

**DOING  
BUSINESS  
IN**

**JAPAN**



**HLB** JAPAN



*doing business  
in Japan*

# *foreword*

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HLB Japan  
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# general information

## FACTS AND FIGURES

Area	380,000sq.km
Population	120 million
Capital	Tokyo
Currency	Yen, JPY
Language	Japanese
Time	UTC +9 (GMT +9)

## LOCATION AND CLIMATE

### Location

Japan is located in the east of Asia (Eurasia) and the northwest of the Pacific Ocean, and consists of 4 major islands of Hokkaido, the Mainland, Shikoku, Kyushu, and the smaller islands nearby. To the West and North of the Sea of Japan are North and South Korea and Russia.

### Climate

Located in the temperate zone, Japan has an annual rainfall of about 1,700 millimeters and it becomes hot and humid in summer. In winter on the other hand, a dry climate continues mainly on the Pacific Ocean side while it snows in some places on the Sea of Japan side. The turn from spring to summer is a characteristic rainy season, while the typhoon comes as seasons change from summer to autumn.

## CONSTITUTION AND POPULATION

Japan is a democratic nation, where the constitution provides for a separation of the three powers. The constitution takes precedence over any "law, ordinance or other act of government" that offends against its provisions.

### Legislative

The Diet in Japan consists of two houses. The term of a member of the

House of Representatives is four years and the House is composed of 480 Diet members. On the other hand, the term of a member of the House of Councillors is six years and half of the members are elected every three years. It is composed of 242 members in total.

### Administrative

The Prime Minister is nominated by Diet resolution, being appointed by the Emperor afterwards. Ministers of state are appointed by the prime minister. A majority of them must be members of the Diet.

### Judicial

The whole judicial power is vested in the Supreme Court and lower courts established by law.

### Emperor

The Emperor of Japan is the symbol of the state and of the unity of the people according to the Constitution of Japan. The Emperor does not have powers related to government but has duties in matters of state.

### The latest election

For the House of Representatives, the last election was held in August 2009, and the Democratic Party won the most seats. As for the house of councillors, the Liberal Democratic Party won a majority of seats in the latest election held in July 2010.

### Local public authorities

In local government, there are two levels namely 47 prefectures and subdivided municipalities. Each municipality has a prefectural governor and a mayor who are directly elected by inhabitants.

## Population

The total population of Japan is about 120 million. According to the website of Bureau of Statistics, the populations of main prefectures are as follows in descending order:

- (1) Tokyo : 13 million  
(6.3million households)
- (2) Kanagawa : 9 million  
(3.8million households)
- (3) Osaka : 8.8 million  
(3.8 million households)
- (4) Aichi : 7.4 million  
(2.95 million households)

## CURRENCY, LANGUAGE AND OTHER FEATURES

### Currency

The national currency is Japanese Yen. The exchange rate to the USD was 78 yen and that to the EUR was 103 yen in April 2012.

Reference: Bank of Japan/Basic exchange rate and arbitrated exchange rate of a foreign currency

### Language

Japanese is the national language and the only one commonly used.

### Transportation

In many cities urban areas have extensive train and subway networks. The main international airports are Narita, Chubu and Kansai, but this year Haneda also extended its international routes.

### Business customs

Business hours are generally from 9am to 5pm (or to 6pm), and lunch time is from noon to 1pm

## LEGAL SYSTEM

### Types of courts

There are five types of courts in Japan: the Supreme Court, High Courts, District Courts, Family Courts, Summary Courts and Intellectual Property Courts.

### Means of dispute solution

The number of litigation cases is fewer than Europe and America, therefore the number of lawyers is also fewer than in these countries.

Outside of lawsuits, arbitration and mediation are used as a means of dispute solution.

## ECONOMY AND ECONOMIC ARRANGEMENTS

### GDP

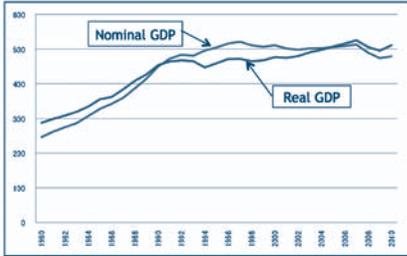
The Japanese GDP of 2010 ranks third in the world with 539 trillion yen after the United States and the People's Republic of China.

In 1990s, after the bursting of the asset bubble, Japan suffered from economic stagnation called the "Lost Decade" due to the problem of non-performing loans. In 2000s Asian emerging countries' growth accelerated Japanese exports and it contributed to reviving the Japanese economy as part of the longest economic boom in the country's history. However "Lehman's fall" in 2008 caused a global recession and the Japanese economy suffered, too. The Japanese government implemented a policy of stimulating consumption by means of tax reduction and an eco-point system for ecology products and succeeded in restoring growth to the Japanese economy.

In March 2011, the Great East Japan Earthquake disrupted the supply chain and power supply in the eastern part of Japan. This biggest-ever disaster forced Japanese GDP to decrease. But according to officials, in 2012, the Japanese economy has been gradually recovering with manufacturing capacity.

## GDP transition graph

(Units : Yen, Scale: Trillions)



Reference: Cabinet Office, Government of Japan National Accounts for 2010

## The main trading partners

- (1) Export (total 67.8 trillion yen) ... 1st The People's Republic of China (19.4%), 2nd The United States (15.4%), 3rd the Republic of Korea (8.1%), 4th Taiwan (6.8%), 5th Hong Kong (5.5%)
- (2) Import (total 62.4 trillion yen) ... 1st The People's Republic of China (22.1%), 2nd the United States (9.7%), 3rd Australia (6.5%), 4th Saudi Arabia (5.2%), 5th UAE (4.2%)

Reference: JETRO, Statistics of Japan in 2010

## Member organizations

Japan belongs to various organizations including the WTO, APEC, OECD and EPA.

## Other economic trends

- (1) Personal financial assets in Japan are one of the largest asset bases in the world and they amount to 1,471 trillion yen (as at September, 2011). It consists of cash and deposits 824 trillion yen (56.0%), insurance and annuity reserves 421 trillion yen (28.6%), equity securities 82 trillion yen (5.6%) and others.  
Reference: Bank of Japan, Statistics of Flow of Funds as of September 2011

- (2) The zero-interest-rate policy was implemented as monetary policy against stagnation following the bursting of the asset bubble in the early 1990s. This is the current policy but it has been suspended several times since the 1990s.

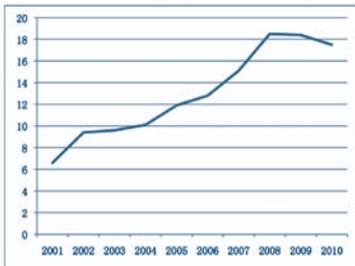
# investment factors

## FEATURES OF THE JAPANESE MARKET

The amount of direct investment from foreign countries increased up to 18.5 trillion yen and after peaking in 2008 it began to decrease. It is considered that the reason for this condition is market maturity in Japan compared with Asian emerging markets or Asian countries' aggressive policy to attract investment from other countries. To address this problem, the Japanese government has been considering a new policy as the "Programme of Japan as an Asian Business Center Promotion and Promotion of Direct Investment to Japan".

Direct investment from foreign countries transition graph

(Units : yen, Scale: trillions)



Reference: Ministry of Finance, Bank of Japan, International Investment Position of Japan

The merits of the Japanese market are as follows;

- (1) The income level is high compared with other countries. Customers are cutting-edge-conscious and brand-conscious.
- (2) The society and politics are steady, and the country risk is low.
- (3) Japanese companies have high technical capabilities, and there are many promising business partners in Japan.
- (4) The environment of transport, the distribution infrastructure, and the communication infrastructure are excellent.

On the other hand, the demerits of Japanese market are as follows;

- (1) The prospect of economic growth in the future is deteriorating, and the real rate of interest has been at a high level owing to deflation.
- (2) Business costs including labor costs are high.
- (3) There are the closed characters of and specific problems in the Japanese market such as the language problem.
- (4) Funding from joint ventures and Japanese banks is difficult.

## GOVERNMENT

To support foreign companies to invest to Japan, the Ministry of Economy, Trade and Industry and Japan External Trade Organization (JETRO), a government-related organization, offer information. The Ministry of Economy, Trade and Industry set up the Invest Japan Business Support Center at JETRO. The relevant government ministries have offices for foreign companies which intend to invest to Japan.

Some municipal organizations attract foreign companies for themselves. In some cases, JETRO helps municipal organizations to invite foreign companies to invest in Japan.

The Ministry of Economy, Trade and Industry (METI) has been studying a variety of measures to attract R&D centers and Asian headquarters of global companies. METI has already implemented them partly as a subsidy measure for initial investment support for establishment of headquarters and R&D centers. METI has been preparing to submit a bill including tax incentive measures to certified companies such as the "Programme of Japan as an Asian Business Center Promotion and Promotion of Direct Investment to Japan".

## SOURCES OF FINANCE

The Japanese government carried out a financial system reform and promoted deregulation of the financial industry in the late 1990s. The Japanese government put up the slogan of “free”, “fair” and “global” and attempted to activate and globalize the Japanese market. The financial system reform lifted a ban on mutual entries of banks, the securities industry and insurance companies into each other’s business areas. A free foreign exchange market was set up by way of amending the Foreign Exchange Act. Trading stocks outside of the normal stock market session became possible. As a result of the financial system reform, financial institutions were reorganized.

The financial institutions of Japan can be divided into banks and other financial institutions.

### Banks

#### *The Central Bank*

The central bank of Japan is the Bank of Japan. The role of the Bank of Japan is to ensure smooth settlement of funds among banks and other financial institutions, thereby contributing to the maintenance of stability of the financial system. The Bank of Japan aims currency and monetary control at achieving price stability.

#### *Commercial Banks*

Commercial banks generally grant short-term loans. Some commercial banks grant medium and long-term loans. The number of commercial banks in Japan is over one hundred. The three largest commercial banks are Mizuho Bank, Bank of Tokyo-Mitsubishi UFJ and Sumitomo Mitsui Banking Corporation in Japan. They have a trust bank, a security firm and other financial companies in their groups.

There is also Japan Post Bank. Japan Post Bank is a bank which started in 2007 following Postal privatization.

Japan Post Bank is not a kind of commercial bank because it does not grant loans. But its asset base is the largest in Japan. So Japan Post Bank plays a vital role.

### Other financial institutions

Cooperative financial institutions  
Securities firms  
Insurance companies  
Foreign financial institutions  
Non-bank institutions (Customer Loan companies, Credit Card companies, Leasing companies)  
Public financial institutions (Development Bank of Japan, Japan Finance Corporation etc)

## FOREIGN EXCHANGE CONTROLS

The Yen is almost freely convertible into other currencies now.

Once, foreign exchange was allowed to limited persons who had permissions from the Minister of Finance. In 1980, the Yen became almost freely convertible in principle by an amendment. In 1998, the requirement to make a report before a foreign exchange transaction was abolished except in certain special cases. Now, remittances of over 5 million yen and capital transactions of over 100 million yen must be reported after a foreign exchange transaction, but reporting before a foreign exchange transaction is not necessary except as part of direct foreign investment, direct domestic investment and contracts of technology.

## SECURITY MARKETS

In the stock market in Japan, there are six general markets (Tokyo, Osaka, Nagoya, Fukuoka, Sapporo, and TOKYO AIM) and five emerging markets (Mothers, JASDAQ, Centrex, Q-Board, Ambitious). Tokyo, Osaka, Nagoya exchange markets have two sections. The Tokyo Stock Exchange is one of the largest Asian stock markets. The Tokyo Stock Exchange ranks 3rd in market

capitalization and 4th in trading volume in the world (as at September 2011). Recently some of the stock markets in Japan have been integrating. In November 2011, it was announced that the Tokyo Stock exchange and the Osaka Stock Exchange had come to an agreement to merge together. The Tokyo Stock Exchange's advantage is in spot trading and the Osaka Stock Exchange's is in derivative trading. The merger of these two large stock markets in Japan is expected to produce a global financial center in Asia. And in March 2012, it was announced that Tokyo AIM will be taken over by the Tokyo Stock Exchange in July 2012 and restart with a new name called "TOKYO Pro Market". TOKYO AIM, modeled on AIM in London, was launched in June 2009 as a joint venture between the Tokyo Stock Exchange and the London Stock Exchange. "TOKYO Pro Market" will adhere to the TOKYO AIM scheme designed to be more flexible for professional investors and is expected to produce the international risk capital market for Asian growth companies as well as such companies in Japan.

### **EMPLOYMENT REGULATIONS**

Rules relating to visas and status of residence

In Japan, the procedure with regard to Japanese residence for foreigners and the resident status system are provided by the Immigration Control and Refugee Recognition Act enacted in 1946. According to this law, in principle, a Japan landing application requires an effective visa. Therefore, it is necessary to apply for a visa previously in Japanese diplomatic establishments overseas in the foreigner's own country.

The resident status system is adopted as a method of managing a foreigner's entry into and departure from Japan.

In general, all foreigners that are allowed to enter into Japan are given some resident status. They can stay and be active based on this qualification.

At the present day, 27 types of resident statuses are provided.

The resident statuses where starting work is not permitted are "Cultural activities", "Brief visit", "Overseas education", "Enter school", "Training", and "Family stay".

The resident status not limited to starting work is "Permanent resident", "Partner of a Japanese", "Partner of a permanent resident", and "Permanent settler".

At the present day, people generally get a "Certificate of Eligibility" in Japan beforehand and apply for the visa in their own country.

### **LABOR REGULATIONS**

The representative examples of Labor related laws in Japan are the Labor Standards Act enacted in 1947, the Labor Union Act enacted in 1945 and the Labor Relations Adjustment Act enacted in 1946. These labor related laws are applied regardless of nationality as long as the work is in Japan. The standards for working conditions fixed by the Labor Standards Act are minimum standards. In principle, this Act applies to all types of employment relationships. An employer shall not have a worker work more than 8 hours per day for each day of the week, 40 hours per week, excluding rest periods.

Wage rate of increase:

Overtime Work	25%
Work on days-off	35%
Night work	50%
Work on days-off (Night work)	60%

An employer shall grant annual paid leave of 10-20 working days corresponding to the number of years of continuous service.

## SOCIAL WELFARE AND SECURITY

In Japan, there are five kinds of social insurance; Medical insurance, Long-term care insurance, Employee's Pension insurance, Industrial accident insurance and Employment insurance.

Amongst these, Medical insurance is the medical insurance system for the whole nation, and it is established to guarantee insurance for everybody.

In principle, social insurance premium is paid fifty-fifty by the employee and the employer (Industrial accident insurance is paid completely by the employer. The long-term care insurance is provided to employees over 40 years old.).

The percentage of gross salary of each social insurance is as follows.

- (1) Medical insurance 9.85~10.16%
- (2) Long-Term care insurance 1.55%
- (3) Pension insurance 16.412%
- (4) Industrial accident insurance 0.3~8.9%
- (5) Employment insurance 0.0135~0.0165%

Social insurance is applied to the corporate office regardless of the kind of business and includes management forcibly. In an office of a private individual, if five workers or more are permanently employed, it is obligatory. For foreign workers, in principle, the company lets all the staff join the social insurance scheme from the viewpoint of public welfare and racial equality.

# types of business organisations

## PRINCIPAL FORMS OF BUSINESS

Various forms of business organization can be selected for foreigners to do business in Japan. Generally, they choose one of the following:

- (1) Japanese corporation
- (2) Branch office
- (3) Representative office
- (4) Partnership
- (5) Solo Proprietorship

### Japanese corporation

A lot of businesses in Japan are incorporated as companies and the most commonly used type is that of a stock company. All these companies are established according to the Companies Act of Japan.

### *Stock Companies*

A stock company allots and issues stocks to shareholders. A stock company is the most suitable vehicle for a large scale operation. If a stock company meets listing criteria, it may apply to be listed on the Stock Exchange and can invite the public to subscribe for shares.

Shareholders take limited responsibility for creditors of company within the limits of the amount of their investment. Profits are distributed to the shareholders depending on their investment.

The operation of a stock company must comply with the requirement of the Companies Act of Japan and the establishment of a shareholders' meeting and directors is essential. Moreover, internal auditors etc. may be required depending on the size and form of the company.

This is the most formal means of conducting business and is able to

achieve a higher credibility in respect of financing and operation than adopting other forms of business entity, and it can facilitate a business process.

### *Membership Companies*

In the membership company category, there are Limited Liability companies by members with limited liability, Partnerships by members with unlimited liability and Limited Partnerships by members with limited liability and unlimited liability.

In a membership company, a member must make an investment. It is given more freedom in how it is organized and operates than a stock company. Corporate autonomy is widely permitted under the authority of the articles of incorporation. Therefore it also allows quicker decision-making than stock companies. Also the proportions for division of profits can be decided flexibly under the authority of the articles of incorporation.

### Branch office

Methods for foreigners to do business in Japan include the establishment of a branch besides corporate formation. This requires a corporate registration after the appointment of a representative of the branch. At least one of the representatives shall have a fixed address in Japan and reside there.

### Representative office

The purpose for the establishment of representative office is setting up a business hub for the preparation of and supplementary activities for business operations in Japan. A representative office is not able to perform direct operation, but it can conduct activities

including collection of information, advertising, market research, and basic study etc. In addition, it does not need the procedure of corporate registration etc. and also its income derived from business is nontaxable unless the representative office has a permanent establishment (PE) in Japan.

## Partnership

### *Silent partnership*

Silent partnership is a contract between a business operator and a silent partner. A silent partner invests in and entrusts all of the management to a business operator who carries on a business. A silent partner receives a profit share and has no liability for debts beyond his/her investment.

### *Limited Liability Partnerships (LLP)*

A LLP is another way to conduct business as a legal entity. A LLP operates under the LLP law in Japan. In the LLP, partners will be liable for the debts of the LLP only up to the amount of their capital. More than one partner as individuals or domestic legal entities are required to establish a LLP and one of them is required to have a fixed address in Japan or to have resided for over a year to date. As for division of profits, it is possible to distribute with different proportions from the investment ratio by agreement of all partners.

## Sole proprietorship

When a foreign company conducts business in Japan without adopting the form of legal entity or partnership, the business may be operated as a sole proprietorship. In this case, based on the Income Tax Act in Japan, it is obliged to pay income tax depending on the business income.

In this case, it is necessary to do final tax returns for the calendar year based on Income Tax Act and Consumption Tax Act etc.

## INITIAL COST

	A stock company	Branch
Stamp tax for articles of incorporation	40,000 yen	
Fee for certification of articles of incorporation by Japanese notary public	50,000 yen	
Registration and license tax	The amount of stamp tax is calculated by multiplying the amount of capital by 0.007. Minimum 150,000 yen	90,000 yen

As to paid-in capital, a stock company could be established with capital of 1 yen under the Companies Act of Japan. But if a representative director is a foreigner, he/she needs to obtain an "Investor/Business Manager" visa status and invest 5 million yen or more.

## LAW, ACCOUNTING REPORT AND ACCOUNTING AUDIT

In Japan, there are several laws regarding accounting and audit. Of these, the Companies Act and Financial Instruments and Exchange Act are the general and main laws. If a company fulfills the conditions set by these laws, it shall report its financial situation within a fixed time limit.

### Accounting and reporting

All companies should hold shareholders' meeting within three months after the financial year end under the Companies Act, and report on the financial statements to the stockholders. Moreover, it is necessary for listed companies to submit quarterly reports within 45 days after the end of each quarter.

Big companies (A company whose capital stock is 500 million yen or more or whose liabilities are 20 billion yen or more in the balance sheet at the end of the business year) and listed companies are obliged to be audited by certified public accountants. A summary of the audit system in Japan is shown at the end of this chapter.

Accounting audit etc.

*System necessary for fiscal report and legal audit*

Big companies and listed companies should have an accounting system and internal control and maintain them so as to be able to prepare and have audited their financial report. It is necessary to keep and to maintain three kinds of books of account (the journal, the general ledger, and the sub ledger) and other related materials.

*Financial year*

Regulation of the financial year does not exist, and corporations can decide freely. Many Japanese corporations adopt March as the end of the financial year.

*Adoption of IFRSs*

The convergence to IFRSs is proceeding currently in Japan. However, it hasn't been decided when the IFRSs should be adopted by compulsion.

IFRSs can be applied at present at the early stage when it meets the arbitrary application requirement of the Cabinet Office Ordinance made public in December, 2009. However, when financial statements are made in accordance with accounting standards of Japan because the companies do not fulfill the arbitrary application requirement, it is necessary to note the difference between accounting standards in Japan and IFRSs.

Legal audit

	Companies Act	Financial Instruments and Exchange Act		
	Accounting audit	Financial statements audit	Quarterly review	Internal control audit
Company for audit	Big company (A company whose capital stock is 500 million yen or more or liabilities are 20 billion yen or more in the balance sheet at the business year end).	Listed company (company with securities listed on the financial instruments exchange)	Listed company (issue company listed on the financial instruments exchange)	Listed company (company with securities listed on the financial instruments exchange)
Audit object	Consolidated financial statements, financial statements, and the supplementary schedules.	Consolidated financial statements and financial statements.	Quarterly consolidated financial statements or financial Statements	Internal control report
Due date of submission	Within 3 months after the closing date	Within 3 months after the closing date	Within 45 days after the end of each quarter	Within 3 months after the closing date

# taxation

## TAX STRUCTURE

Taxation in Japan is complex and ever-changing. The major taxes in the Japanese tax system are as follows:

### Income Taxes

#### *National*

Income Tax  
Corporation Tax

#### *Local*

Prefecture Inhabitants Tax  
Municipal Inhabitants Tax  
Enterprise Tax

### Property Taxes

#### *National*

Inheritance Tax  
Gift Tax  
Land Value Tax  
Registration and Licence Tax  
Stamp Tax

#### *Local*

Automobile Tax  
Property Tax  
Business Office Tax  
City Planning Tax  
Real Property Acquisition Tax  
Etc.

### Consumption Taxes

#### *National*

Consumption Tax  
Liquor Tax  
Tobacco Tax and Special Tobacco Tax  
Gasoline Tax  
Customs Duty  
Etc.

#### *Local*

Local consumption Tax  
Prefecture Tobacco Tax  
Golf Course Utilization Tax  
Municipal Tobacco Tax  
Etc.

The percentage of national revenue represented by direct taxes in Japan is near 60%.

This booklet generally discusses taxation in Japan. In-depth professional advice should be obtained before business is transacted.

## CORPORATION TAX

### General Principle

Corporations engaged in economic activities in Japan are subject to taxes in Japan on the profits generated by those economic activities.

Japanese corporation tax is composed of

- (a) tax on ordinary income
- (b) tax on specific funds (The tax is suspended from 1st April, 1999 until 31st March,2014.)

### Taxpayers

Corporations are classified as either domestic corporations or foreign corporations.

Domestic corporations are defined as those head office or main office is located in Japan. Domestic corporations include public corporations, public interest corporations, cooperatives, ordinary corporations and non juridical organizations.

Foreign corporations include public corporations, public interest corporations, ordinary corporations and non juridical corporations.

The following shows the effect of corporation tax on each type of corporation.

		Tax on ordinary income	Tax on specific funds
Domestic Corporations	ordinary corporations	taxable	taxable
	cooperatives		
	public interest corporations	taxable (only on income from profit-making businesses)	(making a specific fund is not permitted)
	non-juridical organizations		
	public corporations	non-taxable	
Foreign Corporations	ordinary corporations	taxable (only on income from sources in Japan)	
	public interest corporations	taxable (only on income from profit-making businesses in Japan)	
	non-juridical organizations		
	public corporations	non-taxable	

#### Place for tax payment

The place of tax payment of a domestic corporation is the place where its head or main office is located. The tax office with jurisdiction over the place of tax payment is where the corporation is required to file returns, pay tax and file various notifications and requests for approval regarding tax matters.

In the case of a foreign corporation, the place of tax payment is where the corporation's main permanent establishment or estate in Japan is located or the Kojimachi tax office.

#### Tax year

The tax year of a corporation is in line with the company's accounting period. If a corporation's accounting period is longer than one year, each year and fraction of a year in such an accounting period are treated as separate business years.

#### Blue

A corporation may file a blue form tax return with approval from tax office. A corporation filing a blue form tax return enjoys a variety of tax benefits.

A Corporation is required to apply for approval to file a blue return by the day before the first day of commencement of the business year. With respect to the first business year or a new corporation, the application for approval must be made by the day within three months from the date of incorporation or by the last day of the first business year, whichever is earlier.

Privileges granted to blue return corporations in the calculation of income include:

- (a) Carry forward of net losses for nine years (By 2011 tax reform, carry forward of net losses will be extended from 7 years to 9 years).
- (b) Carried-back losses incurred within one year before an accounting period qualify for a refund of corporation tax.
- (c) Allowance of special depreciation.
- (d) Special tax deductions
- (e) Various tax-free reserves are permitted to be deducted as expenses on condition that a blue return is filed.
- (f) Prohibition of the tax office from making corrections to the corporation's tax return not based on an investigation of the books and records.
- (g) The tax office must give the reasons for correction in a correction notice.
- (h) A blue return corporation can request immediate reconsideration by the National Tax Tribunal without requesting the tax office for a reinvestigation.

## Tax return

### (a) Final tax return

Corporations must file a tax return for corporation tax on their income within two months from the day following the last day of each taxable year. One month extension of the deadline for filing a final tax return may be requested, with approval from the tax office, when a corporation is unable to file a final tax return because the accounting audit has not been completed.

### (b) Interim tax return

Corporations whose taxable year exceed six months must file an interim tax return, within two months from the day marking the end of the first six months of the taxable year, for 6 months starting on the first day of that taxable year .

## Tax basis and tax rate

Tax on ordinary income is computed by applying the following formula:

### Ordinary income

- (a) × tax rate
- (b) +Special taxation on family corporations
- (c) +Special taxation on capital gains from land or other similar properties
- (d) +Additional tax on secret expenses
- (e) -tax credits
- (f) =tax on ordinary income

### (a) Ordinary income:

The tax base for ordinary income tax is the corporation's net income for each business year. Net income is the excess of "gross income" over "total costs" for each business year.

Though the tax laws require or allow some adjustments of corporate profit calculated in accordance with generally accepted accounting principles in reaching the ordinary income, the

calculation of corporate net income generally follows normal accounting principles and practice.

### (b) The tax rate:

Ordinary corporations, corporate juridical persons included in the category of public interest corporations, non-juridical organizations

i. not more than 8 million yen of income per annum of a small enterprise (a corporation whose capital amounts to 100 million yen or less, with a few exceptions)

••16.5% (15%)

ii. others•• 28.05%(25.5%)

The tax rate applicable to taxable income corresponding to amounts up to 8 million yen or less of ordinary corporations whose capital are 100 million yen or less, public interest corporations, cooperatives and non-juridical organization is 16.5% as a tentative measure for accounting periods ending during 1st April,2012 to 31st March ,2015.

These tax rates of 16.5% or 28.05% which are the tax rate after a 10 percent special reconstruction corporation tax will be imposed on the corporation tax liability generally for fiscal years beginning in the period from 1st April, 2012 to 31st March, 2015 for reconstruction funding after the Great East Japan Earthquake.

### (c) Special taxation on family corporations:

Special tax due by family corporations is calculated by the following:

(Undistributed profits of family corporation – allowance for undistributed profit) × tax rate

The tax on undistributed profits is levied only on a family corporation with more than 100 million yen capitals. However, additional taxation for retained earnings in a family corporation is applicable to a corporation in 100% group if the capital of its parent company is 500 million yen or more.

The tax rate on distributed profits of a family corporation is as follow:

Not more than 30 million yen per Annum...10%  
Over 30 million yen but not more than 100 million yen per annum...15%  
Over 100 million yen per annum...20%

- (d) Special taxation on capital gains from land or other similar properties: This special taxation has been suspended for capital gains from land transferred from 1st January, 1998 to 31st December, 2013 by the 1998 Tax Reform.
- (e) Additional tax on secret expense: A secret expense is a payment of money if the purpose of payment and the name and address of the recipient is not entered into the corporation's books of account. Small items used for advertising purposes, such as calendars, etc, are not considered secret expenses. The additional tax is 40% of the amount of secret expenses paid during the period from 1st April, 1994 to 31st March, 2012. This will extend from 2012 to 2014 under the 2012 tax reform.
- (f) Tax credits:  
A credit is a deduction from Corporation tax designed either primarily to mitigate the effects of domestic and international double taxation, such as the income tax credit and foreign tax credit, or to provide special incentives.
  - i. Income tax paid on interest, dividends, etc, by Japanese corporations may be credited against Corporation tax.

- ii. A credit for foreign taxes to eliminate international double taxation.
- iii. A tax credit for experimental expenditure, an investment tax credit for specified equipment, etc..

#### General Outline of International taxation

- (a) Exemption of dividends received from foreign subsidiary.  
The foreign dividend exclusion system was introduced by 2009 tax reform, instead of the indirect foreign tax credit system.

Dividends received from a foreign subsidiary are exempted from the taxable income of its Japanese parent company. The foreign subsidiary is defined as a foreign company 25% or more of whose capital has been owned by a Japanese corporation for more than 6 months before the determination date of payment of the dividends. If a tax treaty applicable to the foreign subsidiary has a different percentage from the 25%, the percentage stipulated in the tax treaty shall be applied.

The exempted amounts are 95% of the dividends. Foreign withholding taxes assessed on the dividends are neither deducted as expenses nor credited against Japanese corporate taxes of the parent company. The indirect foreign tax credit system has been abolished.

- (b) Credit for foreign taxes  
In order to eliminate international double taxation on income, the foreign taxes imposed on a Japanese domestic corporation, in the ordinary course of its business, may be credited against Japanese corporation tax. This is called an ordinary foreign tax credit.
- (c) Transfer pricing  
Controls over transfer pricing are for the purpose of preventing tax avoidance by companies through

transactions with their foreign related companies. If a company's taxable income is less than the amount calculated upon arm's length principles, foreign related transactions will be deemed to have been conducted at arm's length prices.

There are various ways of ascertaining arm's length prices. In the case of sales or purchase of goods, the main methods are;

- i. The comparable uncontrolled price method
- ii. The resale price method
- iii. The cost plus method
- iv. Any other method which is acceptable

Tax authorities may ask taxpayers to submit their books or records needed for the calculation of the arm's length price. If a corporation does not submit the required information promptly, the tax authorities will assess the taxable income estimating the arm's length price based on appropriate general transfer pricing methodology. If a corporation does not agree with the price determined and the assessment made by the tax authorities, the corporation has the responsibility to prove that the price applied to the transactions with foreign related companies is arm's length in nature.

Nondeductible in the case of thin capital

This measure is a counter measure for the tax avoidance caused by a taxpayer paying interest on a loan in place of dividends on capital.

A part of its interest payments is not considered as deductible expenses when the corporation has borrowed money exceeding three times the amount of its capital from its controlling shareholders.

Tax haven countermeasure

When a domestic corporation, including

its directors and a family corporation group, owns 10% or more of the issued stocks of a foreign subsidiary in a tax haven, such a portion of undistributed profits as is appropriate to its share is included in the gross income of that domestic corporation.

A foreign subsidiary in a tax haven includes a foreign corporation more than 50% of whose issued stocks or voting-right stocks or preferred stocks is directly or indirectly owned by residents and (a) whose head office is located in a country or territory which does not levy tax on income or (b) whose income tax burden is under 20% of the income.

The countermeasure regarding tax havens is not applicable if the foreign subsidiary satisfies all the conditions below:

- i. The foreign subsidiary is not a corporation whose main business is holding of share certificates or other securities, licensing of industrial rights or copyrights, leasing of vessels or aircraft.
- ii. The foreign subsidiary has a fixed facility such as an office, store or factory which is deemed necessary to conduct primary business in the country where its main office is located.
- iii. The foreign subsidiary manages and controls its own business in the country where its main office is located.
- iv. In cases where the main business of the foreign subsidiary is a wholesale business, banking, trust business, financial instruments business, insurance, shipping or air transport, and the foreign subsidiary conducts its business mainly with persons other than related persons including corporations controlled by directors of related corporations.
- v. If the main business of the foreign subsidiary conducts its business mainly in the country or area where its main office is situated. The exemption from the anti-tax haven rule shall not be permitted if a

company does not keep the evidence required under the rule about the activities or the related foreign subsidiary in a tax haven country.

- (9) Establishment of subsidiary/branch in Japan and tax notification  
Generally there is no material difference between a branch office of a foreign company and a domestic company with respect to computing taxable income. However, a branch and a domestic company have differing legal characteristics and these result in differences in tax treatment in certain area.

A summary of the key differences is set out below.

	Subsidiary (Kabushiki-Kaisha)	Japanese Branch
1. Scope of taxable income	Entire worldwide income	Income source within Japan
2. Local tax (capital per levy)	Depending on capital amount etc	If the capital amount of the head office is huge.
3. Dividends / Profit	Remittance Subject to withholding tax a 20% (or reduced rates under tax treaties)	Not imposed
4. Loan 1) Intra-company (Loan from the head office) 2) Inter-company (Loan from affiliated companies)	1) N/A 2) Interest is deductible  Note: 'Thin Capitalization' rules.	1) Interest is not deductible 2) Interest is deductible

## INCOME TAX

### General Principle

Income Tax is primarily a direct tax on the income of individuals who are residents of Japan and on some kinds of Japanese source income of non-residents.

### Taxpayer

Under the Income Tax Act of Japan, there are two categories of individual taxpayers as below:

#### Residents

A resident is any individual who has a domicile or owns a residence continuously for one year or more. Residents, except for those classified as "non-permanent residents", have an

obligation to pay income tax on their whole income as prescribed by the Income Tax Act.

A non-permanent resident is any individual of non Japanese nationality having domiciles or residence in Japan for an aggregate period of five years or less within the last ten years.

A non-permanent resident is subject to pay income tax in relation to Japanese source income and foreign source income paid in or remitted to Japan.

#### Non-residents

A non-resident is any individual other than the residents mentioned in "Residents" above.

Non-residents are subject to pay the income tax for any income from Japanese sources.

Classification	Income from Sources in Japan		Income from Sources in Abroad	
	Paid in Japan	Paid in Abroad	Paid in Japan	Paid in Abroad
Non-permanent Resident (A resident taxpayer of non Japanese nationality who has had domicile or residence in Japan for an aggregate period of five years or less within the last ten years.)	All income paid in Japan is taxable	All income paid in Japan is taxable	All income paid in Japan is taxable	Only the portion deemed remitted to Japan is taxable
				All income paid in abroad is taxable
Permanent Resident				
Non-resident	Income is, in principle, taxable		Income is not taxable	

### Tax Rate

The following tax rates are applied to the net of taxable ordinary income minus allowable deductions.

(thousand yen)

Over	Not over	Tax rate %	Deduction
-	1,950	5	-
1,950	3,300	10	98
3,300	6,950	20	428
6,950	9,000	23	636
9,000	18,000	33	1,536
18,000		40	2,796

## Method of Taxation

- (a) **Aggregate income taxation:**  
Under the aggregate assessment income taxation system, a taxpayer is taxed on a net basis after allowance deductions on his/her ordinary income amount, retirement income amount, and forestry income amount.
- (b) **Separate Taxation :**  
Income tax is calculated separately from other types of income via the filing of a final tax return.
- (c) **Withholding Tax at Source:**  
Under the withholding tax system, the payers of salaries and wages, retirement allowance, interest, dividends, fees, etc., withhold a certain amount of income tax at the time of payment, and pay it to the tax offices.

### Type of income

The incomes below are taxed under aggregate taxation:

- (a) **Business income**  
Income derived from independent enterprises of commerce, industry, fisheries, agriculture, independent personal services, etc.
- (b) **Income from real estate**  
Income derived from the leasing of land, buildings, sailing vessels, aircraft, etc.
- (c) **Income from interest**  
Income derived from interest and other earnings paid on saving, etc.
- (d) **Income from dividends**  
Income derived from dividends from surplus of corporations, or from distribution of profit, etc, from publicly-subscribed investment trust, excluding income for which you choose to use separate taxation.
- (e) **Employment income**  
Income derived from salaries, wages, bonuses, allowance, etc.
- (f) **Miscellaneous income**

### *i. Public pensions*

Income derived from National Pension, Employee Pension, mutual aid pensions for public servants, and other public pensions etc.

### *ii. Others*

Other income including fees for manuscripts, lectures, annuities from life insurance policies, etc which do not fall into other types of income.

- (g) **Capital gains**  
Income derived from sales of golf club memberships, gold bullion, machinery, etc.
- (h) **Occasional incomes**  
Income derived from lump-sum payments from life insurance policies, prize money, lottery winnings, etc.
- (i) **Income from forestry**  
Income derived from the sales of harvested forestry resources, etc
- (j) **Retirement income**  
Income derived from retirement income, lump-sum pensions, one-time payments of aged pensions, etc.

The income below is taxed under separate taxation:

- (a) **Dividend income**  
Income derived from dividends from listed stock etc.
- (b) **Business income etc on land etc.**  
Business income or miscellaneous income with respect to transfers of land and buildings and the rights thereon
- (c) **Long term or short-term capital gain on land etc**  
Capital gain derived from the transfer of land and buildings and the rights thereon,
- (d) **Capital gains etc. from stocks or shares.**  
Business income, capital gain, miscellaneous income from the sales of stock or shares etc

The income below is taxed under withholding tax at source

- (a) Income from Interest  
Interest on public bonds and debentures, deposits with a bank, distribution of profits of joint operation trusts, and public bonds and debentures investment trusts

#### Type of tax allowance

The following deductions are applicable to a resident taxpayer.

- (a) Deduction for casualty losses  
In the case of damage to property or household effects caused by theft, disaster, or embezzlement
- (b) Deduction for medical expenses  
When annual medical expenses exceed a certain amount
- (c) Deduction for social insurance premiums  
If a person has paid social insurance premiums, such as premiums for National Health Insurance, social medical insurance for the old-aged, and Nursing-care Insurance
- (d) Deduction for small business mutual aid premiums  
If a person has paid such as small business mutual aid premiums, personal pension premiums under the Defined-contribution Pension Law etc
- (e) Deduction for life insurance premiums  
If a person has paid premiums on life insurance policies or qualified individual pension plans
- (f) Deduction for earthquake insurance premiums  
If a person has paid premiums on earthquake insurance policies or long-term casualty insurance policies
- (g) Deduction for donations  
If a person has made donations to the national government, etc in Japan or certain specified political donations

- (h) Exemption for widows or widowers  
If a person is a widow or widower
- (i) Exemption for working students  
If a person is a working student
- (j) Exemption for the disabled  
If a person or his/her spouse qualified for an exemption or dependents have a disability
- (k) Exemption for spouses  
If his/her spouse qualifies for an exemption
- (l) Special exemption for spouses  
If total annual income is not more than 10 million yen and his/her spouse's income does not exceed 760,000 yen but is over 380,000 yen.
- (m) Exemption for dependents  
If a person has any dependents who qualify for an exemption
- (n) Basic exemption  
The basic exemption is 380,000 yen.

Non-residents can only apply for (a), (g) and (n).

#### Type of main tax credits

The following are main tax credits can be deducted from the tax amount

- (a) Credit for dividends  
When earning dividend income, excluding that for which separate taxation is selected
- (b) Special credit for loans relating to a dwelling  
If a person has constructed, purchased or rebuilt a house used as a dwelling or carried out specific additions or improvement, etc
- (c) Special credit for contribution to political parties  
When a person has made certain specified contribution to a political party or political organization
- (d) Special exemption for donation to certified NPO  
If a person has made a donation to a certified NPO
- (e) Special exemption for donation to public interest incorporated association, etc

If a person has made any donation to a public interest incorporated association, etc

- (f) Special exemption for specific earthquake donations  
If a person made an earthquake-related donation to a specific NPO, etc in relation to the Great East Japan Earthquake
- (g) Special credit for anti-earthquake improvement made to an existing house  
In the case of having executed anti-earthquake improvement work to his/her house.
- (h) Special tax credit for specified housing improvements  
If a person has carried out improvement work on his/her house to make it barrier-free or improve energy conservation
- (i) Special tax credit for new building, etc. of a certified long-life quality house  
If a person has built a certified long-life quality house, or purchased one.
- (j) Special credit for digital certificates, etc  
If a person submits his/her final income tax return filing data by an e-Tax, attaching both his/her digital signature and digital certificate pertaining to the digital signature.
- (k) Credit for foreign tax  
If you have paid foreign income taxes
- (l) Deduction for withholding tax  
Income tax which has been withheld from salary or pensions, etc when received

#### Withholding tax system

Under the withholding tax system, the payers of salaries and wages, retirement allowance, interest, dividends, fees, etc., withhold a certain amount of income tax

at the time of payment, and pay it to tax offices.

With respect to employment income earned by a non-resident which is categorized as domestic source income, income tax at a fixed rate of 20% is withheld at source when the payment is made.

When the last salaries and wages of an applicable year are paid, the payer makes a year- end adjustment for the employees.

If a year- end adjustment is applied, employment income earners are not required to file a final return.

However, in the case that income from dividends or business income, etc. or the tax amount withheld at source from the retirement income or employment income is not sufficient, any excess or shortage in tax payment for the year must be adjusted again by filing a final return.

#### CONSUMPTION TAX

##### General outline

The consumption tax is categorized as an indirect tax by which almost every domestic transaction in goods and services and every transaction for the import of foreign goods are affected. They will be subject to taxation at a rate of 4% and together with a local consumption tax rate of 1%, the total effective rate is 5%.

The tax is assessed at each stage of the manufacturing, wholesale, and retail processes. Deductions for consumption taxes paid at previous stages by businesses result in the consumer bearing the full burden of the Consumption Tax.

##### Basic structure

$$\text{Tax due} = \boxed{\text{total amount of consumption tax on sales}} - \boxed{\text{total amount of consumption tax on purchases}}$$

(a) Basic formula to calculate tax  
The basic formula for calculating the tax is as follow:

(b) Taxable transactions  
Taxable transactions are domestic transactions and transactions for the import of foreign goods.

*i. Domestic transactions:*

Domestic transactions in which consideration is paid for the transfer or lease of assets or the provision of services for business purposes will be subject to taxation.

*ii. Import transactions:*

Foreign goods received or removed from a bonded area in Japan will be subject to taxation.

(c) Non-taxable transactions  
The following are classified as non taxable transactions  
Transactions not considered taxable:  
• The transfer or lease of land  
• The transfer of securities or instruments of payment  
• Providing services remunerated in the form of interest on savings or bank deposits or in the form of insurance premiums

Transactions based on social policy considerations.  
• Social insurance medical fee  
• School tuitions  
• The leasing of dwellings  
• Etc

(d) Tax exempt transactions  
The following are classified as tax exemption for exports, etc.  
• Export transactions  
• International communication services  
• International transportation services

(e) Taxpayers

*i. Domestic transactions:*

Enterprises (sole proprietors and corporations) conducting taxable transactions  
Non-residents and foreign corporations are subject to taxation when conducting taxable transactions in Japan.

*ii. Import transactions:*

Individual and corporations removing foreign goods from a bonded area  
Not only enterprises but also individuals who import goods as consumers must pay the tax.

(f) Tax rate  
The rate is a uniform rate of 4%.  
Together with an effective local consumption tax rate of 1%, the total effective tax rate is 5%.

(g) Place for tax payment

*i. Domestic transactions:*

• Place for tax payment by sole proprietors:  
Domicile or the place of resident  
• Place for tax payment by a corporation

The location of its head or main office

*ii. Import transactions:*

The location of bonded area from which the foreign goods are removed.

(h) Taxable period

*i. General rules:*

The taxable period for sole proprietors is the calendar year from January 1 through December 31. The taxable period for a corporation is its business year.

## *ii. Exceptions:*

By filing an application with the director of the tax office, a taxpayer can shorten the taxable period to one month or in the following.

- In case of sole proprietors:  
From January to March, April to June, July to September, and October to December
- In the case of a corporation whose business year exceeds three month:  
The corporation's business year divided into three month period.

(i) Filing tax returns and tax payment

### *i. Domestic transactions:*

The final consumption tax return is generally due two months after the end of the tax period, including special tax period.

Meanwhile, the due date for the final consumption tax return for a sole proprietor is 31st March of the year following the tax year

### *ii. Import transactions:*

Those who receive or remove taxable foreign goods from a bonded area must file a tax return with the director of the relevant customs office and pay tax at the time the goods are removed. In this case, an extension is allowed for up to 3 months if an application for extension of the time limit for payment is submitted and if security is provided.

(j) Interim tax returns

The annual consumption tax of the previous taxable period is:

More than 480,000 yen and less than 4,000,000 yen: Six-monthly interim returns

More than 4,000,000 yen and less than 48,000,000 yen: Three-monthly interim returns

More than 48,000,000 yen: Monthly interim returns

- (k) Bookkeeping obligations  
Enterprises must keep records of the following matters in their books:
- i. Transfers of assets, etc.
  - ii. Taxable purchase
  - iii. The removal of taxable foreign goods from bonded areas.

## **OTHERS**

Inheritance tax and Gift tax

Japanese inheritance tax and gift tax are based on the theory that these kinds of taxes should be considered as special components of the comprehensive individual income tax system which finds the individual's obligation to pay tax by examining the increase in his net assets during a given period.

Inheritance tax is levied on the increase in net assets of an individual resulting from an inheritance, bequest or devise. Gift tax is levied on the increase in the net assets of an individual resulting from a donation from other individuals, whereas a donation from a corporation is subject to income tax as occasional income. Generally, beneficiaries such as heirs domiciled in Japan are subject to inheritance tax or gift taxes on assets received regardless of the location of those assets.

However, if a non-domiciled person meets the following requirements, he or she becomes subject to Japanese inheritance and gift tax even when a person inherits or is gifted non-Japanese assets:

- i. A person has Japanese nationality
- ii. Either the heir or donor had domicile in Japan at any time within 5 years before the deceased's death or the gift.

### Inheritance tax rate (ten thousand yen)

Taxable Amount of Inheritance		Rate %	Deduction
Exceeding	Not Exceeding		
	1,000	10%	-
1,000	3,000	15%	50
3,000	5,000	20%	200
5,000	10,000	30%	700
10,000	30,000	40%	1,700
30,000		50%	4,700

Reference:  
 Kawada, G. (2010). Euwataisho zeikin guide 2010, Japan: Zaikai shoho sya.  
 Darcy, J. (2011). Japan master tax guide 2011/12, Singapore: CCH Asia Pte limited.

### Gift tax rate (ten thousand yen)

Taxable amount of Gift		Rate %	Deduction
Exceeding	Not Exceeding		
	200	10	-
200	300	15	10
300	400	20	25
400	600	30	65
600	1,000	40	125
1,000		50	225

### Other principal taxes

There are a variety of other taxes levied on income, the acquisition/ownership of assets, consumption and other transactions in addition to those described above. For example, taxes levied on the ownership of assets to which many businesses are subject include the fixed asset tax and the city planning tax.

In addition, there is a registration and license tax levied for the registration of real estate/companies and the issue of business licenses, as well as a stamp duty payable as a tax on stipulated documents.

# *HLB in Japan*

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