の交換)

The *Income Tax Law* provides “tax-free” treatment (gain is not recognised until replacement property is transferred in a taxable transaction) for exchanges of certain property an individual taxpayer has held for business or investment purposes (ITL Art 58). In order for deferred tax treatment to apply, the taxpayer must have owned the exchanged property for at least one year and the property must be exchanged for like-kind property which the other party to the exchange has also owned for at least one year (other than property which has been obtained for purposes of an exchange). Property eligible for tax-free exchange treatment includes the following types of property (provided that the property is held for business or investment purposes and is not inventory property):

- (1) land, including surface rights and leaseholds
- (2) buildings, including annexes and attached structures
- (3) machinery and equipment
- (4) ships, and
- (5) mining rights.

Like-kind property

For purposes of the non-taxable exchange rules, an exchange of “like-kind” property occurs when land is exchanged for land or a building for another building. But if land is exchanged for land and a building, the building portion of the exchange property received is treated as boot.

Treatment of boot

Tax-free exchange treatment will not apply if the difference between the fair market value of the properties exchanged (“boot” is generally paid to make up for this difference) exceeds 20% of the value of the property with the greater value.

The gain portion of boot received is equal to the boot received less the amount determined by multiplying the basis (including selling costs) of the property given by the fraction obtained by dividing the amount of boot by the sum of the boot plus the fair market value of the like-kind property received. The gain portion of boot received is taxable to the recipient as long- or short-term capital gains, depending on the taxpayer’s holding period of the property transferred after reduction by applicable special deductions.

Special rules for transfers of real property

Gains and losses from transfers of land and buildings are taxed under the separate assessment taxation system (see ¶3-350).

Law: Art 22(2), Art 33, Art 33(3), Art 33(3)(i), Art 33(3)(ii), Art 33(4) and Art 58 of the *Income Tax Law*; Art 82 of the *Income Tax Law Enforcement Order*; Art 37-11 (repealed) of the *Special Taxation Measures Law*

¶3-237 Occasional income (*Ichiji Shotoku* — 一時所得)

Occasional income is income of a non-recurring nature which is not derived from services or labour or from transfers of assets and is not included in any of the other categories of aggregate assessment income (ie is not interest, dividends, lease income, business income, employee compensation, retirement income, forestry income or capital gains) (ITL Art 34). Examples of occasional income include:

- prizes and wagering income
- lump-sum payments of life insurance and refunds of casualty insurance at maturity
- money and goods received as gifts from corporations, and
- rewards for finding lost articles.

Calculation of occasional income (ITL Art 34(2), Art 34(3))

$$\text{Occasional income} = \text{Amount received} - \text{Costs expended to obtain the income} - \text{Special deduction (maximum ¥500,000)}$$

Taxation of occasional income

Only one-half of occasional income is included with the other categories of aggregate assessment income when the tax on aggregate assessment income is computed (ITL Art 22(2)(ii)).

Law: Art 22(2)(ii), Art 34, Art 34(2) and (3) of the *Income Tax Law*

¶3-238 Miscellaneous income (*Zatsu Shotoku* — 雑所得)

Miscellaneous income consists of income not included in any other category of aggregate assessment income and includes:

- amounts received as public or private pensions and annuities
- manuscript fees and royalties received by persons other than professional authors
- lecture fees, and
- broadcasting gratuities.

Calculation of miscellaneous income (ITL Art 35(2))

$$\text{Miscellaneous income} = \text{Miscellaneous income other than public pensions less necessary expenses} + \text{Public pension income less the public pension deduction}$$

Public pension income (*koteki nenkin* — 公的年金)

The amount of the public pension included in miscellaneous income is reduced by the amount of the public pension deduction, which is based on the amount of the pension received and the age of the recipient, according to the following table (ITL Art 35(4); STML Art 41-15-3(1)).

Table 15A: Japanese Income Tax rates (proposed for 2015 and after)

Taxable income		Pay	Plus % of the excess	of the amount over
Over	But not over			
—	¥1.95m	—	5%	—
¥1.95m	¥3.3m	¥97,500	10%	¥1.95m
¥3.3m	¥6.95m	¥232,500	20%	¥3.3m
¥6.95m	¥9m	¥962,500	23%	¥6.95m
¥9m	¥18m	¥1,434m	33%	¥9m
¥18m	¥40m	¥4,404m	40%	¥18m
Over ¥40m		¥13,204m	45%	¥40m

Fixed rate reduction in income tax (abolished)

Before 2007, the income tax amounts described above were reduced by a fixed rate reduction (*teiritsu genzei*). The reduction was equal to the lesser of 20% of the income tax before the reduction or ¥250,000 (*Tax Reduction Law of 1999 Art 6(2)*). The fixed rate reduction was applied similarly to a tax credit (see ¶3-294). The fixed rate reduction has been abolished effective January 2007 (June 2007 for purposes of the Local Inhabitants Tax on individuals).

Law: Art 89(1) of the *Income Tax Law*; Art 4, Art 5 and Art 6(2) of the *Tax Reduction Law of 1999*; *Draft of the Proposed Law to Partially Revise the Consumption Tax Law, etc., and Fundamentally Reform the Tax System in Order to Secure Stable Resources for Social Security*

¶3-281 Special Reconstruction Income Tax (*Fukko Tokubetsu Shotokuzei* — 復興特別所得税)

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

The standard Income Tax amount is generally the amount of Income Tax for the year before considering any foreign tax credit or incidental taxes (*Restoration Funding Act, Law No 117, 2 December 2011, Art 10*). For special categories of taxpayers, the standard Income Tax amount includes the Income Tax on the following amounts (*Restoration Funding Act, Law No 117, 2 December 2011, Art 10*):

- Residents of Japan other than non-permanent residents: the amount of income subject to the Income Tax.

- Non-permanent residents of Japan: the amount of Income Tax on Japanese source income and foreign source income paid in or remitted to Japan.
- Non-resident of Japan: the Income Tax on Japanese source income.
- Japanese domestic corporation: the Income Tax on dividends, interest, etc.
- Foreign corporations: the Income Tax on Japanese source dividends, interest, etc.

Taxpayers required to prepay taxes (*yotei nozei* — 予定納税) must adjust the required payments to include the related amount of Special Reconstruction Income Tax (*Restoration Funding Act, Law No 117, 2 December 2011, Art 16*). Taxpayers filing a final Income Tax return must include with their return a return of Special Reconstruction Income Tax that contains the following information (*Restoration Funding Act, Law No 117, 2 December 2011, Art 17*):

1. The standard Income Tax amount included in the final Income Tax return.
2. The Special Reconstruction Income Tax computed based on the standard Income Tax amount in the final Income Tax return.
3. The amount of any deduction from the Special Reconstruction Income Tax arising from a special calculation of the amount of withholding tax due.
4. Any amount of unused deduction in connection with item (3).
5. Any amount of deduction from the Special Reconstruction Income Tax arising from a special calculation of the amount of prepaid tax and any unused amounts of such deductions.

Persons responsible for the withholding of Income Tax are also generally legally responsible to withhold and pay over to the tax office the Special Reconstruction Income Tax by the due date for the related Income Tax withholding payment (*Restoration Funding Act, Law No 117, 2 December 2011, Art 28*).

Law: Art 8, Art 9, Art 10, Art 13, Art 16, Art 17 and Art 28 of the *Restoration Funding Act*

¶3-290 Income tax credits (*Zeigaku Kojo* — 税額控除)

Tax credits are amounts deductible from the amount of Income Tax. The main tax credits are:

- the dividends credit
- the foreign tax credit
- special tax credit for home acquisition
- fixed rate reduction in Income Tax, and
- tax credit for electronic filing of tax return.

¶3-291 The dividends credit (*Haito Kojo* — 配当控除)

A credit is allowed for dividends of profits, interim dividends and distributions of surplus received from corporations, which have their headquarters in Japan, and from investment trusts (ITL Art 92). However, no credit is allowed for (STML Art 9(1)):

- dividends from foreign corporations
- construction or fund interest

Carry-forward of loss on sale of residence

A loss resulting from the sale of a home or land, during the period from 1 January 2004 to 31 December 2011, which was owned for more than five years and used as a residence, may be carried forward for three years (STML Art 41-5-2). The 2012 legislation extends the provision through 31 December 2013.

Deferred tax on replacement of business property

Deferral of 80% of the gain from certain transfers of land or buildings used in business is allowed if the replacement of the property is consistent with specific policies regarding land use (STML Art 37).

Deferred tax for prior acquisition transactions involving land used in business (*tochi no senko shutoku* — 土地等の先行取得)

Deferral of the gain from certain transfers of land used in business by an individual or corporation is allowed where land in Japan (parcel 1) is acquired during the period 1 January 2009 through 31 December 2010 and another piece of land (parcel 2) is sold within 10 years from the end of the year parcel 1 was acquired in 2009 or 2010. The gain on the sale of the other piece of land (parcel 2) will not be recognised and will reduce the basis in parcel 1 acquired during 2009 or 2010. Deferral of gain is not allowed for land held as inventory. A request to be eligible for the deferral must be filed by the due date of the tax return for the year parcel 1 was acquired in 2009 or 2010.

Year parcel 1 acquired	Amount of gain deferral allowed
2009	80%
2010	60%

Law: Art 31(1), Art 32(1), Art 33-4, Art 34, Art 34-2, Art 34-3, Art 35, Art 36, Art 36-2, Art 36-3, Art 36-4, Art 36-5, Art 36-2(4), Art 37 and Art 41-5-2 of the *Special Taxation Measures Law*

[¶3-360] Separate withholding taxation (*Gensen Bunri Kasei* — 源泉分離課税)

Under the separate withholding taxation system, tax is withheld at a fixed rate from certain types of income. If the Income Tax liability is satisfied through this withholding, the income need not be reported on a tax return. The principal types of income subject to separate withholding are:

- (1) salaries
- (2) gains from transfers or sales of listed securities if separate withholding taxation is elected by the taxpayer (STML Art 37-11)
- (3) interest (STML Art 3(1))
- (4) dividends (if separate withholding is elected by the taxpayer) (STML Art 8-4)
- (5) dividends from income of publicly offered security investment trusts other than specific stock investment unit trusts
- (6) dividends from publicly offered, open-ended securities investment trusts of the company type, and
- (7) quasi-financial products.

Quasi-financial products

Quasi-financial products include the following (ITL Art 174(1)(iii) to (viii)):

- contracts regarding mortgage securities (*teito shoken*)
- contracts evidencing gold, precious metals and similar property repurchase agreements
- foreign currency deposits (*gaika yochokin*) payable in yen at maturity
- insurance contracts which provide for lump-sum premiums with an insurance period of five years or less, or which have been rescinded within five years from the beginning of the insurance period.

Law: Art 174(1)(iii) to Art 174(1)(viii) of the *Income Tax Law*; Art 3(1), Art 8-4 and Art 37-11 of the *Special Taxation Measures Law*

[¶3-370] Separate withholding tax rates

Table 23: Separate withholding tax rates

Type of income	Income Tax rate	Inhabitants Tax rate
Interest (ITL Art 182)	15%	5%
Dividends (ITL Art 182)	20%	
Dividends for which separate withholding taxation at source has been elected (STML Art 8-5)	35%	
Regular distributions of income from a securities investment trust (STML Art 8-2)	15%	5%
Income from original issue discount on bonds (STML Art 41-12)	18%	
Quasi-financial products (STML Art 41-10)	15%	5%
Qualified transfer of listed stocks through a dealer — before 2012 (the 2011 legislation extends the reduced 10% (7% national and 3% local) rate through 2013)	7%	3%
Qualified transfer of listed stocks through a dealer — after 2011 (after 2013 under the 2011 legislation)	15%	5%
Other stock transfers, including transfers of stocks other than listed stocks through a dealer and transfers by shareholders owning at least 5% (3% under legislation effective beginning on 1 October 2011) of the outstanding shares of the stock being transferred	15%	5%

Law: Art 182 of the *Income Tax Law*; Art 8-2, Art 8-5, Art 41-10 and Art 41-12 of the *Special Taxation Measures Law*

Table 25: Withholding table for employee bonus after deduction for social insurance payments

% Rate of withholding on bonus	Number of dependants and exemptions for handicapped persons, elderly persons, widows and working students										Column B	
	0		1		2		3		4			
	Column A: Prior month salary after deduction for social insurance payments											
	More than	Less than	More than	Less than	More than	Less than	More than	Less than	More than	Less than		
0	Less than 68		Less than 94		Less than 133		Less than 171		Less than 210			
2.042	68	79	94	243	133	269	171	295	210	300		
4.084	79	252	243	282	269	312	295	345	300	378		
6.126	252	300	282	338	312	369	345	398	378	424		
8.168	300	334	338	365	369	393	398	417	424	444		
10.210	334	363	365	394	393	420	417	445	444	470		
12.252	363	395	394	422	420	450	445	477	470	504		
14.294	395	426	422	455	450	484	477	513	504	543		
16.336	426	550	455	550	484	550	513	557	543	592		
18.378	550	668	550	689	550	710	557	730	592	751		
20.420	668	714	689	738	710	762	730	786	751	810		
22.462	714	750	738	775	762	801	786	826	810	852		
24.504	750	791	775	817	801	844	826	872	852	898		
26.546	791	847	817	876	844	901	872	925	898	949		
28.588	847	910	876	936	901	962	925	987	949	1,013		
30.630	910	997	936	1,003	962	1,031	937	1,058	1,013	1,086		
32.672	997	1,337	1,003	1,362	1,031	1,386	1,058	1,410	1,086	1,435		
35.735	1,337	1,551	1,362	1,579	1,386	1,607	1,410	1,636	1,435	1,664		
38.798	1,551	1,735	1,579	1,767	1,607	1,799	1,636	1,830	1,664	1,862		
40.840	1,735 and over		1,767 and over		1,799 and over		1,830 and over		1,862 and over			

% Rate of withholding on bonus	Number of dependants and exemptions for handicapped persons, elderly persons, widows and working students						Column B	
	5		6		7			
	Column A: Prior month salary after deduction for social insurance payments							
	More than	Less than	More than	Less than	More than	Less than		
0	Less than 243		Less than 275		Less than 308			
2.042	243	300	275	333	308	372		
4.084	300	406	333	431	372	456		
6.126	406	450	431	476	456	502		
8.168	450	472	476	499	502	527		

% Rate of withholding on bonus	Number of dependants and exemptions for handicapped persons, elderly persons, widows and working students						Column B	
	5		6		7			
	Column A: Prior month salary after deduction for social insurance payments							
	More than	Less than	More than	Less than	More than	Less than		
10.210	472	496	499	525	527	553	Less than 241	
12.252	496	531	525	559	553	588		
14.294	531	574	559	604	588	632		
16.336	574	622	604	652	632	683		
18.378	622	771	652	792	683	812		
20.420	771	834	792	859	812	884	241	305
22.462	834	879	859	902	884	925		
24.504	879	922	902	947	925	971		
26.546	922	973	947	997	971	1,021		
28.588	973	1,038	997	1,064	1,021	1,089		
30.630	1,038	1,113	1,064	1,140	1,089	1,168	305	563
32.672	1,113	1,459	1,140	1,484	1,168	1,508		
35.735	1,622	1,928	1,651	1,961	1,679	1,994		
38.798	1,692	1,894	1,720	1,925	1,749	1,957		
40.840	1,894 and over		1,925 and over		1,957 and over		555 and over	

Source: Ministry of Finance Notification No 115, 31 March 2012, Separate Schedule 3. (All figures other than percentage are in ¥1,000.)

Law: Separate Sch 3 of the Income Tax Law

[13-410] Withholding for employee health insurance ((Shakai) Kenkohoken Ryogaku (社会)健康保険料額)

The Japanese health insurance system provides coverage for medical and dental care at system hospitals and clinics for all residents in Japan. Employees and their dependants are covered under the Social Insurance system and are subject to the withholding payments described in the table below. A co-payment of 20% usually applies (30% for outpatient services provided to dependants). Other persons are covered under the National Health Insurance System where services generally require a 30% co-payment. Premiums for the National Health Insurance System are calculated by the city or ward office where the resident lives on an annual basis, from April to March the following year, based on income in the previous year and the number of family members.

- 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 2016. 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

year tax years, a portion of bonus expense will be paid in a tax year different from the year the employee services were rendered. Providing a deduction for additions to a reserve for bonuses allowed corporations to recognise bonus costs on a timely basis.

Diagram 5: Journal entry — addition to bonus reserve

Bonus reserve expense	XXX	
Bonus reserve		XXX

In order to make the tax system clearer and more uniform, the bonus reserve system has been abolished for tax years beginning on or after 1 April 1998. The system was phased out over five years, ending with tax years ending during the period from 1 April 2002 through 31 March 2002 when corporations could establish a reserve with only 1/6 of the amount permitted before the provision was abolished (former CTL Art 54).

Law: Former Art 54 of the *Corporation Tax Law*

[4-473] Reserve for retirement allowances (*Taishoku Kyuyo Hikiatate Kin* — 退職給与引当金)

The reserve for retirement allowances was abolished by legislation in 2002. Before the system was abolished, the maximum corporations could add to a reserve and deduct as an expense was the lower of (former CTL Art 54 and CTL-EO Art 106):

- (1) the amount of the increase in retirement allowances owed under union agreements or employment contracts
- (2) 20%* of the excess of the total retirement allowances owed over the balance of the retirement allowance reserve at the end of the year, or
- (3) 6% of compensation paid to employees (this option is not applicable if compensation is paid under a union agreement).

*For tax years beginning during the indicated periods, the following percentages were substituted for 20% in option 2 (former CTL-EO Art 106):

Tax years beginning during the period from	% of the balance of retirement reserve restored to income
1 April 2002 to 31 March 2003	30%
1 April 2003 to 31 March 2004	30%
1 April 2004 to 31 March 2005	20%
After 1 April 2005	20%

Reversion to income of retirement reserve balance

The retirement reserve system has been abolished and any balance of the reserve must be restored to income according to the schedule indicated. However, corporations with capital not exceeding ¥1m may restore the balance to income over 10 years.

Table 24: Restoration of retirement reserve to income

Tax years beginning during the period from	% of the balance of retirement reserve restored to income
1 April 2002 to 31 March 2003	30%
1 April 2003 to 31 March 2004	30%
1 April 2004 to 31 March 2005	20%
After 1 April 2005	20%

Diagram 6: Journal entries — reserve for retirement allowances

Adding to the reserve		
Retirement allowance reserve expense	XXX	
Retirement allowance reserve		XXX
Restoring the reserve to income		
Retirement allowance reserve	YYY	
Retirement allowance recovery income		YYY

Law: Former Art 54 of the *Corporation Tax Law*; former Art 106 of the *Corporation Tax Law Enforcement Order*

[4-474] Reserve for losses from investment (*Kaigai Toshi Nado Sonshitsu Junbi Kin* — 海外投資等損失準備金)

If a domestic Japanese corporation that files a blue tax return makes a designated investment in one of the designated corporations listed in the following table, and the investment is still held on the last day of the taxable year in which it was made, the percentage of the investment indicated in the table may be credited to a reserve for losses from the decline in value of the investment and deducted as an expense in the current taxable year (STML Art 55). Beginning in the sixth year after the credit to the reserve account, the amount credited must be added back into income ratably over the next 60 months. This reserve provision only applies to designated investments made during the period from 1 April 1973 to 31 March 2016.

Table 25: Reserve for losses from overseas investment

Designated corporation	Permissible designated investment	% of investment creditable to reserve
Natural resources development company	Newly issued or purchased stock	30%
Natural resources development investment company	Newly issued stock	30%
Natural resources prospecting company	Newly issued or purchased stock	100%
Natural resources prospecting investment company	Newly issued stock	100%

- computers for servers (limited to that used with the above operating systems)
- database management software (limited to ISO/IEC15408 certified)
- firewall software or equipment (limited to ISO/IEC15408 certified)
- software linking information systems in different departments or enterprises.

Table 29: Minimum investment in eligible assets required to qualify for the incentives

Minimum investment in eligible assets required to qualify for the incentives.	
Capital of the investing company	Minimum investment during the year
Over ¥1b	¥100m or more
Over ¥100m but not more than ¥1b	¥30m or more
Not more than ¥100m	¥3m (reduced to ¥700,000 by 2008 legislation)

Law: Former Art 42-11 of the *Special Measures Taxation Law*

¶4-644A Tax credit for promoting employment (Koyo Sokushin Zeisei — 雇用促進税制)

Legislation effective for tax years beginning on or after 1 April 2011, and until 31 March 2016, provides for a tax credit to corporations filing a blue tax return that increase employment during the year (*Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation* (2011) Art 17; STML Art 10-5, Art 42-12, Art 68-15-2). A similar credit is available for non-corporate employers under the Income Tax. A company is not eligible for the tax credit for promoting employment if it has made discretionary (*jigyonushi tsugo* — 事業主都合) reductions in employment in the current or prior year.

Amount of the credit. The amount of the credit is ¥200,000 for each new employee, determined as the increase in the number of employees covered under the employee unemployment insurance system (*koyo hoken* — 雇用保険, see ¶3-430) by the company in the current year compared to the prior year. Tax legislation in 2013 increases the amount of the credit to ¥400,000 for each new employee.

Income limit. The amount of the total tax credit for promoting employment for the year may not exceed 10% (20% for a medium- or small-sized company) of the company's taxable income before application of the credit.

Minimum increase in employees. A minimum increase of 10% of employees from the prior year and a minimum numerical increase of five employees (two for a medium- or small-sized company) is required for the credit to be available in the current year. Confirmation of the increase in the number of employees covered by the unemployment insurance system is required to be obtained from the public employment security office ("Hello Work").

Minimum increase in salaries. A minimum increase in the employer's salary cost is required to be determined using the salary increase formula below. The 30% factor ($60\% \times \frac{1}{2}$) is based on an estimate that new salaries will be approximately 60% of

existing workforce salaries and new employees may be estimated to be employed on the average for half of the initial employment year. For purposes of this calculation, salary paid to company officers (*yakuin*) or persons related to company officers is excluded.

Salary increase \geq The salary paid in the prior year \times % rate of increase in employees \times 30%

Law: Art 17 of the *Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation*

¶4-644B Tax credit for increase in salaries (Shotoku Kakudai Sokushin Zeisei — 所得拡大促進税制)

Legislation effective for tax years beginning between 1 April 2013 and 31 March 2018 provides for a tax credit to corporations filing a blue tax return that increase salaries by at least 5% compared with a base year (*Law to Partially Revise the Income Tax Law, etc.*, Law No 5 of 2013, 30 March 2013, Art 8 — 所得税法等の一部を改正する法律; STML Art 10-5-4, Art 42-12-4, Art 68-15-5). The 5% salary increase compared to a base year requirement has been revised by 2014 legislation effective for tax years ending on or after 1 April 2014 to require the following minimum increases in salaries compared to a base year:

- tax years beginning before 1 April 2015: 2%
- tax years beginning on or after 1 April 2015 but not after 31 March 2016: 3%
- tax years beginning on or after 1 April 2016 but not after 31 March 2018: 5%.

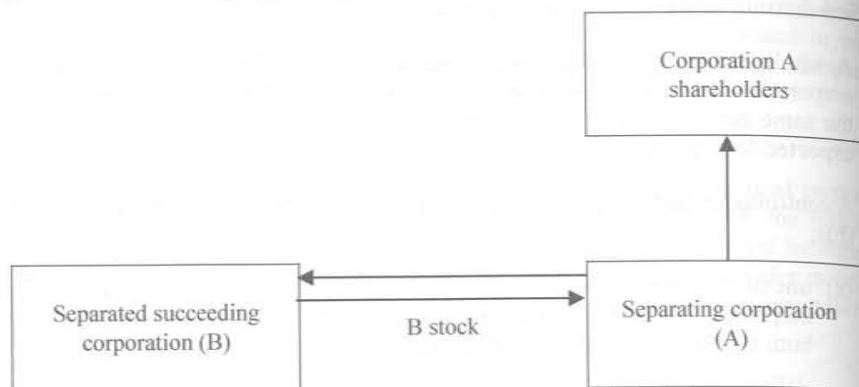
Amount of the credit. The credit is equal to 10% of the increase in salary payments over the previous year, but is not available when the tax credit for promoting employment (¶4-644A) is taken. Salary payments for purposes of the credit include only those paid to employees of company offices located in Japan and do not include payments to company directors or persons with a special relationship to company directors.

Credit limit. The amount of the total tax credit for promoting employment for the year may not exceed 10% (20% for a medium- or small-sized company) of the company's Corporation Tax before application of the credit.

Minimum increase in salaries. Three requirements must be satisfied in order to establish the necessary minimum increase in salaries.

- (1) The salary payments in the current year must be at least 5% greater than the salary payments in the base year. The base year for this purpose is the year preceding the first tax year beginning on or after 1 April 2013.
- (2) The salary payments in the current year must equal or exceed the salary payments in the prior year immediately preceding the current year.
- (3) The average salary payment in the current year must equal or exceed the average salary payment in the prior year immediately preceding the current year. For tax years ending on or after 1 April 2014, the average salary payment in the current year to continuing employees must exceed the average salary payment to those employees in the prior year immediately preceding the current year.

Diagram 11: Subsidiary-type corporate division



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

In a regular tax-free incorporation, the assets and liabilities are transferred by the transferring corporation and received by the subsidiary corporation (the “separated succeeding corporation”, *bunkatsu shokei hojin* (分割承継法人)) at their market values (CTL Art 62). In a qualified tax-free incorporation, the assets and liabilities are transferred and received at their book values and gain is deferred (CTL Art 62-5). A qualified tax-free incorporation may be structured as a wholly-owned industrial group internal investment-in-kind, a controlled industrial group internal investment-in-kind, or an investment-in-kind to manage a jointly-operated business (CTL Art 2(12-14)). The requirements for these qualified tax-free incorporations generally parallel those listed above for a wholly-owned industrial group internal corporate division, a controlled industrial group internal corporate division or a corporate division to manage a jointly-operated business. Certain property located in Japan, including real property, rights to real property, mining or quarrying rights, or assets and liabilities of a business, may not be transferred to a foreign corporation in a qualified tax-free incorporation (CTL Art 2(12-14); CTL-EO Art 4-2(7)).

Effective for transfers on or after the date of promulgation of the 2011 *Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation* (30 June 2011), a contribution of assets located outside of Japan by a foreign corporation to a domestic Japanese corporation does not qualify as a tax-free transaction (*Income Tax Law to Maintain the Tax System in Response to the Severe Economic Conditions and Employment Situation* (2011) Art 3).

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

A subsequent contribution-in-kind incorporation occurs if, within two years of its incorporation, a transferee corporation (*hijigo setsuritsu hojin* — 被事業設立法人) buys pre-existing assets (and liabilities) from a transferor corporation (*jigo setsuritsu hojin* — 事業設立法人) under a contract described in *Japanese Company Law* Art 467(1)(v) or

Insurance Business Law Art 62-2(1)(iv) (CTL Art 2(12-6, 7)). In a qualified subsequent contribution-in-kind incorporation, a gain or loss occurs if the consideration paid by the transferee is different from the cost basis of the net assets sold to the transferor (CTL Art 62-5). Any recognised gain or loss increases or decreases the basis of the transferee stock.

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

- (1) From the time of incorporation of the transferee corporation to the time of the subsequent contribution-in-kind, the transferor corporation has held all of the stock of the transferee corporation.
- (2) After the subsequent contribution-in-kind, the transferor corporation is expected to continue to hold all of the stock of the transferee corporation.
- (3) The subsequent contribution-in-kind has been arranged at the time of the incorporation of the transferee corporation and the subsequent contribution occurs within six months from that time of incorporation. (The tax office may extend this time in the event of unavoidable circumstances delaying the transfer.)
- (4) The price of the assets transferred in the subsequent contribution-in-kind is approximately the same as the amount paid in by the transferor corporation at the time of incorporation of the transferee corporation.

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

Example 9: Qualified subsequent contribution-in-kind incorporation

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

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

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

A share exchange occurs when the stock of an acquired company is received in exchange for stock of an acquiring company. A share transfer is a form of share exchange where the acquiring company is newly incorporated for the purpose of acquiring the stock of the acquired company. Unless a share exchange or share transfer is a qualified share

Type of vehicle (measure of size)	Size of vehicle	Tax	
		Private use (¥)	Commercial use (¥)
	More than 4, but not more than 5	25,500	18,500
Tractor (size)	Small	10,200	7,500
	Regular size	20,600	15,100
Bus (passenger capacity)	30 or less	33,000	12,000
	More than 30, but not more than 40	41,000	14,500
	More than 40, but not more than 50	49,000	17,500
	More than 50, but not more than 60	57,000	20,000
	More than 60, but not more than 70	65,500	22,500
Bus (passenger capacity)	More than 70, but not more than 80	74,000	25,500
	More than 80	83,000	29,000

Environmentally-friendly vehicles qualify for special reduced tax rates. For example, the tax rate is reduced by one-half for electric vehicles or vehicles fuelled by natural gas or methanol (Automobile Tax Law Attached Reg Art 12-3).

Law: Art 145(1) and Art 147 of the *Local Tax Law*; Art 12-3 of the *Automobile Tax Law Attached Regulations*

¶5-510 Automobile acquisition tax (*Jidosha Shutoku Zei* — 自動車取得税)

The automobile acquisition tax is a special purpose tax used to pay for road maintenance. The tax is collected by the prefecture where the vehicle is usually parked, but most of the funds are passed on to municipalities.

Taxpayer

A person who acquires a vehicle with three or more wheels is obligated to pay the automobile acquisition tax (LTL Art 699-2(1)).

Tax basis

The automobile acquisition tax is determined by multiplying the acquisition cost of the vehicle by the tax rate (LTL Art 699-7). If a vehicle is obtained in a transaction where no price is stated, such as a gift, the value of the vehicle is the tax basis.

Tax rate

The tax rate is 2% (3% for acquisitions before 1 April 2014) for vehicles used in business and light vehicles and 3% (5% for acquisitions before 1 April 2014) for private-use, non-commercial vehicles other than light vehicles (LTL Art 119; LTL Attached Reg Art 12-2-2(2)).

Exempt vehicles

Motorcycles and specified low emission vehicles are exempt from the tax, as are vehicles owned by the national or local governments. Vehicles obtained by inheritance or succession, or as the result of a corporate merger, are also not subject to the tax (LTL Art 699-4).

Special exemption

Between 1 April 1990 and 31 March 2018, vehicles with a cost of less than ¥500,000 are exempt from the tax (LTL Art 120, LTL Attached Reg Art 12-2-4).

Low-emission vehicles

Preferential rates of tax apply to the acquisition of low-emission vehicles (LTL Art 699-8; LTL Attached Reg Art 32).

Table 17: Preferential rates of tax for low-emission vehicles (LTL Attached Reg Art 12-2-3(1~8)).

Type of vehicle	Time of purchase	Preferential tax treatment
Electric, natural gas, clean diesel or plug-in hybrid car	1 April 2009 to 31 March 2015	Exempt from tax
Buses and trucks meeting specified exhaust emission regulatory standards and fuel economy standards	1 April 2010 to 31 March 2015	100%, 75%, 50% tax exemption depending on level of exhaust emission and fuel economy standards met

Tax payment

The tax is paid at the time when the vehicle is first registered or inspected. A tax return is required, to which a copy of the receipt for the vehicle should be attached (LTL Art 699-10, Art 699-13). If the vehicle is obtained in a registered transfer, the tax is paid within 15 days of the transfer. In all other cases, the tax is due within 15 days of the day the vehicle is acquired (LTL Art 699-11).

Law: Art 119, Art 120, Art 699-2(1), Art 699-4, Art 699-7, Art 699-8, Art 699-10, Art 699-11 and Art 699-13 of the *Local Tax Law*; Art 12-2-2(2), Art 12-2-3(1~8), Art 12-2-4, Art 32, Art 32(2) and Art 32(6) of the *Local Tax Law Attached Regulations*

¶5-520 Light vehicle tax (*Keijidosha Zei* — 軽自動車税)

The owner of a light vehicle, such as a motorcycle or small three- or four-wheeled vehicle, is subject to the light vehicle tax on a yearly basis. The tax is paid to the municipality where the vehicle is usually parked (LTL Art 442-1(1)). The tax is due by 1 April of each year (LTL Art 445(1)).

The basic exemption of ¥1,100,000 is not available to gifts for which the gift tax is settled at the time of inheritance. Gifts in excess of ¥25m from parents or grandparents are subject to Gift Tax at a rate of 20% (*Inheritance Tax Law* Art 21-13). Gift Tax on gifts from other donors is calculated under the regular system by deducting the basic exemption of ¥1,100,000 and computing the tax using the regular rate table (see ¶6-331).

Inheritance Tax calculations

When a parent or grandparent dies, property received from that parent or grandparent under the elective procedure is added to all other property inherited from that person, but at the amount of its value at the time of the gift (*Inheritance Tax Law* Art 21-15(1), Art 21-16(3)). Gift Tax previously paid on such property is deducted from the amount of Inheritance Tax (*Inheritance Tax Law* Art 21-15(3), Art 21-16(4)). If Gift Tax previously paid on such property exceeds the Inheritance Tax, a refund may be obtained by filing an Inheritance Tax Return (*Inheritance Tax Law* Art 27-3, Art 33-2(1)).

Making the election

An election to apply the "settlement at time of inheritance" procedure may be made by filing a notice of the election with the tax office between 1 February and 15 March of the year after receipt of the gift for which the election is to apply (*Inheritance Tax Law* Art 21-9(2)). The election must be made by each child or grandchild who wishes to use the elective procedure and, once made, cannot be revoked.

Special rules for gifts of non-traded stock

Until this provision terminated in 2008, special rules applied to a gift from a parent to a child of stock which does not have a quoted market price. If a donee child receives a gift of such stock from a parent between 1 January 2007 and 31 December 2008, the presumptive successor may elect to apply the "settlement at time of inheritance procedure" if the parent is at least 60 years of age (STML Art 70-3(3)). In this case, the amount of the special exemption available is increased by ¥5m, from ¥25m to ¥30m. To qualify for these special benefits, the following conditions must be satisfied:

- (1) The total value for estate tax purposes of the outstanding stock of the company must be less than ¥2 billion.
- (2) The following must be satisfied during the four-year period beginning with the date of the election:
 - (a) The donee child must own at least 50% of the stock of the company and at least 50% of the voting rights.
 - (b) The donee child must be engaged in the management of the company as a company representative (*daihyosha*).

Special rules for gifts for residences

Special rules apply to a gift from a parent or grandparent to a child or grandchild to purchase or improve a residence during the period from 1 January 2003 through 31 December 2014. The special rules allow the elective procedure to apply to gifts from parents or grandparents who are not 65 years of age (but the recipient must be at least 20

years old) and the maximum special exemption for gifts from parents is increased from ¥25m by the smaller of the amount of the gift to purchase or improve a residence or ¥10m, to a maximum special exemption of ¥35m (STML Art 70-3(1), Art 70-3-2(2)).

Effective for gifts on or after 1 January 2010, the ¥10m maximum increase in the special exemption is eliminated, limiting the special exemption to ¥25m.

Law: Art 21-9(1), Art 21-9(2), Art 21-12(1), Art 21-13, Art 21-15(1), Art 21-15(3), Art 21-16(3), Art 21-16(4), Art 27-3 and Art 33-2(1) of the *Inheritance Tax Law*; Art 70-3(1), Art 70-3-2(2) and Art 70-3(3) of the *Special Taxation Measures Law*; 2012 Draft of Law to Partially Revise the Consumption Tax Law in Order to Secure Stable Resources for Social Security

TAX RETURNS FOR INHERITANCE TAX AND GIFT TAX (SHINKOKU — 申告)

¶6-400] Tax returns for Inheritance Tax and Gift Tax (*Shinkoku* — 申告)

Both the Inheritance Tax and the Gift Tax use the self-assessment system where the taxpayer prepares a tax return and pays the amount of tax shown on the return.

Tax returns for Inheritance Tax

Every person who receives property by bequest or succession in an amount in excess of the basic exemption must file an Inheritance Tax return within ten months from the time that he or she becomes aware of the opening of succession (*Inheritance Tax Law* Art 27). If such a recipient ceases to have a residence or domicile in Japan before the expiration of the 10-month period, the tax return is due when the period of residence or domicile in Japan ends.

Joint return

A joint Inheritance Tax return may be filed by two or more heirs or successors to property from the same decedent (*Inheritance Tax Law* Art 27(4)).

Revised return

A revised return may be filed after the due date of the Inheritance Tax return if, after the original return is filed, one of the following events occurs:

- undivided interests in property reported as received by the successors has been divided and the value received differs from that originally reported
- the heirs or successors have changed
- a person entitled to a legally secured portion has requested an abatement of property, and
- a will has been discovered or a renunciation of a bequest has occurred.

- (ii) The foreign partner is a limited partner of the investment business Japanese partnership who does not otherwise have a permanent establishment in Japan, does not participate in the management of the Japanese partnership and individually owns less than 25% of the stock of the Japanese domestic corporation.

Law: Art 161(i) of the *Income Tax Law*; Art 177(2)(iv), Art 187(1)(iii)(b), Art 187(4), Art 187(5), Art 187(6) and Art 187(7) of the *Corporation Tax Law Enforcement Order*; Art 280(2)(iv), Art 291(1)(iii)(b), Art 291(4), Art 291(5), Art 291(6) and Art 291(7) of the *Income Tax Law Enforcement Order*; Art 26-31 and Art 39-33-2 of the *Special Taxation Measures Law Enforcement Order*

¶9-213 Gains from transfers of stock, etc, in a related real estate corporation
(*Fudosan Kanren Hojin* — 不動産関連法人)

The 2005 tax legislation added rules requiring gains from the transfer of certain beneficial interests in companies or trusts holding Japanese real estate to be reported on a tax return as Japanese source income subject to tax. The 2005 rules apply if the transferor owned more than 5% of the stock of a company or trust listed on an exchange that is transferred (or 2% of the stock or interest in a trust that is not listed) as of 31 December of the year before the transfer in the case of an individual, or as of the end of the tax year prior to the transfer in the case of a corporation. These rules apply to transfers by individuals on or after 1 January 2006 and to transfers by foreign corporations in years beginning on or after 1 April 2005 (ITL-EO Art 291(1)(iv), Art 291(8), Art 291(9)). The taxable interests are:

- (1) shares or other interests in a company if 50% or more of its asset value is attributed directly or indirectly to real property (including land, buildings and attachments) located in Japan
- (2) beneficial interests in a specified trust if 50% or more of its aggregate asset value consists of real estate located in Japan.

Income tax treaties may contain provisions which override the 2005 legislation. However, the *2004 Japan-US Income Tax Treaty* contains a provision similar to the above rules allowing source country taxation of company shares or trust interests if the underlying value of the interests consists primarily of source country real property (Art 13(2) of the *Japan-US Income Tax Treaty* (2004), see ¶10-334).

Law: Art 291(1)(iv), Art 291(8) and Art 291(9) of the *Income Tax Law Enforcement Order*

¶9-214 Japanese income arising from within and outside Japan

Regulations provide rules for allocating income between Japanese and non-Japanese sources in the event an individual or corporation engages in activities both within and outside Japan (ITL-EO Art 279; CTL-EO Art 176):

- (1) Inventory (other than real property) acquired outside Japan and sold in Japan without any manufacturing, processing or other value added by the seller outside Japan is Japanese source income.

- (2) If inventory is manufactured, harvested, extracted, etc, outside Japan and sold in Japan, or manufactured, etc, in Japan and sold outside Japan, the income on the sale is allocated between Japanese and non-Japanese sources based on arm's length principles.
- (3) Income from construction projects in Japan is Japanese source income regardless of where the contract was entered into or where the personnel or materials were obtained.
- (4) Income from international maritime activities is allocated to Japan based on the percentage of total revenues represented by passengers and cargo originating in Japan. The percentage of income from international aviation activities allocated to Japan is estimated using factors such as the amounts of revenues and expenditures arising in Japan or the amounts of assets employed in the activity located in Japan.
- (5) Income from casualty or life insurance business carried on within and outside Japan is allocated to Japan if the contract was concluded in a business place in Japan or through an agent in Japan.
- (6) Income from advertising services provided to other persons within and outside Japan by publishers or broadcasters is treated as Japanese source income to the extent derived from revenue received for advertising in Japan.
- (7) Income from other businesses is allocated between Japanese and non-Japanese sources based on arm's length principles and factors such as the amounts of revenues and expenditures arising in Japan or the amounts of assets employed in the activity located in Japan.
- (8) Inventory which was not made in Japan and is transferred outside Japan is not Japanese source income.
- (9) Providing auxiliary services, such as advertising, promotion, supplying information or performing market research, to a part of an enterprise located within Japan or outside Japan does not give rise to Japanese source income.
- (10) Providing money, industrial property rights or other property to a part of an enterprise located within Japan or outside Japan does not give rise to Japanese source income.
- (11) Income from lending or investing activities outside Japan by an office in Japan is treated as Japanese source income.

Law: Art 176 of the *Corporation Tax Law Enforcement Order*; Art 279 of the *Income Tax Law Enforcement Order*

¶9-215 Allocation of deductions within and outside Japan

There are regulations that provide rules for allocating deductions between a corporation's activities within and outside Japan (ITL-EO Art 292). Generally, these regulations apply principles similar to the rules for allocation of deductions of corporations with activities within and outside Japan (see ¶9-323).

Law: Art 292 of the *Income Tax Law Enforcement Order*

Table 6: Tax sparing provisions in Japan's Income Tax Treaties

Treaty country	Effective date	Provision for termination of tax sparing in:
Bangladesh	15 June 1991	N/A
Brazil	29 December 1977	N/A
China	26 June 1984	Ten years following the later of 2001 or the year of reduction of Chinese tax (applies only to enterprise income)
India	28 June 2006	2006
Malaysia	31 December 1999	2006
Mexico	6 November 1996	2005
Pakistan	1 August 1961	N/A
Pakistan (2008)	No tax sparing credit	
Philippines	2006 protocol provides for termination 10 years after the date the protocol entered into force (1 January 2009)	
Sri Lanka	22 September 1968	N/A
Thailand	31 August 1990	N/A
Vietnam	31 December 1995	2010
Zambia	23 January 1971	N/A

¶10-320] Business profits

Most of Japan's income tax treaties provide that business profits are not taxable by the source country unless they are attributable to a permanent establishment in that source country. An older principle that treats all source country income as business profits of a permanent establishment has disappeared from all of Japan's income tax treaties, with the exception of the 1959 treaty with Pakistan. Pakistan has requested that the treaty be revised to reform this provision.

Permanent establishments

Although the details vary by treaty, Japan's income tax treaties usually provide that a permanent establishment includes a branch permanent establishment, an agency permanent establishment and a construction activity permanent establishment.

Branch permanent establishment

A branch permanent establishment generally includes: a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Activities not constituting a permanent establishment

Activities of the following types are usually not considered permanent establishments under Japan's income tax treaties:

- the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise, or
- the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.

Dependent agency permanent establishment

Japan's tax treaties generally provide that if a person, other than an agent of independent status, acts on behalf of an enterprise and has, and habitually exercises, in a country the authority to conclude contracts in the name of the enterprise, the enterprise is deemed to have a permanent establishment in that country in respect of any activities which that person undertakes for the enterprise, unless the activities are limited to activities such as the purchase of goods or activities not constituting a permanent establishment.

Independent agency permanent establishment

Japan's income tax treaties usually provide that an enterprise will not be treated as having a permanent establishment in a country merely because it carries on business in that country through a broker, general commission agency or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

Construction activity permanent establishment

Under Japan's income tax treaties, an enterprise is usually deemed to have a permanent establishment in a country if it maintains activities such as building sites or construction or installation projects in the country for a period stipulated in the treaty.

¶10-330] Taxation of investment income

Japan's income tax treaties generally provide for reduced rates of tax imposed by the source country on dividends, interest and royalties received by residents of the home country.

¶10-331] Dividends

Japan's treaties typically tax ordinary dividends at a reduced rate of tax (the maximum rate of source country tax in the table below). A reduced rate is also commonly provided for dividends from a subsidiary corporation if the parent corporation owns at least a minimum percentage of the subsidiary's voting stock (see ownership % in the table below) for at least a specified number of months before the end of the accounting