Major Taxes paid by Corporations in Japan

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Taxes in Japan

Major Taxes paid by Corporations (Company, Legal Entity)

National Corporate Income Tax	(Houjin Zei)
Consumption Tax	(Shouhi Zei)
Prefecture Level Business Tax	(Jigyou Zei)
Prefecture Level Income Tax	(Dou-Fu-Ken Min Zei)
City/Town Level Income Tax	(Shi-Chou-Son Min Zei)
National Withholding Tax	(Gensen Shotoku Zei)
Property Tax	(Kotei Shisan Zei)
Stamp Tax	(Inshi Zei)
Business Office Tax	(Jigyousho Zei)

Major Taxes paid by Individuals

National Individual Income Tax	(Shotoku Zei)
Local Individual Income Tax	(Jumin Zei)
Inheritance Tax / Gift Tax	(Souzoku Zei / Zouyo Zei)

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Taxpayer

Domestic Corporation

Head Office or Main Office in Japan

Worldwide income

Foreign Corporation

Other than Domestic Corporation, typically a branch or a factory

Japan Source Income ex. Income from business in Japan

*Branch and factory is called Type 1 Permanent Establishment. In addition, there is Type 2 (Certain Construction Sites) and Type 3 (Certain Agents).

Tax Codes

Corporate Income Tax Law (CITL, sometimes referred to as Corporation Tax Act, in Japanese Houjin Zei Ho) and Special Measure Tax Law (SMTL, sometimes referred to as Act on Special Measures Concerning Taxation, in Japanese Sozei Tokubetsu Sochi Ho)

- Unofficial translations can be found on http://www.sozeishiryokan.or.jp/corporation_tax/corporation_tax2010e.html.
- Enforcement Orders by Cabinet and Enforcement Regulations by Ministry are also considered as laws.
- Interpretations of Laws by National Tax Agency (NTA) (Tsutatsu) is not a law, but tax auditors usually follow these interpretations.

Filing Due Date

Generally, Tax Return has to be filed within 2 months after the Fiscal Year End.

Extension of Filing can be admitted by 1 month if there is a good reason (audit by public auditor, AIC..).
Extensions for Local Corporate Income Taxes can be admitted by separate procedures.
No extensions are admitted for Japan Consumption Tax.
If not filed timely, Non-Filing Penalty will be assessed (5%, 15%, 20%) in addition to interest.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Tax Rate

Regular Corporation : 30% → 25.5% (28.05%)
Small Corporation : Up to JPY 8 million 18% → 15% (16.5%) (excl. a subsidiary of a big corporation)
Specific Public Corporation : 22% → 19% (20.9%)

*The new rate will be applied from the fiscal year starting on or after 2012/04/01. For 3 years until the fiscal year starting before or on 2015/3/31, 10 % additional tax for Recovery from the Earthquake/Tsunami will be added.

Blue Return

CIT Return can be filed in a blue form (in the past, the color of the paper was blue) if approved by the Tax Office.
Taxpayer has to prepare accounting books correctly and file tax return in time.
One of the biggest benefits of a blue return is that Net Operating Loss Carryover can be used.

Financial Statements to be based

Financial Statements to be used as a base for preparing tax return need to be approved by Shareholders.
These Financial Statements need to be prepared in accordance with Generally Accepted Accounting Standards in Japan.
Income on the Financial Statements will be adjusted to reach to the Taxable Income as stipulated in Tax Law.
There are several items that need to be expensed to be deductible for tax purpose.

Ex. Depreciation
If Maximum Tax Depreciation for a machine is 1,000 and the corporation expensed only 100 on its accounting book, the Tax Depreciation allowed is 100 only.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Net Operating Loss (NOL)

Certain NOL Carry Back or Carry Forward is permitted only when Blue Return is approved.
For a certain corporation, NOL can be Carried Back for 1 year.
Generally, NOL Carry Forward is permitted for 7 years until the fiscal year starting before 2012/04/01.
Generally, except for a small corporation or a Tokutei Mokuteki Kaisha (TMK), from the fiscal year starting on or after 2012/04/01, the taxable income that can be used for NOL Carry Forward is limited to the 80% of Current Taxable Income, but the NOL Carry Forward is permitted for 9 years.
When there is a change in the ownership of a corporation, NOL Carry Back / Carry Forward might be influenced to avoid tax evasion.

Revenue

All sources of economic benefits including revenue from business operation and capital gain are included in Revenue.
Accrual Basis is adopted. Within several approaches in accrual basis, revenue is recorded when the rights to a property is acquired (when title is transferred) ("Rights Acquired Basis").
Additionally, under certain circumstances, revenue is recognized when cash is under control ("Control Basis").

Expenses

All of expenses including loss from business operation and capital loss are included in Expenses.
However, except for depreciation expenses, expenses of which liabilities have not been fixed cannot be deducted ("Fixed Liabilities Basis"). For instance, basically, estimated expenses for bonus allowance are not deductible.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Consolidated Tax Returns

A group of domestic corporations can file a consolidated tax return by their election.

If elected, ALL of the 100 % subsidiaries have to participate this Consolidated Return.

At the time of election, corporations have to re-evaluate certain assets with Fair Value, and the differences from the book values have to be captured as income or deductions.

Before the 2010 (Heisei 22)Tax Reform, it was not possible to bring in subsidiaries' NOL and the NOL was to be extinguished, but now, it is possible to bring in with some limitations.

Consolidated Tax Return is allowed only for National Corporate Income Tax purpose, and Consumption tax nor Local Taxes do not allow consolidated returns.

National Group Corporate Tax

Introduced by 2010 (Heisei 22) Tax Reform. The aimed corporations are fully controlled corporations, including subsidiaries of foreign corporations.

There are some similarities between Group Corporate Tax Law and Consolidated Tax Return System.

Group Corporate Tax Law is applied to all corporations without any elections.

There are several areas that are impacted by this law, but 2 major areas may be as follows:

1. There are several measures that alleviate tax burdens of small corporations (generally, capital is equal to or less than 100 million JPY), but if a small corporation is fully owned by a large corporation (capital is equal to or more than 500 million JPY), these alleviations cannot be used anymore. Examples of alleviations measures are decreased tax rate, additional tax on retained earnings of certain closely held corporation (see the following page) and deductibility of entertainment expenses.
2. Gains and Losses from the sale of certain assets (in general, fixed asset, land, securities etc whose fair value is more than 10 million yen) among domestic group corporations are not recognized until these assets are sold to other persons not in the same group.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Special Treatments of Closely Held Corporations

There are a lot of special tax treatments for Closely Held Corporations ("CHC", Douzoku Kaisha).

CHC is defined in Corporate Income Tax law as follows:

CHC is a corporation in which more than half of its shares are held by equal to or fewer than 3 persons and their related individuals or their related corporations. A person includes both an individual and a corporation. And, related individuals include relatives, a spouse, an unmarried partner and other specific person.

Major special treatments under National Corporate Income Tax Law are:

1. Acts or Calculations by CHC
   If the Tax Office considers that an act or calculation by a CHC reduces the burden of National Corporate Income Tax unreasonably, the Tax Office has a power to deny the acts or calculations, and the Tax Office can recalculate the tax base or tax amount as appropriate.
2. Retained Earning Tax for specific CHC
   In general, the target corporation of this treatment is a CHC in which more than half of its shares are held by one person and its related individuals or its related corporations. But if the person is a corporation, and if the corporation is not owned by one person and its related individuals or related corporations, this rule does not apply.
   Additionally, this rule does not apply if its capital is equal to or less than 100 million yen. However, if the corporation is owned by a large corporation, this rule applies.
   When this rule applies, 10% to 20% of certain retained earnings needs to be paid additionally.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Remunerations for Directors

Remunerations for Directors need special attention in Japan. Traditionally, bonuses to Directors were considered as paid out of Profit (not an expense of a corporation), and treated as non-deductible for tax purposes. However, these days, some portions are treated as deductible with strict limitations. Financially, these items are permanent book-tax differences and might affect effective tax rate.

In general, only 3 following types of regular remunerations are deductible from Corporate Income Tax perspective.

1. Fixed-Term-Fixed-Amount Salary
   This means a monthly salary (fixed-term) in the same amount (fixed-amount). If the monthly amount is not the same among months, they are treated as non-deductible.
   It is considered that the increase of Directors Salaries are decided by Annual General Shareholders' Meeting. Therefore, the increase needs to take place within 3 months after the beginning of a new fiscal year, just after the Annual General Shareholder's Meeting.
   Unreasonably high amounts are not deductible.
   Fringe Benefits such as Monthly Payment for Corporation Provided Housing will be treated as Fixed-Term-Fixed-Amount. Payment frequency of Fringe Benefit has to be watched carefully.
2. Pre-Determined-Notified Salary
   This is a salary to be paid in accordance with a determination to pay at a certain time, and the determination has to be notified to the Tax Office. The main type of this salary is:
   - Determination at a Shareholder's General Meeting
     The notification to the Tax Office has to be made within 1 month after the meeting or within 4 months after the beginning of the fiscal year, whichever earlier.
3. Profit Based Salary
   This is a salary based on the performance of a corporation, but a Closely Held Corporation such as a 100% subsidiary of a foreign corporation cannot use this type. Very strict and complicated rules exist.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Tax Laws and Tax Treaty

As of 2011 October, Japan has tax treaties with 63 countries (number of treaties are 52).
In Japan, a tax treaty overrides tax laws if there are any discrepancies.

Charitable Contribution and Other Contributions

In Japan, Charitable Contribution and Other Contributions defined in National Corporate Income Tax Law are much broader than regular charitable contributions. When a corporation transfer assets or render services free of charge or at lower prices than fair values, it is very probable the Tax Office will considers these transactions as Other Contributions.
There is a limit of the deductible amount for Other Contributions, and the deductible amount is very small. It is planned that the limit of the deductible amount is reduced further from the fiscal year starting on or after 2012/4/1.

Entertainment Expenses

Sometimes, Entertainment expenses, Other Contributions, Advertisement expenses, Employee Benefits expenses might be very difficult to distinguish, but they are treated differently for National Corporate Income Tax purpose. For instance, condolence money for employee's relative in accordance with rules of employment is deductible as an Employee Benefit expenses, but condolence money for a supplier is considered as an Entertainment Expense and generally is not deductible.
For a small corporation, except for a subsidiary of a large corporation, up to 6 million yen, 90% of Entertainment Expense is deductible. However, for a large corporation, there is no deductible amount.

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Transfer Pricing

When a corporation has transactions with a foreign related party and the transactions are not made at the Arm's Length Prices, the Tax Office will assume that these transactions were made at the Arm's Length Prices.

There are several methods to calculate the Arm's Length Prices, and the following methods will be used to calculate Arm's Length Price as appropriate:

(1) Comparable Uncontrolled Pricing method (CUP)
(2) Resale Price method (RP)
(3) Cost Plus method (CP)
(4) Profit Split method (PS)
(5) Transactional Net Margin method (TNMM)

A corporation can have an Advance Pricing Agreement (APA) with the competent tax authority in Japan.

If a corporation is taxed because of Transfer Pricing, and if Japan has a tax treaty with the other country, the corporation can request Japanese competent authority to start mutual agreement procedures with the other country's competent authority to eliminate international double tax.

There are several English guidelines by the Tax Office, but a little bit old.
http://www.nta.go.jp/foreign_language/07.pdf (in English)
http://www.nta.go.jp/shiraberu/zeiho-kaishaku/jimu-unei/hojin/010601/00.htm (in Japanese)

Overview of National Corporate Income Tax (Houjin Zei) in Japan

Thin Capital

Interest payment is a deductible expense, but dividend is not deductible under National Corporate Income Tax Law. In order to avoid tax erosion by using this difference, there is a measure to block this. Generally, if borrowings (including guarantee) from foreign controlling shareholders are 3 times bigger than the capital amount, some portion of interest payment is not deductible.

Additionally, in the Tax Reform 2012, it is planned that certain interest expense bigger than half of profit will become non-deductible.

Tax Haven (Controlled Foreign Corporation)

A domestic corporation can incorporate a subsidiary in a low tax country or a jurisdiction, and by using this foreign corporation it might be possible to evade Japanese tax. In order to avoid this type of tax erosion, some profit of Specific Foreign Subsidiary is incorporated into the domestic corporation, and National Corporate Income Tax will be levied.

There are several tests to judge whether this article applies or not, and one of them depends on the corporate income tax rate of the country or area (Trigger Tax Rate). There was a tax reform in 2010 (Heisei 22), and the current trigger tax rate is reduced to 20% from 25%.

Foreign Tax Credit

There are 2 ways to eliminate international double taxation. One way is to use Foreign Tax Credit and the other is to use Foreign Income Exclusion.

In general, Japan uses Foreign Tax Credit (FTC). In the past, it was also possible to use FTC for foreign income taxes paid by certain subsidiaries, but after the Tax Reform 2009 (Heisei 21), as for the dividends from certain subsidiaries, FTC cannot be used but Foreign Income Exclusion (up to 95%) can be used under some limitations.

In Bailiwick of Guernsey, it is possible for a corporation to decide the corporate income tax rate with the government, but this tax is not eligible for FTC from 2011/6/30.

Overview of National Withholding Tax (Gensen Shotoku Zei) in Japan

National Withholding Taxes

When a person makes payments, the person might need to withhold certain amount of payments in accordance with Individual Income Tax Law (IITL, sometimes referred to as Income Tax Act, in Japanese Shotoku Zei Ho) or Special Measure Tax Law (SMTL, sometimes referred to as Act on Special Measures Concerning Taxation, in Japanese Sozei Tokubetsu Sochi Ho).

In addition to National Withholding Taxes, Local Withholding Taxes may apply to certain payments such as interests paid by financial institutions.

The purpose of National Withholding Tax is either as a backup to be settled later at the time of Tax Return / Year End Adjustment, or as a final tax payment in Japan.

Examples of payments that need withholding are:

1. Salary/Wage/Bonus to Residents
2. Retirement Pay to Residents
3. Certain Interests to Residents or Domestic Corporations
4. Certain Dividends to Residents or Domestic Corporations
5. Certain Public Pensions to Residents
6. Certain Private Pensions, Profit Distributions from TK or others to Residents or Domestic Corporations
7. Most of payments to Residents : This type includes payments to
   - Professionals such as Lawyers, Certified Public Accountants, Certified Tax Accountants, etc.
   - Translators,
   - Instructors such as English Teachers,
   - Investment Advisors,
   - Designers, etc.

The amount to be withhold depends on type of work, but usually 10 % of the amount up to JPY 1 million and 20 % for the amount above JPY 1 million. From 2013, Additional Tax to help Recovery will be added.

Overview of National Withholding Tax (Gensen Shotoku Zei) in Japan

Withholding Taxes (Continued)

Examples of payments that need withholding are (Continued) :

8. Certain payments to Non-Resident Individuals or Foreign Corporations: This type includes payments of
   - Most of Nin-i-Kumiai (NK) profit distribution,
   - Real Estate sales proceeds,
   - Payments to compensate for dispatching certain personal services to others ,
   - Rental Payments for Real Estate, ships, airplanes, etc.,
   - Interests,
   - Dividends,
   - Royalties,
   - Payments for translation,
   - Software development expenditures,
   - Salaries, Public Pensions, etc.,
   - Prizes for advertizing business,
   - Pensions based on insurance agreements, etc.
   - TK profit distribution, etc.

   However, if Japan and the country where the Non-Resident or Foreign Corporation is located have a Tax Treaty and the Tax Treaty has different stipulations, the Tax Treaty overwrites the tax law.

   The Withholding Tax Rate is 10%, 15% or 20% depending on the type of payments. From 2013, Additional Tax to help Recovery will be added (2.1% of original withholding tax).

   Salary Payments to a Non-Resident by a foreign corporation might need special attention when the office in Japan was a branch. In this case, the salary paid in a foreign country is deemed to have been paid by the Japanese branch, and the Japanese branch is liable to withhold tax, and has to withhold 20% of the payment (From 2013, Additional Tax to Help Recovery will apply). This applies to stock options exercised after repatriated too (http://www.nta.go.jp/shiraberu/zeiho-kaishaku/shitsugi/gensen/06/48.htm).

Overview of National Withholding Tax (Gensen Shotoku Zei) in Japan

Responsibility / Due Date / Penalty

It is the payer who has to withhold the tax amount even if there is no description of withholding on the invoice. And, generally, the amount withheld has to be paid to the Tax Office on the 10th of the following month of the payment, which is quite a tough schedule.

If the payer was not able to make the payment to the Tax Office timely, the payer has to pay penalty which is equal to 5% or 10% of Withholding Tax, and interest, which are not deductible for the Corporate Income Tax purpose.

Ex.
A corporation received a JPY 100 million invoice from an Indian Software corporation based in India (no PE in Japan) as Software Development Fee. The corporation has to withhold JPY 20 million and pay JPY 80 million to the Indian Software corporation.
If the company fails to withhold JPY 20 million, and pays JPY 100 million to the Indian Software corporation, the corporation will have to do the following:

The company has to pay JPY 20 million as withholding tax,
The company has to pay JPY 2 million as a penalty + interest, and
The company has to request the Indian Software corporation to return the JPY 20 million.

Overview of Consumption Tax (Shouhi Zei) in Japan

Nature of Consumption Tax

Consumption Tax (CT) is similar to Value Added Tax in Europe. This can be categorized as a multi-stage indirect tax, and charged to almost all domestic transactions.

Taxpayer

There are 2 types of Taxpayers for Consumption Tax.

1. Business Person

Generally, if a Business Person executes sale of taxable assets, lending of taxable assets, or performing of services with a price in Japan, the Business Person is liable for Consumption Tax.

Business Person includes both individuals and corporations, but this overview describes Consumption Tax of corporations only.

If the sale in the Base Period (usually 2 years ago) is equal to or less than JPY 10 million yen, the Business Person does not have to pay Consumption Tax, unless otherwise is elected. From 2013, another test to check the sales volume or total salaries of the first half of the previous year will be needed to decide whether the Business Person is liable for Consumption Tax or not.

There is a special rule for a newly established corporation. Generally, if the amount of capital is less than JPY 10 million yen, it is not liable for consumption tax unless otherwise is elected.

The above applies to foreign corporations even if the corporations do not have a branch or a Permanent Establishment (PE) in Japan.

2. Goods imported from abroad

Generally, all the persons who import goods from abroad have to pay Consumption Tax.

Tax Codes

Consumption Tax Law (CTL, sometimes referred to as Consumption Tax Act, in Japanese Shouhi Zei Ho)

Overview of Consumption Tax (Shouhi Zei) in Japan

Filing Due Date

Generally, Consumption Tax Return has to be filed within 2 months after a fiscal year end.
Generally, NO EXTENSIONS are allowed !!

Tax Rate

Currently, there is only 1 rate which is 5%. 4% is National Consumption Tax portion and 1% is Local Consumption Tax portion.
As for the goods exported from Japan and services rendered to Non-Residents, generally, Consumption Tax Rate is 0%, and called as Tax Exempt (Men-zei) Transactions.

* It is planned that Tax Rate is increased to 10 % by the middle of 2010's. The increased revenue is planned to be used for social insurance.

Type of Transactions

1. Taxable Transaction: A transaction which CT is charged.
2. Tax Exempt (Men-Zei) Transaction: The same as 0% CT. A transaction which is similar to export that includes a transaction to export goods and certain services performed to a Non-Resident. Transportation of Passengers or Cargo, Telecommunication, or mail between Japan and other countries also falls into this category. It is required to keep certain documents to be eligible for this treatment.
3. Non-Taxable (Hi-Kazei) Transaction: A transaction which CT is not charged because of nature of transaction or because of government policy.
4. Out-Of-Scope (Fu-Kazei) Transaction: A transaction which CT is out of scope. This type includes a transaction in an overseas country, a transaction without a price such as a general donation, contribution, and dividend on equity.

Overview of Consumption Tax (Shouhi Zei) in Japan

Non-Taxable (Hi-Kazei) Transactions

Major Non-Taxable Transactions include the following. It is considered that AP accountants need to understand these so that they can record the Consumption Tax correctly.

1. Sale or Lending of Land, including rights on Land.
However, lending of land for shorter than 1 month, or lending of land in association with premises such as parking lot is not a Non-Taxable transaction.
2. Sale of certain Securities and Monetary Assets including Government Bond and Stocks.
3. Sale of Payment Means in general.
4. Interest, Guarantee Fee, Insurance Premium, etc.
5. Sale of Postal Stamp, Stamp Duty, etc.
6. Sale of Gift Certificate, Prepaid Card, etc.
7. Most of Service Fee performed by government body.
8. Service Fee for Foreign Exchange Operation.
9. Certain Medical Service Fee except for cosmetic treatments or over-the-counter medicines.
10. Certain Service Fee for services provided under Long-Term Care Insurance Act.
11. Certain Service Fee for services provided under Social Welfare Act.
12. Certain Service Fee for delivering a child provided by obstetricians and other persons.
13. Service Fee for cremation or burial.
14. Sale or Lending of certain equipments for handicapped persons.
15. Fee for certain Schools.
16. Sale of certain books to be used at elementary schools, junior high schools or high schools.
17. Lending of certain housing to be used for dwelling.

Overview of Consumption Tax (Shouhi Zei) in Japan

Transaction in Japan

Whether a transaction was executed in Japan is decided depending on the location as follows in accordance with type of transaction.

1. Sale or Lending of Asset

General Rule: The location of Asset when the sale or lending is executed.

Exceptions:
(1) Ships: The location of Registration Agency.
(2) Airplanes: The location of Registration Agency.
(3) Mining Right, Quarrying Right etc: The location where the mine, the quarry etc. is located.
(4) Patent Right, Trademark Right, etc: The location of Registration Agency. If registered at multiple agencies, the main office address of seller/lender.
(5) Copyrights and know-how: The main office address of seller/lender.
(6) Goodwill, Fishing Right: The main office address of the person who performs the business.
(7) Securities (except for Golf Facility Usage Stock): The place where the Securities are located.
(8) Registered Government Bonds: The location of Registration Agency.
(9) Investment in Certain Corporations: The main office address of the legal person.
(10) Monetary Assets: The location of an Lender's Office in charge of the sale.
(11) Golf Facility Usage Stock: The location of the Golf Course.
(12) Asset whose location is not clear: The location of Office in charge of the sale or the lending.

Overview of Consumption Tax (Shouhi Zei) in Japan

Transaction in Japan (Continued)

2. Performance of Services

General Rule: The location where the service is performed.

Exceptions:

(1) Transportation of Passengers and Cargo between Japan and foreign countries:
Either Departing Location or Arriving Location

(2) Telecommunication between Japan and foreign countries:
Either Outgoing Location or Incoming Location

(3) Mail Services between Japan and foreign countries:
Either Outgoing Location or Incoming Location

(4) Insurance:
The location of office involved in the insurance contract.

(5) Information Provision or Design
The location of office involved in the Information Provision or Design.

(6) Service performed in association with Research and Planning requiring Professional Science Technology that involves Construction or Manufacturing of Production Plant etc:
The location where most of materials required for Construction or Manufacturing of Production Plant etc are obtained.

(7) Service whose location of performance is not clear :
The location of office which involves in the performance of the service.

3. Lending of Money
The location of the office in charge of the Lending.

Overview of Consumption Tax (Shouhi Zei) in Japan

Tax Exempt (Men-Zei) Transaction

The following transactions are exempt from Consumption Tax.

(1) Sale or Lending of Asset in the form of Export from Japan

(2) Sale or Lending of Foreign Cargo

(3) Transportation of Passengers or Cargo, or Telecommunication between Japan and foreign countries.

(4) Sale and Lending of Airplanes or Ships that are mostly used for transportation of (3) above to Vessel Operators, and certain repairs paid to Vessel Operators

(5) Transactions similar to above

- (a) Sale, Lending or Repairs of Overseas Vessels to Vessel Operators, and services in association with Overseas Vessels
- (b) Services in association with Cargo Handling, Transportation, Storage, Tally, Appraisal, etc of Foreign Cargo
- (c) Mail between Japan and foreign countries
- (d) Sale and Lending of Intangible Fixed Asset etc to Non-Resident
- (e) Services to Non-Resident except for the following:
  - (i) Transportation or Storage of Assets located in Japan.
  - (ii) Eating, Drinking and Accommodation in Japan
  - (iii) VERY SIMILAR (Junjiru) services to above whose benefits can be enjoyed in Japan directly.

In order to be treated as a tax exempt transaction, certain documents have to be kept for 7 years and 2 months after a fiscal year end.

The definition of Non-Resident is different from the definition in the Individual Income Tax Law, and includes a branch in Japan. It is defined in Foreign Exchange and Foreign Trade Act.

Overview of Consumption Tax (Shouhi Zei) in Japan

Calculation of Consumption Tax Payable

There are 2 types of calculation.

1. Standard Method

The basic calculation is as follows:

CT on Taxable Sale
– (minus)
Amount based on CT on Taxable Purchases (“Purchases CT Deduction”)

Unfortunately, calculation of Purchases CT Deduction is complicated. The calculation is different depending on the Taxable Sale Ratio.

$$\text{Taxable Sale Ratio} = \frac{\text{Taxable Sale (excluding CT)}}{\text{Gross Sale (excluding CT)}}$$

Both Gross Sale and Taxable Sale include Tax Exempt Sale and Bad Debt Sale.
Gross Sales includes Non-Taxable Sale, but does not include Out-Of-Scope transactions, Sale of Payment Means, Sale of certain Account Receivables, certain Repurchase Agreement of bonds (sell and buy: similar to financing).
However, the gain or loss from certain Resale Agreement of bonds (buy and sell: basically receiving interest) are included in Gross Sale.
As for certain securities, the amount to be add in Gross Sale is 5% only of the Sale Price.

In order to be eligible for Purchase CT Deduction, supporting documents such as invoices, accounting books have to be kept in the office for at least for 7 years and 2 months after a fiscal year end.

Overview of Consumption Tax (Shouhi Zei) in Japan

Calculation of Consumption Tax Payable (Continued)

1. Standard Method (continued)

   (1) If Taxable Sale Ratio is equal to or more than 95%, and from the fiscal year starting on or after 2012 April, if the Taxable Sale is equal to or less than JPY 500 million,

   Purchases CT Deduction = The same amount as CT paid.

   (2) If Taxable Sale Ratio is less than 95%, or from the fiscal year starting on or after 2012 April, if the Taxable Sale is more than JPY 500 million,

   The amount of Purchases CT Deduction is limited to the amount that corresponds to Taxable Sale.

   The taxpayer has to elect either of the 2 options, and if Pro-Rata is elected, the taxpayer has to maintain the elected option at least for 2 years.

   (i) Individual Matching Method

   All of transactions have to be categorized into 3 types.

   (a) Purchases associated with Taxable Sale Only
   (b) Purchases associated with Non-Taxable Sale Only
   (c) Purchases associated with both Taxable Sale and Non-Taxable Sale

   Purchases CT Deduction = (a) + (c) x Taxable Sale Ratio

   Instead of Taxable Sale Ratio, other reasonable ratio can be used if approved by the Tax Authority.

   (ii) Pro-Rata Method

   Purchases CT Deduction = CT Paid x Taxable Sale Ratio

Overview of Consumption Tax (Shouhi Zei) in Japan

Calculation of Consumption Tax Payable (Continued)

2. Simplified Method

If the Taxable Sale in the Base Period is equal to or less than JPY 50 million, the taxpayer can elect to use Deemed Purchase Ratio. If the taxpayer performs only 1 Business Type, the calculation of Purchase CT Deduction is as follows:

Purchases CT Deduction = Net CT Received X Deemed Purchase Ratio

Deemed Purchase Ratio is different depending on the Business Type as follows:

Wholesale Business:	90%
Retail Business:	80%
Manufacturing Business:	70%
Other Business:	60%
Service Business:	50%

Because Simplified Method uses only the Sales side numbers, No Refund is possible even if Purchases are bigger than the Taxable Sale. An election should be made cautiously.

Once Simplified Method is elected, it is not allowed to change the method for at least 2 years.