This report provides helpful information on the current business environment in Japan. It is designed to assist companies in doing business and establishing effective banking arrangements. This is one of a series of reports on countries around the world.

Global Banking Service

Report on Japan

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RBC Royal Bank®

Important to Know

Official language

- Japanese

Currency

- Yen (JPY)

Bank holidays

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Source: www.goodbusinessday.com.

Types of Business Structure

Under Japanese law, there are many different business structures available. Broadly, there are two types: corporations (*kaisha)* and partnerships (*kumiai*). Joint stock companies are the most typical business structure in Japan. A financial institution must hold the paid share capital in a restricted account until the business is legally established.

Kaisha

Corporations are governed by the Company Law of 2005, which became effective in May 2006. *Mochibun kaisha* are a class of corporations that combine the legal personality of a *kaisha* with the functionality of partnerships.

Public limited liability company

KK (*Kabushiki-Kaisha*). This is a company whose shares are not registered to their owners and are tradable on a public stock market.

Private limited liability company

GK / LLC (*Godo-Kaisha*). This is a company whose shares are registered to their owners and therefore are not publicly tradable. This requires a minimum share capital of JPY 1. A GK is a type of *mochibun kaisha*.

Kumiai

Silent /anonymous partnership

TK (*Tokumei kumiai*). A TK, which is governed by the Commercial Code, is an arrangement in which anonymous (silent) partners invest in a venture operated by a manager. This is similar to a limited partnership and it has no legal personality.

General partnership

Nin-i kumiai. This is a partnership that is governed by the Civil Code, in which all partners have full and joint liability.

Limited liability partnership

LLP (*Yugen Sekinin Jigyo Kumiai*). This is a partnership formed only by the equity participants, who all enjoy limited liability. Taxes are levied on profits allocated to equity participants, not the LLP. This requires a share capital of JPY 2.

Cooperatives

There are many cooperatives (*kyodo-kumiai*) in Japan for various sectors, particularly in agriculture, but also medical care, insurance, housing, universities and for credit unions. A Shinkin bank is a cooperative regional bank for SMEs and local residents.

Branches and representative offices

Non-Japanese companies are entitled to establish a branch or a representative office in Japan. A branch's activities are subject to Japanese company law, although it is considered part of the company's head office and thus not a separate legal entity.

Branches require no minimum share capital. To open a branch, a company must file a number of documents, including head office accounts. While branches are permitted to make sales, representative offices may not sell directly in Japan. The establishment of representative offices does not require registration.

Opening and Operating Bank Accounts

Residency

To be considered resident, a company must have its principal or head office in Japan, unless it is considered resident in another country under a double taxation treaty.

Domestic and foreign currency account restrictions

Residents are permitted to hold local currency (JPY) accounts outside Japan and foreign currency accounts both within and outside Japan.

Non-residents are permitted to hold local currency and foreign currency accounts in Japan.

All local currency accounts are fully convertible into foreign currency.

Anti-money laundering and counter-terrorist financing rules

- Account opening procedures require formal identification of the account holder.
- Financial institutions have to identify clients for domestic or international transactions, including wire transfers exceeding JPY 100,000.

Supplied by BCL Burton Copeland (www.bcl.com). Data as at July 2009.

Special purpose accounts required by local regulation

None.

Value-added tax (VAT) on banking services

Under Japanese law, banking and financial services are subject to Japanese Consumption Tax (JCT) at a standard rate of 5%. Transfer or leasing of land, transfer of securities, transfer or exchange of currency, interest on loans, guarantee fees and insurance premiums, and medical care covered by insurance are exempted. All export transactions are zero-rated.

Payment and Collection Instruments

Electronic funds transfers are the most common payment instrument for domestic payments in Japan by value. They can be initiated using Internet and other electronic banking facilities. Non-urgent bulk credit transfers are the primary payment method used to make payroll payments. They are also a common method of payment for business-to-business and supplier payments, along with cheques and promissory notes. Both debit and credit card payments are commonly used for consumer transactions, with a significant rise in credit card usage in the past few years.

Pre-authorized direct debits are increasingly used by utility and mortgage companies to collect domestic payments, but there is no standardized direct debit scheme in Japan. Cheques have been in decline in favour of electronic forms of payment, but, although rarely used by individuals, are still used by the Japanese government and by companies. Promissory notes are still a popular method of cashless payment for business-to-business transactions. The use of electronic money schemes is growing for low-value consumer payments.

Payment Instrument Use (domestic)

Payment instrument	Transactions (million)		% change 2007/2006	Traffic (value) (JPY billion)		% change 2007/2006
	2006	2007		2006	2007	
Cheques	134.2	123.6	– 7.9	477.9	463.3	– 3.1
Credit transfers	1,361.6	1,398.0	2.7	2,535.8	2,707.5	6.8
Debit cards	10.9	11.5	5.5	0.79	0.77	– 2.5
Credit cards	4,547.6	N/A	N/A	34.8	N/A	N/A
Card-based electronic money	N/A	809.6	N/A	N/A	0.56	N/A
Total	**5,964.3**	**2,243.7**	**N/A**	**3,049.3**	**3,172.1**	**N/A**

Source: Bank for International Settlements, CPSS – Red Book statistical update, March 2009.

International Payments

Some international payments, including import/export settlement payments and JPY-involved foreign exchange transactions, are processed through the Foreign Exchange Yen Clearing System (FXYCS), while the rest are processed using traditional correspondent banking techniques.

Payment Processing Times

Transactions processed (JPY-denominated)	Value dating rules	Cut-off time(s) in local Japan Time (JT)
High-value and urgent domestic transfers	Settlement in real time with immediate finality	All participants = 17:00 JT Advance applications = 19:00 JT
Non-urgent, low-value domestic consumer payments	Payments are settled on a same-day basis	15:30 JT for electronic payments. The cut-off times for cheque payments vary among banks.
High or low-value, JPY-denominated legs of cross-border electronic payments, JPY transactions involving non-residents	Settlement in real time with immediate finality	14:00 JT

Central Bank Reporting

The Bank of Japan (BOJ), on behalf of the Ministry of Finance, collates balance of payments statistics from the responses to mandatory reporting by resident companies on all non-trade related transactions greater than JPY 30 million (or equivalent) involving non-resident bank accounts, and on all capital transactions greater than JPY 100 million (or equivalent) involving non-resident entities.

Companies submit reports electronically to the BOJ on a monthly basis.

Exchange Arrangements and Controls

Japan applies few currency exchange controls.

The Ministry of Finance (MOF), the Ministry of Economy, Trade and Industry and the BOJ manage any foreign exchange controls. Customs must notify the MOF of any imports/exports of cash (including cheques, promissory notes and securities) with a value greater than JPY 1 million, or of gold weighing more than 1 kg. Restrictions apply to capital transactions made by insurance companies (which may only invest up to 30% of their assets outside Japan).

Prior notifications must be made for inward direct investment in agriculture, oil, mining and air and maritime transportation, and for direct outward investment in arms manufacturing, narcotics and fisheries.

Cash and Liquidity Management

Because of Japan's thin capitalization and other tax rules, establishing an efficient cash and liquidity management structure including Japanese companies can be complex.

Physical Cash Concentration

Physical cash concentration is available from several cash management banks in Japan. Resident and non-resident companies can participate in the same domestic cash concentration structure.

A number of banks offer cross-border physical cash concentration. Japanese companies, particularly multinationals, have established cross-border sweeping structures, both in Japan and abroad, since the relaxation of foreign exchange tax laws. However, companies do need to take into account Japan's thin capitalization rules.

Notional Cash Pooling

Notional cash pooling is available but rarely used due to tax ambiguity.

Short-term Investment

Bank instruments

Interest-bearing current accounts are generally not available, though sweeping into interest-bearing overnight accounts is available. Banks offer time deposits in a range of currencies for terms from one month to ten years. Foreign currency time deposits have been particularly popular in the last several years in light of Japan's zero-rate policy. Banks also issue fixed-rate certificates of deposit (CDs), usually for terms of three months but are also available up to five years.

Non-bank instruments

Japanese companies can issue commercial paper. The maximum maturity of the paper is generally one year, although is usually issued for shorter periods, i.e., three months.

The Japanese government issues Treasury bills for periods of three to six months.

Japanese companies have access to money market funds, which are increasingly available and popular.

Short-term Borrowing

Bank

Overdrafts, bank lines of credit and bank loans are usually all available in Japan to both resident and non-resident companies. Banks will usually charge a margin over Libor or Tibor (the London or Tokyo Interbank Offered Rate) for JPY-denominated or other foreign currency facilities. Collateral may be taken and compensating balances may sometimes be required.

Non-bank

Japanese companies can only issue JPY-denominated commercial paper, while foreign companies can issue Euroyen notes abroad and JPY (samurai) commercial paper in Japan. Issues require a credit rating of A3 or must have a guarantee from a financial institution. Maturities range from two weeks to one year, with a minimum issuance of JPY 100 million.

Trade bills discounting and factoring (mostly disclosed) are available.

Taxation

Corporate Taxation

- The effective tax rate is 39.54% (40.69% for entities based in Tokyo), comprising national tax (30%), local inhabitant's tax and enterprise tax.
- Inhabitant's tax varies depending on the size and location of the company, with the rates ranging between 17.3% and 20.7% of the national corporation tax liability. Inhabitant's tax also contains a per capita levy in addition to the income levy.
- Enterprise tax has three components: 7.2% of taxable profits, 0.48% of a "value-added" factor and 0.2% of share capital and capital reserves. (Rates quoted are the standard rates, but actual rates may differ depending on the local tax jurisdiction and the taxable income of the company).
- Small companies with a stated capital of JPY 100 million or less are taxed at 22% on the first JPY 8 million of taxable income, and 30% on the balance for national corporate tax. Small companies are subject to only one component of enterprise tax; rates range from 9.6% to 10.08% of taxable profits; Tokyo uses 10.08%. For small companies the effective tax rate is 40.86% (42.05% for Tokyo).
- The consolidated tax return system (CTRS) applies to a domestic parent company and all of its 100% domestic subsidiaries. The CTRS is voluntary, however, it does not allow the parent company to choose which subsidiaries to include or exclude. CTRS filing requires approval from the tax authorities. Once approved, use of the CTRS can be rescinded only with approval from the tax authorities.
- In general, companies established in Japan are subject to the national corporation tax on worldwide income, including income earned by branch offices established in foreign countries but not remitted to Japan. A non-resident company with a permanent establishment in Japan is taxed under the "force of attraction" method under domestic law or the "attributable" income method, depending on the relevant tax treaty.
- Dividends received by a Japanese company from an overseas company have been subject to corporate income tax, with foreign tax credit relief potentially available. However, for fiscal years beginning on or after April 1, 2009, Japanese companies will be able to effectively exclude 95% of foreign dividends received from their tax calculation (although there is no longer foreign tax credit relief). In order to qualify for the exemption, the Japanese company must have held at least 25% of the shares of the foreign entity paying the dividend for at least six months prior to the dividend declaration date. The provisions allow for the minimum shareholding to be reduced under certain tax treaties.
- Tax losses may be carried forward for seven years.

Advance Tax Ruling Availability

- There is a formal advance tax ruling system for transfer pricing and other transactions.

Withholding Tax (subject to tax treaties and other exemptions)

- Non-residents may also qualify for a reduction of, or exemption from, withholding tax on interest, dividends, royalties and other income if the non-resident beneficial owner is able to obtain a reduced rate under a double tax treaty.

Payments to	Interest	Dividends	Royalties	Other income
Resident companies	20%*	20%**	–	***
Non-resident companies	15% or 20%†	20%††	20%	***

* Interest on loans is not subject to withholding tax.

** Dividends of listed shares; 10% for an individual and 7% for a company.

*** Generally no withholding tax is paid, but this depends on the type of income and circumstances.

† Fifteen percent on bonds and deposits; 20% on loans.

†† Dividends of listed shares: 10% for an individual who has a permanent establishment in Japan, 7% for an individual who has no permanent establishment in Japan and also for a company.

Capital Gains Tax

- Capital gains of a resident Japanese company are not subject to separate or preferential taxation. Instead, all such gains must be reported when realized, and are taken together with other ordinary corporate income.
- Under Japanese domestic tax law, where a foreign investor, along with specially related persons, owns 25% or more of a domestic company at any point during the current fiscal year or preceding two fiscal years, and sells 5% or more of the outstanding shares of such domestic company in the current year, the gain would be Japanese-sourced income and subject to national corporate tax. Certain tax treaties between Japan and various countries protect shareholders not resident in Japan from capital gains taxation. However, under some treaties, Japan retains taxing rights.
- Gains from the transfer of “real-estate rich companies” will be subject to Japanese tax if the seller (together with specially related parties) owns more than 2% of the shares of such a company (5% if listed) at the end of the fiscal year immediately prior to the year of sale. A real-estate rich company is any company where at least 50% of its assets consist of real estate located in Japan.

Stamp Duty

- Where there is a transfer of land, buildings or business or certain notes and agreements there is a stamp duty on the seal that is placed on the agreement. It can range from JPY 200 to JPY 600,000.

Thin Capitalization

- Japanese thin capitalization rules come into play where the ratio of total average debt to total average equity exceeds 3:1 (safe harbour ratio). The rules prevent a Japanese company from deducting interest expenses to the extent that such expenses are attributable to foreign interest-bearing debt exceeding three times the average balance of equity owned by foreign controlling shareholders (direct or indirect ownership of 50% or more of the stock of the Japanese company).

- The following debts and related interest are included in the calculation of non-deductible interest under the Japanese thin capitalization rules.
  - Debt obtained from an unrelated foreign entity (unless the interest from such debt is taxable in Japan) which is guaranteed by a controlling foreign shareholder of the Japanese company. (In this case the guarantee fee paid by the Japanese company will also be treated as interest paid for thin capitalization purposes.)
  - Debt obtained from an unrelated foreign entity (unless the interest from such debt is taxable in Japan) which is collateralized by bonds borrowed from a controlling foreign shareholder of the Japanese company. (In this case any consideration paid for the bonds will be treated as interest paid for thin capitalization purposes.)
- Repurchase agreement (repo) transactions may be excluded from the thin capitalization calculation. However, if they are excluded the safe harbour ratio is reduced to 2:1.
- Such non-deductible interest constitutes a permanent difference in Japan. However, the denied portion would nonetheless be subject to withholding tax at the time of payment.
- In general, the amounts of principal, interest and "equity" for thin capitalization purposes follow Japanese GAAP.
- If the company has retained losses, the equity for thin capitalization purposes is the amount of stated share capital and capital surplus (any additional paid in capital).

Transfer Pricing

- Under self-assessment, companies are required to prepare their corporate tax returns using arm's length principles. Where arm's length pricing was not initially applied to transactions with related parties, appropriate adjustments to profits must be made when completing the return. In determining what an arm's length price is, Organisation for Economic Co-Operation and Development (OECD) transfer pricing guidelines should be applied. Companies must maintain sufficient documentation to support the prices used and any adjustments made. Failure to do so can lead to penalties being charged. Also, the tax authority requires taxpayers to disclose their cross-border related-party transactions by type and counterparty on schedule 17(3) of the corporate tax return. Information requested includes the name, location and financial data of the counterparty, the amount and type of transaction, and the transfer pricing methodologies used.

Sales Taxes / VAT

- Japanese consumption tax (JCT) is levied on all taxable goods and services and on all taxable goods imported into Japan. The standard rate is 5%, but there is also a zero rate for certain categories of goods and services. Exports are exempt.

Payroll and Social Security Taxes

- All Japanese companies, including subsidiaries of foreign companies, are "resident employers". Non-Japanese companies may also be resident employers if they have an office in Japan. Resident employers are required to withhold payroll and social security taxes at source. The social security premium (15.35%) is borne by the employer and the employee on a 50:50 basis, as is the health insurance premium of 8.2%. There are upper limits for the amount of remuneration to which these rates are applied. Other premiums are workers' accident compensation insurance, where the entire premium is borne by the employer (from 0.45%, the rate varying according to the nature of the business activity), and employment insurance, normally a 1.5% premium, with 0.9% borne by the employer and 0.6% by the employee.
- The employer's contribution is deductible for corporation tax purposes.

All tax information supplied by Deloitte LLP (www.deloitte.com). Data as at March 1, 2009.

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