Tax on corporate lending and bond issues in Japan: overview

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A Q&A guide to tax on corporate lending and bond issues in Japan.

This Q&A provides a high level overview of finance tax in Japan and focuses on pre-completion tax clearances and disclosure of finance transactions, corporate lending and borrowing (including withholding tax requirements), taxation of the borrower and lender when restructuring debt, the Foreign Account Tax Compliance Act (FATCA) and bank levies, bond issues, plant and machinery leasing, securitisation and proposals for reform.

To compare answers across multiple jurisdictions, visit the tax on corporate lending and bond issues *Country Q&A Tool*.

The Q&A is part of the global guide to tax on transactions. For a full list of jurisdictional Q&As visit *global.practicallaw.com/taxontransactions-guide*.

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Tax authorities

1. What are the main authorities responsible for enforcing taxes on finance transactions in your jurisdiction?

The main authority responsible for enforcing national taxes is the National Tax Agency (NTA) (*kokuzei-cho*) which is an external body of the Ministry of Finance. The NTA is responsible for assessing and collecting taxes (*Articles 18 and 19, Act for Establishment of the Ministry of Finance*).

The NTA has:

- One head office.
- 11 regional taxation bureaus (*kokuzei-kyoku*).
- One Okinawa regional taxation office (*Okinawa kokuzei-jimusho*).
- 524 tax offices (*zeimu-sho*).

The tax offices are front line administrative offices responsible for assessing and collecting national taxes, although the regional taxation bureaus also levy and collect taxes directly from large taxpayers. The regional taxation bureaus and the tax offices generally have the closest contact with taxpayers.

The main authorities responsible for local taxes are the governors of each local government. However, the responsibilities of each governor are delegated to the tax department of its local government so that, in practice,

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local taxes are enforced by a tax department of each local government (*Articles 2, 3 and 3-2, Local Tax Act (LTA)* and *Article 149(iii), Local Government Act*).

Pre-completion tax clearances

2. Is it possible or necessary to apply for tax clearances from the tax authorities before completing a finance transaction?

Circumstances for obtaining clearance

There is no tax clearance system from the tax authority, but in certain cases the taxpayer can submit an enquiry before a transaction to request a written response from the NTA about whether it will be subject to taxes. This advance enquiry to the NTA functions in practice as a tax clearance. A taxpayer can generally request a written response from the NTA if the following conditions are satisfied:

- The taxpayer conducted, or will conduct, a certain transaction by itself.
- The taxpayer provides necessary information and materials for the transaction.
- No clear interpretation has been revealed by other written rulings.

Mandatory or optional clearance?

Submitting an advance enquiry is optional.

Procedure for obtaining clearance

The taxpayer requesting a written response must consent to the public disclosure of its enquiry and to the response from the NTA being publicly available, and file an application with the regional taxation bureau or the tax office that covers the place of tax payment.

A taxpayer can also obtain informal guidance on the tax treatment of a particular transaction through informal consultation with tax officers at regional taxation bureaus or tax offices. This informal guidance may provide some comfort for the taxpayer. When requesting informal guidance, general practice is to disclose the taxpayer's identity and detailed information about the transaction.

Disclosure of finance transactions

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3. Is it necessary to disclose the existence of any finance transactions to the tax authorities?

Circumstances where disclosure is required

There are no general requirements to disclose the existence of a finance transaction to the tax authority when the transaction closes. However, taxpayers must submit records of payments to the tax authorities (including the identities of recipients and payment details), such as interest, dividends, salaries, remunerations, certain fees and real estate rental fees. Generally, taxpayers must submit required payment records by the end of January of the next year. In a tax audit, a tax officer can request a taxpayer to disclose the existence and contents of finance transactions to examine whether the taxpayer's tax filing is legitimate and appropriate. The taxpayer must generally comply with a request from the tax officer for this information.

In addition, a company that seeks various tax deductions, exemptions or other benefits relating to finance transactions may be required to file documents that show an outline or details of the finance transaction to obtain the deduction, exemption or benefit. In relation to the filing, the company may have to disclose the existence of a finance transaction.

Under the attributable income principle that comes into effect the fiscal year commencing on or after 1 April 2016, where a domestic corporation's income is attributable to its permanent establishment in a foreign jurisdiction, the corporation must prepare documents evidencing the internal transaction with its permanent establishment in the foreign jurisdiction. As for a foreign corporation, if the income derived from a transaction with a third party is attributable to the foreign corporation's permanent establishment in Japan, the foreign corporation must prepare a document to evidence that the income is attributable to the permanent establishment.

In the Base Erosion and Profit Shifting (BEPS) Action Plan report (*Action Plan 13*), the OECD/G20 recommended adopting a new transfer pricing documentation rule that will require large-size multinational enterprises to file a master file, a country-by-country report and a local file with the relevant tax authorities. In the master file, the ultimate parent company of a multi-national enterprise must provide and explain an outline of any intergroup finance transactions.

Manner and timing of disclosure

The timing of disclosure is either on request from the tax officer or when a company seeks and applies for tax deductions, exemptions or other benefits. The manner of disclosure is usually to provide the related documents. As for the master file, the ultimate parent company must submit the master file within one year from the end of each fiscal year.

Taxes on corporate lending/borrowing

Taxes potentially chargeable on amounts receivable

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4. What are the main corporate taxes potentially chargeable on interest and other amounts receivable under a loan?

Interest and other amounts receivable under a loan usually constitute taxable income of the corporation. The main corporate income taxes are:

- National corporation tax.
- Local inhabitants' tax and local corporation tax.
- Local enterprise tax and special corporate enterprise tax.

Local inhabitants' tax and local enterprise tax are imposed by each local government according to the LTA and ordinances made by each local government, and therefore can vary to some extent. A certain portion of local inhabitants' tax and local enterprise tax was restructured as local corporation tax and special corporate enterprise tax imposed by the national government instead of each local government for the purpose of enabling the national government to redistribute that portion among local governments and address the regional tax revenue disparity.

National corporation tax

Key characteristics. National corporation tax is imposed on the taxable income (or net income) (*shotoku*) of domestic corporations, foreign corporations and other entities treated as corporations for Japanese tax purposes. Foreign corporations and other foreign entities are only liable to pay national corporation tax on income from sources in Japan. Domestic corporations must pay tax on all taxable income from domestic and foreign sources (*Article 4, Corporation Tax Act* (CTA))

Calculation of tax. A corporation's taxable income for each accounting period is generally calculated by subtracting deductible expenses from gross income. Interest and other amounts receivable under loans are classified as gross income (*Article 22, CTA*).

Triggering event. A corporation is liable to pay corporation taxes to the extent that it has earned taxable income during each accounting period.

Applicable rate(s). The normal national corporation tax rate is 23.4% for the fiscal years commencing on or before 31 March 2018 and 23.2% for the fiscal years commencing on or after 1 April 2018. A reduced rate of 15% applies to the first JPY8 million of taxable income earned by small or medium-sized companies , which are companies with a stated capital of JPY100 million or less (however, for a fiscal year commencing on or after 1 April 2019, a 19% corporate tax rate is applied to the first JPY8 million of taxable income earned by small or medium-sized companies which had average incomes greater than JPY1.5 billion in the preceding three years).

Local inhabitants' tax

Key characteristics. Local inhabitants' tax consists of tax on a per capita basis, and tax on a corporate tax basis.

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Calculation of tax. In general, the amount of tax on a per capita basis ranges from JPY70,000 to JPY3.8 million per year, based on the capital amount of a corporation and the number of employees. Tax on a corporation tax basis is calculated based on the amount of the national corporation tax.

Triggering event. A corporation is liable to pay local inhabitants' tax for each accounting period.

Applicable rate(s). The standard tax rate was 12.9% (the prefectural rate was 3.2% and the municipal rate was 9.7%) for fiscal years starting between 1 October 2014 and 30 September 2019, and the current standard tax rate has been reduced to 7.0% (the prefectural rate has been 1.0% and the municipal rate has been 6.0%) for the fiscal year commencing on or after 1 October 2019 (*Articles 51(1) and 314-4(1), LTA*), although some local governments imposed a slightly higher rate (for example, a corporation with its head office in the 23 special wards (*tokubetsu-ku*) of Tokyo was subject to rates from 12.9% to 16.3%) for fiscal years commencing between 1 October 2014 and 30 September 2019. In addition, the current applicable tax rate for a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo has been reduced by amendment of the Tokyo Metropolitan Tax Ordinance for the fiscal year commencing on or after 1 October 2019 (for example, a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo is subject to rates from 7% to 10.4%).

Local corporation tax

In 2014, to redress the tax income gap among local governments, the Japanese Government created a new local corporation tax in exchange for reducing the local inhabitants' tax. The tax is 4.4% on the amount of corporation tax for fiscal years commencing between 1 October 2014 and 30 September 2019, and 10.3% for fiscal years commencing on or after 1 October 2019.

Local enterprise tax

The rates and calculation of local enterprise taxes generally differ depending on the amount of the stated capital of a corporation (*Article 72-2, LTA*).

If the stated capital amount of a corporation is over JPY100 million, local enterprise tax is imposed on the basis of:

- A value-added factor on the amount of the added value. The tax rate is generally 1.2%, but some prefectures impose a slightly higher rate (for example, the tax applied to a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo is 1.26%).
- A capital factor on the stated capital amount. The tax rate is generally 0.5%, but some prefectures impose a slightly higher rate (for example, the tax applied to a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo 0.525%).
- An income factor on the taxable income. The progressive tax rate is generally from 0.3% to 0.7% for the fiscal years commencing on or before 30 September 2019, and from 0.4% to 1% for the fiscal years commencing on and after 1 October 2019. but some prefectures impose a slightly higher rate (for example, a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo was subject to a progressive rate from 0.395% to 0.88% for the fiscal years commencing on or before 30 September 2019, and is subject to a progressive rate from 0.495% to 1.18% for the fiscal years commencing on and after 1 October 2019).

(*Article 72-24-7(1), LTA* and *Article 2, Act on Interim Measures concerning the Local Corporation Special Tax*.)

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If the stated capital amount of a corporation is JPY100 million or less, local enterprise tax is only imposed under the income factor, at a progressive tax rate from 3.4% to 6.7% on or before 30 September 2019, and at a progressive rate from 3.5% to 7.0% for the fiscal years commencing on or after 1 October 2019 (*Article 72-24-7(1) LTA* and *Article 2, Act on Interim Measures concerning the Local Corporation Special Tax*).

In addition, insurance companies, gas suppliers and certain electrical suppliers calculate this tax based on their income (*Article 72-24-7(2), LTA*).

Local corporation special tax (abolished in 2019)

In 2008, the Japanese Government created a local corporation special tax in exchange for reducing the local enterprise tax, to redress the tax income gap between local governments and redistribute tax income among local governments. Local corporation special tax is an interim measure until the local tax reform regarding the tax income gap between local governments is implemented. Therefore, local corporation special tax was applicable only for fiscal years commencing on or before 30 September 2019 and was abolished on 1 October 2019 in exchange for the increase in the local enterprise tax (*see above, Local enterprise tax*) and the introduction of special corporate enterprise tax (*see below, Special corporate enterprise tax (introduced in 2019)*). The amount of the local corporation special tax was generally:

- For fiscal years commencing between 1 April 2016 and 30 September 2019, 414.2% of the income factor tax amount of the local enterprise tax, if the stated capital amount of a corporation is over JPY100 million.
- 43.2% of the amount of the local enterprise tax, for other corporations.

(*Article 9, Act on Interim Measures Concerning the Local Corporation Special Tax.*)

Special corporate enterprise tax (introduced in 2019)

In 2019, the Japanese Government created a special corporate enterprise tax, in exchange for reducing the local enterprise tax, to redress the tax income gap between local governments and to redistribute tax income among local governments. The special corporate enterprise tax is applicable for the fiscal years commencing on and after 1 October 2019.

If the stated capital amount is over JPY100 million, the special corporate enterprise tax is 260% of the general income factor tax amount of the local enterprise tax (*Article 7(i), Act on Special Corporate Enterprise Tax and Special Corporate Business Transfer Tax*).

Effective tax rate

The effective tax rate on taxable income for a corporation in Japan is generally about 29.74% (the rate is a little different in some prefectures).

Tax treaties and domestic law

The government has entered into tax treaties and conventions with many countries. When a tax treaty is applied to a transaction and there are differences between the tax treaty and domestic law, generally the tax treaty will apply.

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This chapter sets out Japanese domestic rules, regulations and procedures. Tax treaties vary from country to country, and apply many exemptions and reduced tax rates, as well as requirements that would otherwise apply under domestic law.

Tax reliefs available for borrowing costs

5. What corporate tax reliefs are available for borrowing costs (including interest and other amounts payable under a loan)?

Borrowing costs, including interest and other amounts payable under a loan, are generally deductible expenses. A borrower can deduct these costs from gross income when calculating taxable income for the accounting period. If interest on a loan is lower than the fair market rate, donation taxes can be imposed on the lender, while the borrower can only deduct the actual amount of interest paid (not the fair market rate of interest).

There is a thin capitalisation rule in cross-border transactions, which can limit the amount that a Japanese corporate borrower can deduct as interest and other amounts from its gross income for tax purposes.

Generally under this rule, if the average balance amount of loans and other credits and debts that a foreign controlling shareholder provides (by itself and through third parties) exceeds three times the amount of its equity share, interest and other debt costs payable to it relating to the excess debt are not deductible from taxable income of the Japanese corporation, unless the average balance amount of all debt bearing interest does not exceed three times the amount of the shareholders' equity (*Article 66-5(1), Act on Special Measures Concerning Taxation (ASMCT)*).

Instead of this three-times-multiple standard, a Japanese corporation can use other debt-to-equity ratios found to be appropriate compared with similar companies of the same size that conduct the same business.

For fiscal years commencing on or after 1 April 2013, the Japanese earnings stripping rule applies. Under this rule, if interest and other debt costs payable to certain controlling persons (and not subject to Japanese income tax or corporation tax) exceed 50% of the statutory base income amount, such excess was generally not deductible (*Article 66-5-2(1), ASMCT*).

In 2019, the Japanese Government revised the Japanese earnings stripping rule. For fiscal years commencing on or after 1 April 2020, if interest and other debt costs payable to persons (and not subject to Japanese income tax or corporation tax) exceed 20% of the statutory base income amount, that excess is generally not deductible.

However, any non-deductible excess may be carried forward for 7 fiscal years and deducted until the 50% (20% for fiscal years commencing on or after 1 April 2020) threshold has been reached (*Article 66-5-3(1), ASMCT*).

If both this rule and the thin capitalisation rule described above are applicable, the larger non-deductible amount will apply (*Article 66-5(4), 66-5-2(7), ASMCT*).

Tax payable on the transfer of debt

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6. What corporate, transfer, stamp or other taxes are payable on the transfer of a debt under a loan?

Corporation tax

A lender's gain from the transfer of a loan is taxable income subject to corporate taxes (*see Question 4*). The gain is generally calculated by deducting the base cost of the transferred loan from the sale price of the transferred loan.

Similarly, if a lender makes a loss on the transfer of a loan, the loss is generally deductible from its taxable income. The price of the transferred loan must be at fair market value, considering various factors including valuation of collateral, status and conditions of the borrower's assets and business. Overpricing or underpricing can trigger donation tax issues.

A borrower is generally not liable to pay tax when the lender transfers the loan.

Stamp tax

Stamp tax is imposed on an agreement to transfer a loan, and both the transferor and the transferee are jointly liable to pay stamp tax. An original agreement (or its amending agreements) to transfer a loan incurs a JPY200 stamp tax on each document, if the contract price specified in the agreement is greater than or equal to JPY10,000 or such price is not specified in the agreement. If such price is less than JPY10,000, no stamp tax will be imposed.

Withholding tax

7. Is there withholding tax on interest or any other payments under a loan?

When withholding tax applies

No withholding tax is imposed on interest or any other payments under a loan payable to Japanese residents or Japanese domestic corporations.

Interest under a loan payable to non-residents or foreign corporations is subject to Japanese withholding tax, provided the source of interest is from Japan. The source of interest is generally deemed to be from Japan when the borrower conducts its business in Japan and uses funds provided under the loan for business in Japan. Lenders should be aware that source rules under a tax treaty can override Japanese source rules.

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Applicable rate(s) of withholding tax

The rate of withholding tax on interest is 20.42% unless a reduced rate or exemption under a tax treaty applies (*Articles 161, 162, 212 and 213, Income Tax Act (ITA), Article 28, Act on Special Measures for Securing Financial Resources Necessary to Implement Measures for Reconstruction Following the Great East Japan Earthquake (ASMRGEJE)*).

Exemptions from withholding tax

No withholding tax is imposed on interest under a loan payable to a non-resident or a foreign corporation that has a permanent establishment in Japan where the interest is attributed to the permanent establishment in Japan, if the non-resident or foreign corporation obtains a certificate from the relevant tax office and presents the certificate to the borrower before any payments of interest (*Articles 180 and 214, ITA*), although this interest is subject to Japanese income tax or corporation tax imposed on the non-resident or the foreign corporation.

In addition, no withholding tax is imposed on interest paid by a financial institution on a deposit or a loan recorded in a special international financial transactions account (as set out in the Foreign Exchange and Foreign Trade Act) to a foreign corporation (*Article 7, ASMCT*).

Other exemptions from withholding tax or a reduced rate of withholding tax on interest payments may be available if the lender benefits from a tax treaty.

For a comparative summary of withholding tax on interest, see table, *Withholding tax requirement on interest on corporate debt, and the key exemptions*, in this global guide.

Guarantees

8. Do any particular tax issues arise on the provision of a guarantee?

A commission or charge payable from a borrower to a guarantor in relation to a guarantee is generally deductible from the borrower's taxable income, and is taxable income of the guarantor.

If a guarantor is a foreign corporation without a permanent establishment in Japan, guarantee commissions or charges payable to the guarantor are not Japan-source income. As a result, the guarantor is not liable to Japanese tax on the income from guarantee commissions or charges.

In the context of the thin capitalisation rule (*see Question 5*), loans and other debts guaranteed by a foreign controlling shareholder are treated as loans from the foreign controlling shareholder. Deduction of interest paid on these loans and other debt, as well as guarantee commissions and charges, may be restricted by the thin capitalisation rule (*Article 39-13(14) and (16), ASMCT Enforcement Order*). Please note that if a guarantor is a controlling person under the Japanese earnings stripping rule (*see Question 5*), then guarantee commissions or charges payable to such guarantor are subject to the limits on deduction (*Article 39-13-2(3)(i), ASMCT Enforcement Order*).

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Restructuring debt

Unpaid or deferred interest or capital

9. What is the tax treatment of the borrower and the lender if interest or capital is unpaid or deferred?

Lender

The lender must generally recognise interest income on an accrual basis, even if the borrower does not actually pay the interest to the lender (*Corporation Tax Basic Circular (CTBC) 2-1-24*). However, the lender can recognise interest income on a cash basis if one of the following applies (*CTBC 2-1-25*):

- Any interest payable during the six months from the last date of the accounting period is unpaid to the lender and, other than that interest, little or no interest is paid to the lender for that six months, due to the borrower's insolvency or other reasonable reasons regardless of the lender's demand to the borrower.
- In relation to the borrower, procedures under the Corporate Reorganisation Act begin.
- Risk of loss of all or a considerable portion of a loan arises, because the borrower's insolvency continues for a reasonable period and there is no expectation of an upturn in the business or assets condition of the borrower, or other similar reasonable reasons.
- On determination of approval under the Corporate Reorganisation Act by a creditors' meeting or other similar reason, the collection of all or a considerable portion of the loan is extended over about two years.

Borrower

The borrower is not subject to tax if interest, capital or principal is unpaid or deferred. If the lender waives the borrower's debt capital or principal, the borrower must recognise the amount of debt waived as taxable income (*see Question 10*).

Debt write-off/release and debt for equity swap

10. What is the tax treatment of the borrower and lender if a loan is:

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- Written off or released (wholly or partly)?
- Replaced by shares in the borrower (debt for equity swap)?

Write-off or release of a loan

Bad debt loss. The lender can deduct the entire amount of the write-off or release of a loan under a borrower's legal bankruptcy procedure or reasonable out-of-court workout procedure (*CTBC 9-6-1*). Further, when it becomes clear to the lender that the entire amount of the loan is uncollectable in light of the borrower's ability to repay and the borrower's asset situation, the lender can deduct all the amount of the write-off. Before any deduction, the lender must first dispose of, and make collections based on, any collateral that secures repayment of the loan (*CTBC 9-6-2*).

If a parent company has to write off or release a loan to its subsidiary in connection with, for example, the winding-up or sale of the subsidiary, and the parent company has a material reason to do so, so that the parent company may incur additional losses without the write-off or release, the parent company can also deduct the write-off or release of the loan to the subsidiary (*CTBC 9-4-1*).

In these cases, the borrower is deemed to receive debt-waiver income (that is, deemed to have received income equivalent to the debt that is released) which is taxable income. In certain cases (for example, under the Corporate Reorganisation Act), the borrower can use net operating losses that have already expired to offset debt-waiver income.

Bad debts reserve. The lender that establishes a bad debts reserve account can deduct the credited amount to a bad debt reserve account from taxable income, subject to certain restrictions and limitations under the CTA (*Article 52, CTA*). However, this deduction is only available to:

- Small or medium-sized companies.
- Banks, insurance companies or other similar companies.
- Certain companies holding certain monetary claims, including those arising from a lease treated as finance lease (*see* Question 21).

Debt-for-equity swap (DES)

A DES is generally carried out through a contribution-in-kind, in which the creditor contributes debt of the borrower in exchange for receiving shares in the borrower. A DES where a corporation directly or indirectly holds all the issued shares of the other corporation is usually tax-qualified (*see below*). In other DESs, requirements to be tax-qualified are hard to satisfy.

Both of the following apply if the DES is classified as a tax-qualified contribution-in-kind:

- The lender acquires the borrower's shares at a price equal to its book value of the loan (*Article 62-4, CTA*). Therefore, the lender is not subject to corporate tax for the DES.

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- The borrower receives the loan at the lender's book value. If the lender's book value is equal to the face value of the loan, the borrower is also not subject to corporation tax for the DES.

Both of the following apply if the DES is not tax-qualified:

- The lender acquires the borrower's shares at a price equal to the fair market value of the loan. If there is a difference between the book value and the fair market value of the loan, the lender recognises (that is, reports for corporation tax purposes) a gain or loss equal to the difference. In this case, the loss is only thought to be tax deductible for tax purposes if the DES is based on a reasonable turnaround plan.
- The borrower receives the loan at the fair market value of the loan. If the fair market value of the loan is lower than the face value of it, the borrower must recognise the difference as debt-waiver income.

Foreign Account Tax Compliance Act (FATCA)

11. Has your jurisdiction entered into an intergovernmental agreement (IGA) to implement FATCA, or do you intend to enter into an IGA to implement FATCA?

Japan entered into an IGA, the "Statement of Mutual Cooperation and Understanding between the US Department of the Treasury and the Authorities of Japan to Improve International Tax Compliance and to Facilitate Implementation of FATCA", on 11 June 2013. This IGA is in line with the Model 2 IGA released by the IRS.

The principal terms of the IGA are as follows:

- A foreign financial institution in Japan is not required to execute an FFI Agreement with the IRS.
- Each Japanese financial institution that registers and implements the requirements of an FFI Agreement should be treated as complying with the requirements of, and as not subject to withholding under, the US FATCA.
- The United States should not require a Japanese financial institution to withhold tax under the US FATCA with respect to an account held by a recalcitrant account holder, or to close such an account, as long as:
    - the Japanese financial institution carries out the necessary due diligence and reporting required by the IGA; and
    - the account information of non-consenting holders requested by the IRS is provided with the IRS through the Japanese NTA.

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12. Have there been any particular difficulties in light of your jurisdiction's domestic legislation with implementing the FATCA requirements?

Implementing the FATCA requirements raised issues related to the Personal Data Protection Act in Japan and to the confidentiality obligation owed by financial institutions. To reconcile these issues with FATCA requirements, the IGA provides a framework for inter-government information exchange. Specifically:

- A Japanese financial institution is not required to report individual account information but instead required to report aggregate account information held by non-consenting US persons.
- The US authority will request that the Japanese authority provide it with information regarding account information that the non-consenting US persons hold, under the information exchange clause in the Japan-US tax treaty.
- Under domestic Japanese laws, the Japanese authority obtains the requested information from the specified Japanese financial institution, and provides it to the US authority. The Japanese financial institution will provide relevant information to the Japanese authority in accordance with Japanese domestic laws.

13. Are there any provisions of your jurisdiction's IGA and/or domestic implementing legislation, if any, that are more onerous than the US FATCA requirements?

There are no such more onerous provisions.

Bank levies

14. Are there any bank levies or similar taxes imposed specifically on financial institutions?

There are no bank levies or similar taxes imposed specifically on financial institutions in Japan.

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15. On what are any such levies or taxes charged?

Not applicable (*see Question 14*).

Exemptions

16. At what rate(s) are the levies or taxes charged?

Not applicable (*see Question 14*).

17. Are there any thresholds or exemptions?

Not applicable (*see Question 14*).

Bond issues

18. For corporate taxation purposes, are bonds treated any differently from standard corporate loans?

Withholding tax

In contrast to interest payments under a loan (*see Question 7*), interest on bonds (including national government bonds, local government bonds or bonds issued by Japanese corporations) paid to a Japanese resident or a Japanese corporation is subject to national level withholding tax at 15.315% (*Articles 23, 181, 182, 212 and 213, ITA and Article*

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28, ASMRGEJE). Only Japanese individual residents are subject to local withholding tax of 5% in addition to the above income withholding tax (*Article 71-6, LTA*).

Interest on bonds paid to a non-resident or a foreign corporation is subject to withholding tax at 15.315% (*Articles 161, 212 and 213, ITA* and *Article 28, ASMRGEJE*) if it is Japan-source income. Even when a non-resident or a foreign corporation has a permanent establishment in Japan, no exemption from the withholding tax under Article 180 or Article 214 of the ITA is available.

Corporate bondholders

Bonds are classified as securities for corporation tax purposes. If a Japanese company holds corporate bonds for the purpose of making profits on market movements on a short-term basis, it must assess corporate bonds on a market value basis at the end of its accounting period, and recognise any changes in value as income or loss for that period (*Article 61-3, CTA*).

Interest on bonds paid to a Japanese domestic corporation constitutes taxable income of the domestic corporation and is subject to corporate income taxes. Amounts that have been withheld as withholding taxes are deducted from the amount of corporate income taxes that the domestic corporation would have to pay.

Corporate issuers

For corporate issuers, the tax consequences of issued bonds are basically the same as those for corporate loans (*see Question 4 and Question 5*).

Interest on bonds paid to bondholders is generally a deductible expense for tax purposes.

Expenses incurred to issue bonds can, at the option of the taxpayer, be expensed in the accounting year in which they are incurred, or capitalised and deducted in the following years (*Article 64(1)(i), CTA Enforcement Order*).

The difference between the amount received for the issuance of a bond and its face amount is recognised as a profit or loss in an equal amount over the total months of the redemption period of the bond, on a straight-line method (*Article 136-2(1), CTA Enforcement Order*).

Taxes payable on the issue and/or transfer of a bond

19. What stamp, transfer or similar taxes are payable on the issue and/or transfer of a bond?

Stamp tax on the issuance of bonds

No stamp tax is imposed when the issuer issues corporate bonds without physical bond certificates (such as when bonds are issued under a book-entry transfer system). However, the issuance of physical bond certificates is subject to stamp tax at the following rates:

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- JPY200 for a bond certificate of up to JPY5 million.
- JPY1,000 for a bond certificate of more than JPY5 million to JPY10 million.
- JPY2,000 for a bond certificate of more than JPY10 million to JPY50 million.
- JPY10,000 for a bond certificate of more than JPY50 million to JPY100 million.
- JPY20,000 for a bond certificate of more than JPY100 million.

The bond issuer is liable to pay the stamp tax. The stamp tax is only triggered when the issuer issues a physical bond certificate.

Income tax on transfer of bonds

For corporations, the profit from the transfer of bonds is treated as taxable income subject to corporate taxes. The profit is generally calculated by deducting the base cost of the transferred bond from the sale price of the transferred bond (*Article 22(2) and 61-2, CTA*).

Similarly, if corporations make a loss on the transfer of bonds, the loss is generally deductible from its taxable income. The price of the transferred bonds must be at a fair market value (*Article 22(3) and 61-2, CTA*).

For individuals, profits from the transfer of government bonds or bonds issued by Japanese corporations are generally taxable separately from other income (*Articles 37-10 and 37-11, ASMCT*). The amount of applicable capital gains tax is 20.315% of the net proceeds of sale less the acquisition cost of the bonds for residents of Japan (and 15.315% of the net proceeds of sale less the acquisition cost of the bonds for non-residents of Japan).

Stamp tax on transfer of bonds

Bond transfers are not subject to stamp tax.

Exemptions

20. Are any exemptions available?

Exemption from Japanese income/corporation tax

Subject to certain requirements set out in the ASMCT, non-resident individuals and foreign corporations are entitled to be exempted from income tax and corporation tax on interest on and profits from redemptions of the following:

- Corporate bonds that were issued outside Japan and the interest paid outside Japan.

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- Japanese government bonds or local government bonds issued in the book-entry transfer system in Japan.
- Corporate bonds issued in the book-entry transfer system in Japan.

(*Articles 5-2, 5-3, 6, 41-13 and 67-17, ASMCT*.)

For individuals, profits from the transfer of discount bonds are exempt from income tax (*Article 37-15, ASMCT*).

Exemption from withholding tax

Interest on public or corporate bonds that are issued in the Japanese book-entry transfer system and recorded in the transfer accounts of the bondholder is exempt from withholding tax, if the bondholder is either:

- A financial institution that has a business office in Japan.
- A corporation confirmed by the book-entry transfer institution as having a stated capital of JPY100 million or more.

(*Article 8, ASMCT* and *Articles 3-3(7), (8) and (9), ASMCT Enforcement Order*.)

Interest on bonds received by securities investment trusts or pension trusts is exempt from withholding tax (*Articles 176 and 180-2, ITA*).

Plant and machinery leasing

Claiming capital allowances/tax depreciation

21. What are the basic rules for enabling the lessor or lessee of plant and machinery to claim capital allowances/tax depreciation?

Japanese tax law generally recognises lease transactions in which the lessor holds ownership of the assets and leases the assets to the lessee. Therefore, the lessor can claim a tax allowance for depreciation of the leased assets.

However, if a lease transaction meets both the following requirements, the leased asset is treated as a finance lease when the leased asset is transferred from lessor to lessee:

- The contract of the lease cannot be cancelled during the lease term (non-cancellable).
- The lessee can effectively enjoy economic benefits arising from the asset, and is substantially obliged to pay for expenses incurred due to use of the asset (full-payout).

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(*Article 64-2, CTA*.)

Under a finance lease, the lessee is treated as the buyer of the leased asset and, as a result, can claim a tax allowance for depreciation relating to the asset. The lessor recognises the excess of the lease payments over the cost of the leased asset as income.

A lease transaction entered into before 1 April 2008 is recognised as a finance lease for tax purposes (that is, the leased asset is treated as if it were sold to the lessee) if it satisfies one of the following conditions or its equivalent (title transfer conditions), in addition to the two conditions set out above:

- The leased asset will be transferred to the lessee at no charge or for a nominal charge during or at the end of the lease period.
- The lessee has the right to purchase the leased asset at a significantly low price during or at the end of the lease period.
- Considering the type, intended purpose and installation circumstances of the leased asset, only the lessee is expected to use the asset throughout its useful life or it is hard to identify the leased assets.
- Considerable differences between the lease period and the statutory useful life of the asset allow a remarkable decrease of corporation tax or income tax of the lessee or the lessor.

(*Article 21, Supplementary Provisions of the 2007 amendments to CTA Enforcement Order (Cabinet Order No. 83 of 2007).*)

If a lease is not treated as a finance lease, the lessor can claim a tax allowance for depreciation on the leased asset.

Rate of capital allowances/tax depreciation

22. What is the rate of capital allowances/tax depreciation; does it depend on the type of assets?

The rate (useful life) and method of tax depreciation depends on the type and the acquisition date of the asset.

The lessee in a finance lease which satisfies one of the title transfer conditions (*see Question 21*) (title transfer finance lease) must depreciate the leased asset using the same method as other depreciable assets that are acquired by the lessee. A lessee in a finance lease other than a title transfer finance lease must depreciate the leased asset using the straight-line lease period method (*Article 48-2(1)(vi), CTA Enforcement Order*).

Lessees not carrying on business in the jurisdiction

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23. Are there special rules for leasing to lessees that do not carry on business in your jurisdiction?

In lease transactions entered into before 1 April 2008 that satisfy the non-cancellable and full-payout requirements (*see Question 21*), if the lessee is a non-resident or a foreign corporation, the lessor must use the former straight-line foreign lease period method to calculate depreciation. In this formula, the acquisition price minus the estimated residual value is depreciated using the straight-line method (*Article 48(1)(vi), CTA Enforcement Order*).

If a lease transaction was entered into on or after 1 April 2008 and satisfies the non-cancellable and full-payout requirements, that lease transaction is treated as a finance lease. Therefore, the lessee is treated as the buyer of the leased asset and can claim tax depreciation relating to the asset. The lessor recognises the excess of the lease payments over the cost of the leased asset as income (*see Question 21*).

If a lease transaction does not satisfy the non-cancellable and full-payout requirements and was entered into on or after 1 April 2008, the lessor must depreciate the leased asset using the same method as ordinary depreciable assets, even if the lessee is a non-resident or a foreign corporation.

Leases of assets to entities that are not Japan-resident are generally exempt from Japanese consumption tax (*Article 7, Consumption Tax Act*).

Taxation of rentals

24. How are rentals taxed?

If a lease transaction is recognised as a finance lease for tax purposes, the lessee generally treats the rent payments that it makes as instalment payments of the purchase price for the leased asset and interest on them. The lessor treats the rent payments that it receives as the collection of accounts receivable and interest on them related to the sale of the leased asset by deferred payments.

If a lease transaction is not deemed to be a finance lease (and is treated as an ordinary lease), rent payments by the lessee are usually deductible from taxable income and rental payments received by the lessor are generally taxable income of the lessor.

Rulings and clearances

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25. Is a ruling or clearance necessary or common?

No ruling or clearance is necessary (*see Question 2*).

Securitisation

26.Briefly explain the key features of the tax regime applicable to securitisations, including details of any specific tax rules that apply or issues that arise in relation to securitisations.

The tax regime and tax issues on securitisations vary depending on securitisation schemes and structures. This answer looks at general tax aspects of:

- A *Tokumei Kumiai* (TK) agreement, which is commonly used for securitisation of real estate.
- A *Tokutei Mokuteki Kaisha* (TMK), which is a special corporation designed for securitisation vehicles.

TK structure

A TK agreement is a bilateral agreement between a business operator (*eigyo-sha*) and a silent partner (*tokumei-kumiai-in*) under the Commercial Act of Japan. A silent partner (usually an investor) contributes (or agrees to contribute) cash or other assets into the business operator, in exchange for participating in profits and losses of the business (TK Business) of the business operator. A TK is not a legal entity but a bilateral agreement between a business operator and a silent partner. All titles, assets, rights and obligations of the TK Business belong to the business operator.

The business operator is liable to pay tax on the TK Business. However, the profits of the TK Business allocated to the silent partner are deductible from the taxable income of the business operator, while the losses of the TK Business allocated to the silent partner must be added to the taxable income of the business operator (*CTBC 14-1-3*). Distribution of profits under a TK agreement is subject to withholding tax at the rate of 20.42% (*Articles 161, 174 and 210 to 213, ITA and Articles 26 and 27, ASMRGEJE*).

TMK structure

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A TMK is a corporation established under the Law Concerning Liquidation of Assets (Securitisation Law), and is classified as a domestic corporation for tax purposes and therefore subject to corporate tax similar to ordinary corporations in Japan, but is entitled to enjoy some preferable tax treatment.

The main feature of a TMK is that a TMK can claim a deduction for dividends payable to shareholders in calculating taxable income, if the requirements listed below are satisfied (*Article 67-14, ASMCT and Article 39-32-2, ASMCT Enforcement Order*).

Requirements relating to the TMK structure itself. All of the following requirements must be satisfied:

- The TMK is established and registered under the Securitisation Law.
- One of the following four requirements is met:
  - the TMK has issued bonds through a public offering, and the amount of the bonds is JPY100 million or more;
  - the issued bonds are subscribed for only by certain categories of institutional investors (defined in the ASMCT and its ordinance), such as banks, securities companies and insurance companies;
  - the preferred shares (Yusen Shussi) of the TMK are subscribed for by 50 or more investors; or
  - the preferred shares are subscribed for only by institutional investors.
- The TMK's asset securitisation plan specifies that more than 50% of each series of preferred shares and certain subordinated equity shares are offered in Japan.
- The fiscal periods of the TMK must be one year or less.

Relating to the TMK in each accounting year when the TMK claims a deduction for dividends. All of the following requirements must be met:

- The TMK conducts its securitisation business in accordance with its asset securitisation plan and does not conduct other business.
- The TMK has entrusted the specified assets (which generally means underlying assets of the securitisation) in a trust account, or delegated management and disposal of the specified assets to the third party.
- The TMK is not a certain type of family corporation (defined in Article 2(x) of the CTA) at the end of the accounting year.
- The amount of dividends relating to the accounting year exceeds 90% of the earnings available for dividends for that accounting year.
- The TMK is not an unlimited liability shareholder in any general partnership corporation (*Goumei Kaisha*) or any limited partnership corporation (*Goushi Kaisha*).
- The TMK does not own any assets other than the specified assets set out in its asset securitisation plan and other necessary assets to conduct its securitisation business.
- If the TMK owes loans, the lenders are institutional investors described above and not subordinated equity shareholders in the TMK.

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A TMK also enjoys reduction of real estate taxes. Real estate acquisition tax is imposed on a real estate buyer. In calculating real estate acquisition tax, the tax base of buildings and land which a TMK acquires under its asset securitisation plan before 31 March 2021 is reduced to two-fifths of normal taxable base, when 75% or more of the specified assets that the TMK owns are buildings and land (and their equivalent) (*Article 11(3), Supplementary Provisions of the LTA* and *Article 7(3), Supplementary Provisions of LTA Enforcement Order*).

Registration and licence tax is imposed on a person who seeks to register ownership of real estate, or mortgages on them. The rate of registration and licence tax on the transfer of buildings and land that the TMK acquires under its asset securitisation plan before 31 March 2021 is reduced to 1.3% of the price of the real estate, as long as certain requirements set out in the ASMCT are satisfied (*Article 83-2-2, ASMCT*).

Reform

27. Please summarise any proposals for reform that will impact on the taxation of finance transactions described above.

Under the tax reform in 2020, tax measures to promote open innovation and encourage investment, wage increases and so on were introduced in order to achieve sustainable economic growth. In addition, the NISA (Nippon Individual Savings Account, a tax exemption programme for small investments) system and the international taxation system were revised. However, there has been no specific tax reform that has had a major impact on finance transactions that requires further discussion in this chapter.

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Recent transactions

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- Representing a Japanese corporation at the National Tax Tribunal concerning assessment of a withholding tax on a securitisation transaction and winning a final judgment ordering the cancellation of the tax assessment.
- Representing a Japanese bank in tax litigation concerning repurchase agreement transactions and winning a final judgment at the Supreme Court of Japan for a recovery of JPY6.3 billion.

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