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COUNTRY

Doing Business in Japan

Preface

This guide has been prepared by Baker Tilly Japan, an independent member of Baker Tilly International. It is designed to provide information on a number of subjects important to those considering investing or doing business in Japan.

Baker Tilly International is the world's 8th largest accountancy and business advisory network by combined fee income, and is represented by 138 firms in 104 countries and over 24,000 personnel worldwide. Its members are high quality, independent accountancy and business advisory firms, all of whom are committed to providing the best possible service to their clients, both in their own marketplace and across the world.

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Doing Business in Japan has been designed for the information of readers. Whilst every effort has been made to ensure accuracy, information contained in this guide may not be comprehensive and recipients should not act upon it without seeking professional advice. Facts and figures presented are correct at the time of writing.

Up-to-date advice and general assistance on Japanese matters can be obtained from Baker Tilly Japan; contact details can be found at the end of this guide.

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1 Fact Sheet

Geography

Location	Situated in eastern Asia, Japan consists of about 6,800 islands, of which Honshu, Hokkaido, Kyushu and Shikoku are the largest. Japan's closest neighbours are Korea, Taiwan and China. The Sea of Japan separates the Asian continent from the Japanese archipelago
Area	378,000km²
Land boundaries	None
Coastline	29,751km
Climate	Varies from tropical in the south to cool temperate in the north; characterised by four distinct seasons
Terrain	Mostly rugged and mountainous
Time zone	GMT +9

People

Population	Over 126 million; most reside in densely populated urban areas. The population of the Tokyo metropolitan area, including the city, some of its suburbs and the surrounding area, is approximately 12 million
Ethnic groups	Japanese 98.5%, Korean 0.5%, Chinese 0.4%, other 0.6%
Religion	Shinto and Buddhist 84%, other 16%
Language	Japanese

Government

Country name	Japan
Government type	Constitutional monarchy with a parliamentary government
Capital	Tokyo
Administrative divisions	The National Diet is the highest organ of state power and the sole law making body. It consists of the House of Representatives (480 seats) and the House of Counsellor (247 seats). The judiciary, which is completely independent of the executive and legislative branches of government, consists of the Supreme Court, eight high courts, a district court in each of the prefectures except for Hokkaido, which has four, and a number of summary courts. In addition, there are many family courts to adjudicate domestic complaints

Economy

GDP – per capita	US$40,000 (2007)
GDP – real growth rate	2.1% (2007 est.)
Labour force	66.69 million (2007 est.)
Unemployment	5.4%
Currency (code)	Yen (JPY)

2. Business Entities and Accounting

2.1 Companies

2.1.1 Joint stock corporation (KK)

A joint stock corporation is governed by directors and officers, has perpetual life and limited liability.

Legal authority for the management of a joint stock corporation lies with the board of directors. At least one director must be appointed by resolution or at a shareholders' meeting.

Directors may be held personally liable to the entity and to third parties for damages resulting from personal transactions with the corporation, approval of illegal distribution of profit, granting loans from the corporation to a director, acting in competition with the corporation or violation of law or the articles of incorporation.

Each entity must appoint at least one representative director, who is authorised by law to perform all acts on behalf of the corporation and bind it with respect to third parties without further corporate authorisation.

Joint stock corporations with capital of JPY500m or aggregated liabilities of JPY20bn must appoint an independent auditor who must be a certified public accountant or a firm of certified public accountants.

2.1.2 Limited liability company (LLC)

A limited liability company is an independent legal entity, has perpetual life and limited liability. Management authority is vested in the directors, who represent the corporation.

A limited corporation must have at least one director with authority to represent the entity, to perform all acts on its behalf and to bind it with respect to third parties without further corporate authorisation. The limited corporation is not required to appoint a statutory auditor.

2.2 Partnerships

2.2.1 Unlimited commercial partnership corporation

All partners are jointly and severally liable for the partnership's obligations. The unlimited commercial partnership corporation is a separate legal entity for all purposes, including tax purposes. Corporations may not be partners of the unlimited commercial partnership corporation.

Each partner has the right and duty to manage the affairs of the partnership corporation unless otherwise provided in the articles. Each partner has the authority to represent and to bind the partnership to third parties. A withdrawn or removed partner remains liable for all partnership obligations for a period of two years. Upon dissolution, the partners remain liable for obligations of the partnership corporation for a period of five years.

2.2.2 Limited commercial partnership corporation

A limited commercial partnership corporation has partners of both unlimited and limited liability. The liability of limited partners cannot exceed the amount of their partnership contributions. The limited commercial partnership corporation is a separate legal entity for taxation purposes.

A limited partner of a limited commercial partnership corporation may not bind the partnership corporation with respect to third parties.

2.2.3 Civil code association

For Japanese tax purposes, profits and losses of a civil code association flow through to the members in proportion to their interests. The association itself does not file a tax return nor is the association recognised as a corporation under the Commercial Code. Rights to profits and liability for obligations and losses accrue to members in proportion to their respective contributions unless otherwise provided in the association agreement.

2.2.4 Undisclosed association

An undisclosed association is an arrangement whereby an individual or entity undertakes a business activity on behalf of one or more undisclosed partners who receive or bear a portion of the ultimate gain or loss in the business activity. Each undisclosed partner has a separate contract with the entity and there is no contractual relationship between the undisclosed partners. The undisclosed partners report for tax purposes their portion of the ultimate gain or loss as agreed by contract.

For legal purposes, the establishing entity is considered to be conducting business and owns all assets and is liable for all liabilities of the business, although the partnership contract may provide for the undisclosed partners to bear a portion of such liabilities.

2.3 Sole Proprietorships

Sole proprietorship is the structure commonly used is respect of retail shops and small sub-contractors.

2.4 Branches

Establishment by a foreign enterprise of a branch office in Japan as its base for business is considered to be a “direct domestic investment” under the Foreign Exchange and Foreign Trade Control Law. The branch office is required to report to the Minister of Finance and other relevant ministers after its establishment and to register as a foreign company under the provisions of the Commercial Code.

2.5 Audit and Accounting Requirements

Shareholders’ meetings must be held no later than three months after the company’s financial year-end. The company’s financial statement must be approved by the shareholders at that meeting.

There is no external independent audit requirement for small companies (those with capital amount less than JPY500m and aggregated liabilities less than JPY20bn).

3. Finance and Investment

The environment pertaining to foreign investment is relatively benign. Capital may be freely repatriated and foreign companies may seek a listing on the Nikkei (the Tokyo stock exchange).

There are no foreign exchange controls, although some transactions must be reported.

The Bank of Japan is the country's central bank. The bank is responsible for currency and monetary control in order to maintain the stability of Japan's financial system.

3.1 Investment Incentives

The Government of Japan imposes few formal restrictions on foreign direct investment (FDI) in Japan.

There is a variety of financial support programmes designed to help international businesses participate in the Japanese marketplace. Support comes in the form of trade/import financing, research and development grants and project financing. Other incentive programmes are provided through local government on a project specific basis.

Additionally, tax concessions are available to branches of foreign corporations. These include carry-back and carry-forward of tax losses and tax credits for qualifying expenditures.

4. Employment Regulation and Social Security

4.1 Work Permits

A work permit (work visa) is required prior to working in Japan. These may be valid for either one or three years and the application process is usually straight forward.

Dependents' and students' visas do not confer the right to work.

4.2 Engagement and Dismissal

Most terms and conditions of employment are stipulated in work rules established by each employer. Provided that the conditions comply with Japanese law, the work rules are regarded as being equivalent to the content of an employment contract. However, any contract provision that is more favourable to the employee than the work rules takes precedence. An employer must make the work rules known to all employees.

Work rules typically cover:

- Working hours and days
- Regular wages
- Extraordinary and minimum wages
- Disciplinary action, including grounds for suspension and termination of employment
- Compulsory retirement
- Other matters that apply generally to all employees at the work place.

Dismissal is particularly difficult in Japan. An employer may dismiss an employee only if there is a justifiable rationale, eg a loss or significant lack in ability/capability to do the work, misconduct or breach of the work rules, or a strong business necessity (where there is no alternative to achieve the personnel reduction).

Advance notice of at least 30 days must usually be given (unless a longer notice is stipulated in either the work rules or the employment contract) prior to termination. If notification is not given within this time, the employer must pay a minimum of 30 days' of average wage. If payment of average wage has been made for any number of days, the period of notification may be shortened by that number.

4.3 Trade Unions and Worker Councils

The Constitution of Japan guarantees the right to organise and to act and bargain collectively. Further, the Trade Union Law prohibits employers from refusing collective bargaining with a union or interfering with a trade union's operation.

Almost all issues over which the employer has any control are regarded as coming within the scope of collective bargaining.

4.4 Social Security Contributions

There are four types of social welfare insurance applicable to almost all businesses in Japan:

- Health insurance
- Welfare pension insurance
- Workers' compensation insurance for accidents
- Unemployment insurance.

Employers are subject to various reporting requirements and failure to comply with such requirements may result in criminal liabilities. The premiums borne by the employer are tax deductible.

5. Taxation

Japan has both national and local taxes.

	National	Local
Taxes on income	Income tax (withholding income tax and assessment income tax) Corporation tax	Prefecture inhabitant tax Enterprise tax Municipal inhabitant tax
Taxes on property		Fixed asset tax
Taxes on consumption	Consumption tax	Local consumption tax
Taxes on transactions	Stamp tax Registration and license tax	Real property acquisition tax

Land value tax is imposed on both individuals and corporations. The basic rate is 0.15% and exemptions may apply.

5.1 Corporate Taxes

- The corporation tax rate is 30%.
- The corporation tax rate applied to income up to JPY8m is 22% provided that total equity is less than JPY100m.
- In addition to the national corporation tax, there are two classes of local tax paid by the corporation:
  - Local inhabitant tax (not deductible)
  - Business enterprise tax (deductible).

  These significantly increase the rate of corporation tax to around 40% – 42%.
- Dividend income is not classed as regular income. Dividends received by one Japanese company from another when the holding in the equity is less than 25%, are taxed at 20% of the dividend after deducting financing expenses.

There are special provisions for tax to be deducted at source from the following payments:

- Royalties – 20%
- Dividends – 20%
- Interest – 20%
- Interest on bonds, bank deposits – 15% (non-resident only).

These rates may be reduced if the recipient is a resident of a country with which Japan has a tax treaty.

Interest on government bonds is exempt from deduction at source (non-resident only).

Business enterprise tax is assessed upon enterprises managed in Japan. The rates for corporations are 5.6% – 12.1% (the higher rate is in respect of a corporation with income in excess of JPY8m).

Local inhabitant tax varies between regions; it is comprised of a capital levy (between JPY70,000 and JPY3.8m) and an income levy (rates vary between 17.3% and 20.7%).

5.2 Individual Taxes

Taxation of an individual's income is progressive at rates ranging from 5% – 40%. Reduced rates of tax for certain income earners apply.

Tax Table (Rates Applicable for 2007)

(Unit: JPY1,000)

From	Less than	Tax rate	Amount of deduction
–	1,950	5%	–
1,950	3,300	10%	97.5
3,300	6,950	20%	427.5
6,950	9,000	23%	636.0
9,000	18,000	33%	1,536.0
18,000	–	40%	2,796.0

Individuals pay tax on their income as a wage earner or as a self-employed person. Tax for individuals who meets the criteria of a "permanent resident" in Japan is calculated on their income in Japan and abroad. A foreign resident who is employed in Japan pays tax only on income earned in Japan.

Generally, there are three classes of tax payers:

- Permanent resident
- Non-permanent resident (those who have been living in Japan for less than five years)
- Non-resident.

Self-employed individuals are liable to business enterprise tax at 3% – 5% and the income levy portion of local inhabitant tax at the rate of 10%.

5.2.1 Capital gains

Capital gains are added to and generally taxed as regular income.

Specific rules apply to capital gains arising on the sale of real estate and shares. These may result in the application of rates of tax different to those charged on regular income.

5.2.2 Inheritance tax

In the case of Japanese residents, all inheritances are taxed, including those that have their source overseas. For foreign residents the obligation is solely in respect of assets in Japan. The rates of the tax are between 10% – 70%, imposed progressively according to the value of the asset. There is an additional tax of 20% when the matters concern an inheritance by an heir who is not a family member.

The inheritance is subject to a basic exemption of JPY50m and each heir benefits from an exception of JPY10m.

5.2.3 Gift tax

The basis of gift tax is similar to that stated for inheritance tax. A gift to an individual by a corporation is subject to income tax and not to gift tax.

A basic exemption of JPY1.1m per calendar year applies.

5.3 Expatriates

Expatriates are liable for income and inhabitant tax.

Branches established in Japan by foreign enterprises are usually liable to income tax applicable to permanent residents.

Expatriates are treated as non-permanent resident taxpayers for the first five years of residence in Japan and as permanent resident taxpayers thereafter.

Permanent residents are taxed on their worldwide income. Non-permanent residents are taxed on Japanese income sources and overseas income on a remittance basis.

Income tax is payable each calendar year.

Inhabitant tax for the calendar year is calculated based on taxable income for the preceding calendar year. It is assessed on residents in Japan as of 1 January of the taxable year. Therefore, if an expatriate terminates their assignment in Japan and leaves Japan on 2 January, they are liable for the entire inhabitant tax for the year of their departure from Japan based on the taxable income for the preceding year.

5.4 Indirect Taxes

5.4.1 Consumption tax

Consumption tax is similar to value added tax (VAT) and is imposed on most sales and services provided in Japan and on imports. Businesses may offset consumption tax paid on expenses against the tax due on income. The consumption tax rate is 5%.

Companies with capital of JPY10m or more are required to file consumption tax returns. Companies with capital less than JPY10m are exempt from the requirement to file consumption tax returns for the first two fiscal years. Thereafter, returns are required for fiscal years in which taxable sales exceed JPY10m. Exempt companies may elect to be treated as a taxable enterprise during the first two fiscal years. Such an election may be beneficial if consumption tax recoverable on purchases exceeds consumption tax payable on sales.

5.4.2 Import duties

The average tariff rate is 3.4%. Japan adheres to the harmonised system (HS) of product classification and duties are generally assessed on the cost, insurance and freight (cif) value at *ad valorem* or specific rates. In some cases a combination of both is charged.

5.5 Other Taxes

5.5.1 Stamp duty

Stamp duty is imposed upon 20 types of contract, such as the transfer of real estate, the right of lease, construction business, trade notes receivable etc.

5.5.2 Real estate purchase tax

The basic rate is 4% although this is reduced to 3% for resident real estate.

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