JAPAN

GDP Growth 1.71%
Inflation +0.47%
Population 126.8 M
GDP per Head USD 38,428.1
World Bank Ease of Doing Business Rank 39

Data collected from data.worldbank.org based on 2017 report. Ease of Doing Business Rank is based on 2018 report.
ESTABLISHING AN ENTITY

In practice, foreign companies establishing a business entity in Japan can choose from 4 basic types of entities: (1) subsidiary company being a joint stock company (Kabushiki Kaisha or KK), (2) subsidiary company being a limited liability member company (Godo Kaisha), (3) branch (of a foreign company) and (4) representative office.

A KK is generally the most trusted form of entity in Japan. The procedure for setting up a KK in Japan must be conducted in Japanese and typically takes one month to complete.

A KK and A GK can be set up with a minimum capital of JPY 1.

In Japan, a KK and a GK require at least 1 authorised representative who does not need to be a resident of Japan while Branch and Representative Officer require at least 1 authorized resident director.

FOREIGN BUSINESS RESTRICTIONS

The vast majority of industries have been liberalized and made available for foreign direct investment. Such investment is treated as “foreign direct investment in Japan” under the Foreign Exchange and Foreign Trade Law (Foreign Exchange Law) and is differentiated from financial and portfolio investment. In principle, advance authorization is not required and the submission of ex post facto notification (subsequent report) to the Minister of Finance and the Minister(s) with authority over a particular industry is sufficient.

Prior notification is, however, required for investments in industries which (1) threaten the nation's security, become an obstacle to the maintenance of public order, or hinder public safety or (2) are categorised as belonging to industries which Japan has not yet liberalised.

Furthermore, investment by companies from certain countries is also subject to prior notification requirement.

INVESTMENT INCENTIVES

As a means of attracting corporate investment, local administrative bodies have enacted various regulations and programs to authorize tax incentives including reductions of and exemptions from business, fixed asset, real estate acquisition taxes, subsidies and loans to finance the acquisition of land and buildings, operating expenses and facilities investment. There are even some grants available for a very restricted range of investments.
WORK PERMITS AND VISAS

In Japan, a Certificate of Eligibility (COE) needs to be applied first, and after issuance, a foreign national files application for a visa with the COE at the Japanese Embassy/Consulate in his/her home/residential country. At the time of entry, a residential card is issued to him/her. The permitted scope of activity is limited to respective residential statues. The standard procedural time is one month to 3 months.

The Japanese Immigration system is liberalized towards allowing the employment of foreign professionals while strengthening measures to supervise illegal/undocumented residents.

In 7 May 2012, the category of Highly-Skilled Foreign Professionals was introduced. Those who fall under this category can receive preferential treatment such as grant of the 5-year period of stay, relaxation of requirements for grant of permanent residence permission, etc.

In 1 September 2017, the category of Nursing Care was introduced. Considering the high demand of elder-care workers, the government decided to open the door for foreign care workers. The Immigration system is not particularly simple, but the acquisition of the COE is not particularly difficult for foreign professionals.

TAXATION

Corporations engaged in economic activities in Japan are subject to taxes in Japan on the profits generated by those economic activities. Taxes include corporate tax (national tax), corporate inhabitant tax (local prefectural and municipal tax) and corporate business tax (local prefectural tax) (hereinafter collectively referred to as “corporate taxes”). The effective tax rate combining national corporate tax, corporate inhabitant tax and business tax (tax burden on corporate income) is calculated at around 30%.

Capital gains from investments are generally treated as part of the ordinary taxable income for corporate tax purposes. Where a tax loss is realised in a given tax year, it may be carried forward by the company for use in sheltering taxable profits of future tax years for 9 years (10 years from the fiscal period starting after 1 April 2018), provided the company has a “blue-form” tax return filing status. The loss carry back rule has been suspended since 1992, except in certain limited situations.

Consumption tax is categorised as a value added tax applied to almost every domestic transaction and every import transaction except for financial transactions, capital transactions, medical services, welfare services and educational services. Provision of digital services by foreign service providers to domestic businesses or domestic consumers is also included as a domestic chargeable transaction. The aggregate consumption tax rate is now 8%.
Companies classified as Small and Medium-sized Enterprises (SMEs) can get significant reduced rates across the board for corporate taxes but only for the first JPY 8 million of profit.

To qualify as an SME, companies must not have a capital exceeding JPY 100 million and a Group capital of less than JPY 500 million. These companies will have an effective rate of national and local corporate tax of 21 to 25% on the first JPY 8 million of profit only. For SMEs there is also a provision to carry back losses for one year which is not available to larger companies.

The Japanese withholding tax rate on dividends, interest and royalties payable to a non-resident is generally 20.42% (15.315% for certain types of interest). On payments of dividends, interest and royalties made to a resident, withholding taxes are levied at rates between 10.21% to 20.42%.

Personal Taxation and Welfare Insurance is quite complex. The deduction systems and timing of deductions for national income tax, local income tax, state health pension contributions and labour insurance are all completely different and in practice are difficult for smaller companies without dedicated HR departments to operate by themselves, leading to the widespread outsourcing of payroll to professional providers. Japan taxes its residents on their global income but there are transitional concessions for foreigners taking up residence in Japan for the first time.

**AUDIT AND ACCOUNTING**

The Japanese Companies Act stipulates that a “large company” (a company with a stated capital of JPY 500 million or more, or total liabilities of JPY 20 billion or more, as at the end of its most recent business year) or a “company with committees” is required to have an external “accounting auditor” or kaikeikansanin and to have its financial statements audited by the auditor.

An accounting auditor must either be a CPA professional or a licensed audit firm. If a company is neither a large company nor a “company with committees”, it is not required to have an accounting auditor. Some other laws also stipulate a statutory audit by a CPA, including the Financial Instruments and Exchange Act, which is applicable to listed companies, certain regulated entities such as banks and insurance companies and other companies that raise capital publicly.

All KK are required to make an annual return and should provide updates on changes of directors and other key information. They are also required to disclose a summary of their balance sheet either through the official gazette, another newspaper or on their own website.

Specific to Japan is also the corporate auditor system (Kansayaku). The corporate auditor is a company structure specified in the Companies Act, and its role is to audit the directors’ execution of their overall duties, including those related to accounting. One should be aware of the fact that corporate auditors in Japan do not need to be CPA professionals or accredited accounting firms.
COUNTRY QUIRKS

- Smaller companies may have the option of choosing whether or not to register for consumption tax in the opening period of the business year. Some significant tax planning opportunities exist in this area and careful consideration needs to be taken of this issue when registering a company.

- Representative offices of foreign companies can in most cases be set up without any formal process of approval other than registering for taxation. However, a Representative Office cannot hold a bank account or take a lease of real property, thus in practice an individual such as an appointed representative will act as a proxy for the Office.

- Functional currency accounting is not allowed.
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