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Asia-Pacific Region



Doing Business in

# Japan

Nov 2010



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# Doing Business in Japan

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## Introduction

This guide is written for foreign companies and individuals interested in doing business in Japan. It outlines key facts and figures on Japan's economy, business infrastructure, laws and taxation. This information contained herein is for guidance only and no responsibility for loss from action taken based on any material herein can be accepted. It is recommended readers obtain further information and professional advice prior to making any decision.

## About JHI

JHI is a flourishing worldwide network of approximately 130 member firms in 55 countries. The largest association of its kind, JHI exists to enhance the ability of member firms and their clients to drive business locally and internationally through a variety of distinctive programs and services.

Its members are respected leaders, offering a broad range of accounting, auditing and management consultancy services in every business sector. They play key roles in setting the course for the profession. This extends to JHI members who serve in leading positions with worldwide bodies such as the Forum of Firms, an organization of international firms that perform audits of financial statements that are, or may be, used across national borders. Potential new members are subject to a rigorous selection process based on criteria including the quality of practice, reputation and geographical location.



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# Doing Business in Japan



## JHI in Japan

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# Doing Business in Japan



## Key Facts

**Population:** 127,360,000  
(Sep 2010 est.)  
**Currency:** Japanese Yen  
**Time Zone:** Japan Standard Time (JST) is 8 hours ahead of GMT (GMT+8)

**Dialling Code :** +81  
**Language :** Japanese  
**Fiscal Year :** 1 Apr - 31 Mar  
**Business hours :** 0900 - 1700  
Monday to Friday

**Public holidays :** There are 15 national holidays in 2010.

## Political overview

The Constitution of Japan, which came into effect in 1947, is based on the principles of popular sovereignty, respect for fundamental human rights and advocacy of peace. Japan's political system is one of constitutional democracy. The emperor is the symbol of the State and unity of the people.

The Constitution of Japan proclaims a system of representative democracy in which the Diet is the highest organ of state power. It is formally specified that the Diet, as the core of Japan's system of governance, takes precedence over the

government's executive branch. The designation of the prime minister, who heads the executive branch, is done by resolution of the Diet. Japan practices a system of parliamentary cabinet by which the prime minister appoints the majority of the cabinet members from among members of the Diet.

The Diet is divided into two chambers: the lower chamber, or the House of Representatives, and the upper chamber, or the House of Councilors.

# Doing Business in Japan

## Economy

Once Japanese economy had registered negative growth after the global financial crisis in the fall of 2008, it has been recovering gradually since the second quarter in 2009 thanks to the export to the expanding market in Asia and the economic-stimulus package for consumption such as automobile and consumer-electronics introduced by Japanese government. Japanese economy accounted for 8.7% of the world GDP in 2009 and the GDP is expected to achieve 1.9% growth in 2010.

In Japanese markets and industries, the following four sectors are seen to have significant potential for future

growth in addition to the automotive sector as represented by the Japanese top global automakers.

- Information and Communication Technology
- Medical and Health Care
- Automotive parts
- Environment

The Japanese central bank has kept the interest rate at 0.10% as of August 2010, which is the lowest rate in the world's leading economies.

## Legal and judicial system

In accordance with the principle of separation of powers, the activities of national government are formally divided into legislative, judicial, and executive organs and the independent standing of the judicial branch of government is protected. All legal conflict, whether of a civil, administrative, or criminal nature, are subject to judgment in courts of law.

Established by the constitution, the Supreme Court is Japan's highest judicial organ and there are four types of

lower courts- high courts, district courts, family courts and summary courts. Japan's court system is basically a three-trial system in which parties to a dispute have the right to undergo two additional court hearing and decisions following initial court hearing and decision. The lay judge system, in which ordinary individuals chosen from among Japan's citizens deliberate alongside judges at designated criminal trials, went into effect on May 21, 2009.



## Immigration to Japan

### Types of working statuses

Below are shown the principal statuses of residence related to investment in Japan and the activities authorized in Japan for each status.

#### Investor/Business Manager

1. A person who invests in, commences and operates a business in Japan
2. A person who operates a business in Japan on behalf of the foreign nationals or foreign corporations that invested in and commenced that business (the chief executive officer or representative director responsible for that business) or
3. A person engaged in the management of a business in Japan on behalf of the foreign nationals or foreign corporations that invested in and commenced that business (e.g. a director or department manager employed in the management of that business under the chief executive officer or representative director).

#### Legal/Accounting Services

Activities to engage in the legal or accounting business. An applicant must be a foreign attorney, a foreign

certified public accountant or those with some other legal qualifications.

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## Engineer

Activities to engage in services that require technology and/or knowledge pertinent to physical science,

engineering, or other natural science fields, on the basis of a contract with a public or private organization in Japan.

## Specialist in Humanities/ International Services

Activities to engage in services that require knowledge pertinent to jurisprudence, economics, sociology or other human science fields, or to engage in services that

require specific ways of thought or sensitivity based on experience with foreign culture, on the basis of a contract with a public or private organization in Japan.

## Intra-company Transferee

Activities on the part of personnel who are transferred to business offices in Japan for a limited period of time from business offices that are established in foreign countries by public or private organizations which have head offices,

branch offices or other business offices in Japan and who engage at the business offices in the activities described under “Engineer” or “Specialist in Humanities/International Services”.

## Skilled Labor

Activities to engage in services that require industrial techniques or skills belonging to special fields, on the

basis of a contract with a public or private organization in Japan.

## Family members accompanying working foreign nationals

Spouses and children dependent on working foreign nationals are granted a “Dependent” status of residence. Activities such as attendance at school fall within the scope of activities of a “Dependent”, but work for compensation is in principle prohibited;

part-time work (in principle no more than 28 hours per week) is possible if permission to engage in activities other than that permitted under the status of residence previously granted is received.

# Doing Business in Japan



## Setting up a Business in Japan

### Introduction

Japan is a business destination that offers abundant potential for foreign enterprises to increase their profit. The number of firms seeking to expand their business

in Japan with a long-term investment strategy is steadily increasing. Foreign companies generally establish a business presence in Japan in one of four modes.

### Representative offices

Representative offices are established as locations for carrying out preparatory and supplemental tasks aimed at enabling foreign companies to engage in full-scale business operations in Japan. These offices may conduct market surveys, collect information, purchase goods and implement publicity/advertising efforts, but they are not permitted to engage in sales activities. The

establishment of representative offices does not require registration. A representative office cannot ordinarily open bank accounts or lease real estate in its own name, so agreements for such purposes must instead be signed by the head office of the foreign company or the representative at the representative office in an individual capacity.

### Branch offices

The simplest means for a foreign company to establish a base for business operations in Japan is to set up a branch office. The branch office can begin business operations as soon as an office location is secured, the branch office representative determined, and the necessary information registered. A Japanese branch office is a business location that provides services in Japan decided upon by an organization authorized by the foreign company, and ordinarily is not expected to

engage in independent decision making. A branch office does not have its own legal corporate status, but instead is deemed to be encompassed within the corporate status of the foreign company. In general, therefore, the foreign company is ultimately responsible for all debts and credits generated by the activities of its Japanese branch office. A Japanese branch office, however, may open bank accounts and lease real estate in its own name.

# Doing Business in Japan

## Companies

A foreign company establishing a subsidiary company in Japan must choose to establish the subsidiary company as either a joint-stock corporation (Kabushiki-Kaisha (K. K.)) or limited liability company (Godo-Kaisha (LLC)) stipulated by Japan's Corporate Law. Both unlimited partnerships (Gomei-Kaisha) and limited partnerships (Goshi-Kaisha) are granted corporate status under the Corporate Law, but they are rarely chosen in practice. All types of subsidiary companies can be established by completing the required procedures stipulated by law and then registering the

corporation. A subsidiary is a separate corporation from the foreign company, so the foreign company will bear the liability of an equity participant stipulated by law for all debts and credits generated by the activities of the subsidiary. Other methods by which a foreign company may invest in Japan using a Japanese corporation but without establishing a subsidiary are by establishing a joint venture with a Japanese enterprise or investment company, and by equity participation in a Japanese enterprise.

## Limited Liability Partnerships

It is also possible to do business by using a Yugen Sekinin Jigyo Kumiai. This type of entity, considered the Japanese version of a limited liability partnership (LLP), is not a corporation, but a partnership formed only by the equity participants, who have limited liability. LLPs

are also distinguished by the fact that internal rules can be freely determined by agreement between the equity participants, and that taxes are levied on profits allocated to equity participants without LLPs themselves being liable for taxation.

# Doing Business in Japan



## Foreign Investment

Foreign Direct Investment (FDI) in Japan has been steadily increasing. The amount of FDI into Japan at the end of 2008 was 18.5 trillion yen (3.6% of GDP) and grew 3.4 trillion yen from the end of 2007, the maximum growth rate in the past. Japanese government set a goal of increasing FDI more than 5% of GDP by 2010.

The foreign exchange law stipulates that foreign investors need to report to the finance minister and the minister in charge at the investment unless the investments are exempt from the procedures. Under the revision to the foreign exchange law in 1992, it is only

necessary to file most of the reports to the ministers after the investment. The prior notifications to the ministers are necessary when the foreign investment is made from the investors in specific countries or regions and the businesses they invest are special industries such as armaments and nuclear industries.

Generally, foreign investors can purchase all kinds of real estate in Japan freely. The foreign investors who purchase real estate in Japan need to report to the finance minister within 20 days after the acquisition date in some cases.

# Doing Business in Japan



## Employment

Japan has a number of laws pertaining to labor and the protection of workers. These include: the Labor Standards Law which sets forth the minimum standards on working conditions; the Industrial Safety and Health Law which sets forth the minimum standards on working conditions regarding health and safety; and the Minimum Wage Law. These laws apply

in principle to all enterprises in Japan, regardless of whether the employer is Japanese or foreign, or the company is a foreign or Japanese-registered corporation. They also apply to foreign workers in Japan provided that the foreign workers meet the definition of workers under these laws.



# Taxation

## Corporate Income Tax

### Taxation of foreign companies

Foreign corporations beginning operations in Japan often use a representative office or branch office. A representative office can not engage in sales activity or have a permanent establishment such as a factory or warehouse in Japan. Generally, no income tax or corporate tax is payable in Japan for a representative office. On the other hand, a branch office is treated as

a permanent establishment and is subject to corporation tax on its entire Japanese source of income. Under tax treaties, a foreign corporation may be exempt from taxation on industrial or commercial profit derived in Japan if the income is not attributed to a branch office or other permanent establishment in Japan.

### Calculating taxable income

The amount of income used as the tax base for corporate taxes for each taxable year is determined by making the necessary tax adjustments to corporate profits calculated using accounting standards generally accepted as fair and appropriate. Costs and expenses incurred in earning profits are deductible, except in certain exceptional instances, such as nondeductible entertainment expenses and bonuses or excessive retirement benefits for directors.

Foreign corporations face no restrictions as to the costs and expenses incurred in Japan and deducted from Japanese source of income. However, detailed statements must be prepared in case that the costs and expenses are incurred overseas and deducted from income in Japan. These costs and expenses should be allocated fairly in accordance with the arm's-length principle.

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## Corporate income tax rates

**Corporate Tax (national tax):** 30% of taxable income

In case of the capital amount of the company with less than one hundred million Yen, the corporate tax rate for taxable income up to 8 million Yen is reduced at 18%. In addition to the national tax above, inhabitant tax, enterprise tax, and special local corporate tax, they are all local taxes, are levied on income. The standard tax rates for the company with less than one hundred million Yen of share capital are as follows:

**Inhabitant tax (local tax):** 17.3% of the national corporate tax

**Enterprise tax and special local corporate tax total (local tax):**

Taxable Income	Tax Rate
Up to 4,000,000 yen	5.0%
Over 4,000,000 yen or under 8,000,000 yen	7.3%
Over 8,000,000 yen	9.6%

A size-based corporate tax, where enterprise tax is computed based on not only income, but also value added and share capital, is applied for a company with at least one hundred million Yen of share capital.

## Depreciation

Fixed assets are classified as either depreciable or non-depreciable assets. Depreciable assets include buildings, machinery, automobiles, tools and equipment. Land and leaseholds are classified as non-depreciable assets. Generally, the declining method and straight-line

method are used to calculate depreciation expenses except for buildings. Only the straight-line method is allowed to use for the buildings. The useful lives of each depreciable asset are designated by the law.

## Carrying losses forward and Carryback rules

There are two types of corporate tax returns, Blue form returns and White form returns. Net operating loss can be carried over seven years if the corporation files a blue form returns.

Carryback rule may be applied to the blue form return corporation having its share capital of less than one hundred million Yen.

## Thin-capitalization rules

If a corporation's borrowing from an overseas controlling shareholder exceeds three times its equity (or an alternative reasonable ratio), interest on

borrowing corresponding to the excess cannot be deducted from taxable income.

## Individual Income Tax

An individual who has a domicile in Japan and an individual who has a residence in Japan for more than one year are treated as a resident. A resident is further classified into permanent resident and non-permanent resident. A resident having a domicile or residence in Japan for more than five years treated as permanent resident and the worldwide income, regardless of the location of the source of income, is subject to Japanese income tax. A resident having no Japanese citizenship and having a domicile or residence in Japan for less than five years during the most recent ten-year period is a non-permanent resident. The scope of taxation for non-permanent residents corresponds to that for residents, but tax will not be assessed in Japan on income sourced outside Japan as long as that income is not paid within Japan or is not remitted to Japan. All individuals other than residents are nonresident and income derived in Japan is subject to Japanese income tax.

The tax rates for Japanese income tax on individual income are as follows:

Brackets of Taxable Income	Tax Rate
Under 1,950,000 yen	5%
Over 1,950,000 yen Or under 3,300,000 yen	10%
Over 3,300,000 yen Or under 6,950,000 yen	20%
Over 6,950,000 yen Or under 9,000,000 yen	23%
Over 9,000,000 yen Or under 18,000,000 yen	33%
Over 18,000,000 yen	40%

An individual who has a domicile in Japan as of January 1 each year are subject to individual residential taxes (prefectural tax and municipal tax). Individual residential taxes are assessed based on income and deductions of the previous year.

The standard rates of individual residential taxes are:

Prefectural tax rate	Flat rate	4%
Municipal tax rate	Flat rate	6%

Individuals engaged in certain businesses specified in local tax laws must pay enterprise taxes. Individual enterprise tax rates range from 3% to 5%, depending on the type of business.

## Withholding Tax

Foreign corporations and non-residents are subject to Japanese tax on the Japanese source income. The payments such as dividends, interest and royalties made in Japan to a foreign corporation or a non-resident will be subject to withholding income tax unless they have a permanent establishment in Japan. The withholding tax rates for typical type of incomes are as follows:

Type of Income	Tax Rate
Qualified dividends from listed companies	7%
Other dividends	20%
Interest from government bonds, bonds issued by Japanese corporations and interest on deposit with a bank office in Japan	15%

Type of Income	Tax Rate
Other interest	20%
Royalties	20%
Gains from transfer of real property	10%
Salaries, wages, bonuses and other compensation	20%

Japan has concluded tax treaties with 55 countries. Under the tax treaties, the withholding tax rates above may be reduced or the foreign corporations and non-residents may be exempt from the withholding tax if the requirements are met.



## Consumption tax, Customs duty

### Consumption tax

The domestic and import transactions, except for certain transactions such as financial transactions and capital transactions, are subject to consumption tax.

The aggregate consumption tax rate is 5%, consisting of the national consumption tax rate of 4% and the local consumption tax of 1%.

### Customs duty

There are many kinds of Customs rates and the rate depends on what type of the goods you import and from where you import.

### Real property acquisition tax

The real property acquisition tax is a prefectural tax on individuals or corporations who acquire land or who acquire or construct houses located in the prefecture during the year. The basis for the tax is fair market value of the property at the time of acquisition.

The basis of a residential property may be reduced if the requirements are met.

The tax rates applied for land and residential building is 3% and for building other than residential purpose is 4%.



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## Fixed assets tax and City planning tax

The fixed assets tax and city planning tax are municipal flat-rate taxes imposed on the registered owner of the property located in cities, towns, and villages according to the fixed asset tax rolls as of 1 January of each year.

The standard tax rate of fixed assets tax is 1.4% and city planning tax is 0.3%, total 1.7% of the fair market value of the property as recorded in the tax rolls.