

Tax on corporate transactions in Japan: overview

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TAX AUTHORITIES

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

National tax

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.

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*).

Local tax

The main authorities responsible for local taxes are the governors of each local government. The responsibilities of each governor are delegated to the tax department of the local government, which enforces local taxes in practice.

Pre-completion clearances and guidance

2. Is it possible to apply for tax clearances or obtain guidance from the tax authorities before completing a corporate transaction?

Japanese tax laws do not provide a tax clearance system from the tax authority. However, in certain cases, a taxpayer can submit an enquiry before a transaction to request a written response from the NTA as to whether it will be subject to tax in accordance with NTA procedures. This advance enquiry would work as a *de facto* tax clearance. However, the written response from the NTA is not legally binding. A taxpayer requesting a written response must apply to the regional taxation bureau or the tax office that covers the place for tax payment. In addition, the content of the enquiry and response is published on the NTA website.

A taxpayer can also obtain informal guidance on the tax treatment of a particular transaction through informal consultation with the tax officers of the regional taxation bureaus or tax offices. This informal guidance may provide some comfort for the taxpayer, although it is also not legally binding. When requesting informal guidance, general practice is to disclose the taxpayer's identity and detailed information about the transaction.

MAIN TAXES ON CORPORATE TRANSACTIONS

Transfer taxes and notaries' fees

3. What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions?

Corporation tax

See *Question 4*.

Registration and licence tax

Key characteristics. This tax is imposed on various registrations, such as registrations, charters, patents, licences, authorisations, permissions, and so on.

Triggering event. This is imposed on a change in the real estate register concerning real estate acquisition.

Liable party/parties. The acquirer is liable to pay this tax.

Applicable rate(s). The tax basis is the value of the real estate, which is registered in the fixed asset tax rolls, and the standard rate is 2%. This rate is reduced to 1.5% if registration is made on or before 31 March 2015 (*Item 1(2)c of Annex 1 to the Registration and Licence Tax Act (RLTA), Article 7, the supplementary provision of it, and Article 72(1)(i), Act on Special Measures Concerning Taxation (ASMCT)*).

Real estate acquisition tax

Key characteristics. This is generally imposed on real estate acquisition. As an exception, real estate acquisition tax is not imposed on the transfer of real estate that is made through a merger or demerger (*Article 73-7(ii), Local Tax Act (LTA)*).

Triggering event. This tax is imposed when ownership of real estate is transferred.

Liable party/parties. The acquirer is liable to pay this tax.

Applicable rate(s). The tax basis is the value of the real estate, the amount of which is primarily derived from that registered in the fixed asset tax rolls. The standard rate is 4%, which may be reduced under Article 11-2 of the supplementary provision of the LTA (*Article 73-15, LTA and Article 11-2, the supplementary provision of LTA*).

Stamp duty

Key characteristics. Stamp duty is imposed when certain types of documents are executed. No stamp duty is imposed on documents not listed in Annex 1 to the Stamp Tax Act, such as share purchase agreements.

Triggering event. This tax is imposed on a variety of documents, which include:

- Real estate transfer agreements (the level of tax per document can be up to JPY480,000) (*Article 91(2), ASMCT*).
- Business transfer agreements (the level of tax per document can be up to JPY600,000 (*Annex 1 to the Stamp Tax Act*).
- Share certificates (the level of tax per document can be up to JPY20,000) (*Annex 1 to the Stamp Tax Act*).
- Merger agreements and demerger agreements (the level of tax per document is JPY40,000) (*Annex 1 to the Stamp Tax Act*).

Liable party/parties. The person or entity that prepares the documents must pay stamp duty.

Applicable rate(s). See above, *Triggering event*.

Corporate and capital gains taxes

4. What are the main corporate and/or capital gains taxes potentially payable on corporate transactions?

The main corporate taxes that a corporation's income on corporate transactions is potentially subject to are:

- National corporation tax.
- Local inhabitants' tax.
- Local enterprise tax.

Local inhabitants' tax and local enterprise tax are imposed by each local government in accordance with the LTA and ordinances established by each local government, and therefore vary to some extent. In 2008, the government created a new local corporation special tax as an interim step in exchange for reducing the local enterprise tax.

National corporation tax

This is imposed on the taxable 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 corporation tax on income from sources in Japan. Domestic corporations are liable to pay taxes on all taxable income from domestic and foreign sources.

A corporation's taxable income for each accounting period is generally calculated by subtracting deductible expenses from gross income. For deductible expenses, a company that consecutively files blue returns (*aoiro-shinkoku*) and incurs tax losses in any given tax year can carry forward such losses to deduct from future taxable profits for up to the following nine years. This is applicable to tax losses incurred in fiscal years ending on or after 1 April 2008. Losses incurred before 1 April 2008 can be deductible for the following seven years. Due to the 2011 tax reform, a ceiling on the deductible amount for companies other than small or medium-sized companies has been reduced from 100% to 80% of the taxable income for the fiscal tax year commencing on or after 1 April 2012.

The normal corporation tax rate is 25.5% for a fiscal year commencing on or after 1 April 2012. 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.

Special reconstruction corporation tax

To secure fund raising to support recovery programmes for the Great East Japan Earthquake in 2011, a special reconstruction corporation tax was introduced under the 2011 tax reform (*Act on Special Measures for Securing Financial Resources Necessary to Implement Measures for Reconstruction Following the Great East*

Japan Earthquake (ASMRGEJE)). When it was implemented, this tax was intended to be imposed on domestic and foreign companies for three fiscal years from 1 April 2012 to 31 March 2015, assuming that the companies continued to select fiscal years which started from 1 April and ended 31 March. However, the 2014 tax reform repealed this tax one year earlier. As such, this tax does not apply starting from fiscal year 2014, the first day of which is 1 April 2014 (*Articles 40(x) and 45(1), ASMRGEJE*). The tax base is the base corporation tax liability (corporation tax liability before taking income/foreign tax credits, and so on into account) for each taxable fiscal year and tax rate is 10%.

Local inhabitants' tax

The local inhabitants' tax consists of:

- Tax on a per capita basis, generally based on the capital amount of a corporation and the number of employees, which ranges from JPY70,000 to JPY3.8 million per year.
- Tax on a corporation tax basis, generally based on the amount of corporation tax.

The tax rate is generally 17.3% (the prefectural rate is 5%, and the municipal rate is 12.3%). This rate will be decreased for fiscal years beginning on or after 1 October 2014 to 12.9% (the prefectural rate will be decreased to 3.2% and the municipal rate will be decreased to 9.7%). Some prefectures, however, impose a slightly higher rate (for example, a corporation with its head office in Tokyo is subject to rates ranging from 17.3% to 20.7%, although these rates will also be decreased for fiscal years beginning on or after 1 October 2014 to new rates (which range from 12.9% to 16.3%)). The decreased rate (4.4%) equals the rate of local corporation tax which will be introduced for fiscal years beginning on or after 1 October 2014 (*see below, Local corporation tax*).

Local enterprise tax

The rates and calculation of local enterprise taxes generally differ depending on whether the stated capital amount of a corporation is over JPY100 million or not (*Article 72-2(1)(i), LTA*).

If the stated capital amount is over JPY100 million, local enterprise tax is imposed based on:

- A value added factor (0.48%) on the amount of the added value.
- A capital factor (0.2%) on the stated capital amount.
- An income factor (that ranges from 2.2% to 4.3% at a progressively increasing rate) on the taxable income.

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%.

In addition, insurance companies, electrical suppliers and gas suppliers calculate this tax based on their income (*Article 72-2(1)(ii), LTA*).

Local corporation special tax

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. The amount of the local corporation special tax is generally (*Article 9, Act on Interim Measures Concerning the Local Corporation Special Tax*):

- 67.4% 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.

Local corporation tax

This tax will be introduced for fiscal years beginning on or after 1 October 2014. The tax base is the base corporation tax liability (corporation tax liability before taking income/foreign tax credits, and so on into account) for each taxable fiscal year and the tax rate is 4.4%.

The tax rate is equal to the decrease in the local inhabitants' tax which will take effect for fiscal years beginning on or after 1 October 2014. This reform is intended to redress the tax income gap among local governments.

Effective tax rate

The effective tax rate on taxable income for a Japanese corporation is generally about 35% (the rate is a little different in some prefectures). However, the effective corporation tax rate for the two fiscal years commencing on or after 1 April 2012 is about 38% due to the special reconstruction corporation tax (*see above, Special reconstruction corporation tax*).

Tax treaties and domestic law

The Japanese 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 the domestic law, the tax treaty generally prevails. Tax treaties vary from country to country and stipulate many exemptions, reduced tax rates and requirements that may apply.

Value added and sales taxes

5. What are the main value added and/or sales taxes potentially payable on corporate transactions?

Consumption tax

Key characteristics. Consumption tax is similar to value added tax, as it is calculated by offsetting the amount of consumption tax on taxable purchases (and other certain amounts) from the amount of consumption tax on taxable sales (*Article 30, Consumption Tax Act*).

Triggering event. Consumption tax is imposed on taxable transactions, which generally include:

- The transfer or lease of assets or services that are provided as a business in Japan for consideration (domestic transactions) (*Article 4(1), Consumption Tax Act*).
- Import transactions (*Article 4(2), Consumption Tax Act*).

This chapter focuses on domestic transactions.

The transfer or lease of assets located in Japan is generally deemed to be made in Japan. However, consumption tax is not imposed on certain transactions, including the (*Article 6(1), Annex 1, Consumption Tax Act*):

- Transfer or lease of land.
- Transfer of securities, equity interests, loans and other similar financial instruments.

Liable party/parties. Residents, domestic corporations, non-residents and foreign corporations are liable to pay consumption tax, if the relevant transaction is a domestic transaction (*Article 5(1), Consumption Tax Act*).

Applicable rate(s). The rate of consumption tax is 8%, which comprises 6.3% national tax and 1.7% local tax (*Article 29, Consumption Tax Act and Article 72-83, LTA*). This rate will be raised to 10% (7.8% national tax and 2.2% local tax) on 1 October 2015.

Cross-border services via telecommunications. Under the current Consumption Tax Act, consumption tax is not imposed on services that are provided to clients outside of Japan via telecommunications, because these transactions are considered to be neither domestic nor imports under the Consumption Tax Act. However, the Japanese government has considered taking steps to apply consumption tax to these types of transactions, and details of the steps to be taken are now under discussion for the 2015 tax reform.

Other taxes on corporate transactions

6. Are any other taxes potentially payable on corporate transactions?

Registration and licence tax

When a corporation changes or amends registered matters, it must apply to alter or amend the registered matters with the relevant local legal affairs bureau, which triggers registration and licence taxes. A corporation that increases its stated capital must pay 0.7% registration and licence tax on the increased amount of stated capital (*Item 24(1)d-h of Annex 1 to the RLTA*). This rate may be reduced for a capital increase by merger.

Taxes applicable to foreign companies

7. In what circumstances will the taxes identified in Questions 3 to 6 be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability)?

Corporation tax

Source rules. Foreign companies are only liable to pay corporation tax and income tax on income from sources in Japan (domestic-source income) (*kokunai-gensen shotoku*), which is set out in the Income Tax Act (ITA) and the Corporation Tax Act (CTA) (*Article 161, ITA and Article 138, CTA*). Dividends paid by Japanese corporations to foreign corporations are deemed to be domestic-source income and are subject to withholding tax.

Under the current source rule, adopting the entire-income principle, income tax and corporate tax are generally imposed on all domestic-source income when a foreign company has a permanent establishment (PE). This rule will be changed in line with the Authorised OECD Approach and will adopt the attributable-income principle. Under the new rule income tax and corporate tax will be imposed on income attributable to a PE. In principle, this new rule will take effect on 1 April, 2016 (*Article 19(1) and 25, the supplementary provision of the 2014 amendments to that (Law No. 10 of 2014)*).

Taxation by self-assessment. The scope of a foreign company's taxable income varies depending on whether it has a PE in Japan and accordingly the type of PE (*Articles 141 and 138, CTA*). For a foreign company that has branch offices, factories or any other fixed places for conducting business in Japan, all domestic-source income is subject to corporation taxes.

Specific rules apply to other foreign companies, for example those involved in construction work in Japan for more than one year and those with a foreign company that has an agent in Japan authorised to conclude a contract on its behalf (excluding an independent agent).

Capital gains from the following transfers of certain shares held by a foreign company are subject to corporation taxes under certain conditions, even if the foreign company does not have a PE in Japan:

- The transfer of more than 2% (or 5%, if the shares are listed) of the shares in a corporation that derives 50% or more of the value of its gross assets directly or indirectly from real estate (including related rights on real estate) situated in Japan.
- The transfer of shares, that consists of 5% or more of the outstanding shares in a domestic corporation, by a foreign company, where the foreign company owns 25% or more of the domestic corporation's shares at any time during the taxable year of the transfer or during the two preceding years.

Withholding tax. Most domestic-source income paid to a foreign company is subject to withholding tax. The rate is generally 20% (or 20.42% on or after 1 January 2013), but is 10% (or 10.21% on or after 1 January 2013) for certain income, or 15% (or 15.315% on or after 1 January 2013) for interest on Japanese national government bonds, local government bonds, bonds issued by a domestic corporation, bonds issued by a foreign corporation attributed to a business in Japan, and other certain domestic-source income (*Articles 212(1), 213(1) and 161, ITA, and Article 28, ASMRGEJE*).

A foreign company with a PE in Japan may be exempt from withholding tax on certain types of income if it obtains a certificate from the relevant authorities and provides a copy of this certificate to the payer of the income (*Article 214, ITA*).

Registration and licence tax

Registration and licence tax relating to transfer of real estate (*see Question 3*) applies to foreign companies, irrespective of whether they have a PE in Japan. Registration and licence tax relating to other corporate transactions (*see Question 6*) does not generally apply to foreign companies.

Real estate acquisition tax

Real estate acquisition tax (*see Question 3*) applies to foreign companies, irrespective of whether they have a PE in Japan.

Stamp duty

Stamp duty (*see Question 3*) applies to foreign companies if the relevant agreements or documents are executed in Japan, irrespective of whether they have a PE in Japan.

Consumption tax

Consumption tax (*see Question 5*) applies to foreign companies if they conduct a transaction subject to consumption tax, regardless of whether they have a PE in Japan.

DIVIDENDS

8. Is there a requirement to withhold tax on dividends or other distributions?

Dividends or any other form of distribution (including capital repayments or part of the consideration for a share buyback (*see Question 29*)), paid by one Japanese corporation to another Japanese corporation, are subject to withholding tax. The standard rate is 20% (or 20.42% on or after 1 January 2013), which was reduced to 15% (or 15.315% on or after 1 January 2013) and was further reduced to 7% (or 7.147% on or after 1 January 2013) for dividends paid before 31 December 2013 if shares in the distribution payer are listed on a stock exchange. Individual shareholders who have less than 3% of the shares of a distribution company can also enjoy the reduced tax rate of 10%, which consists of 7% national tax and 3% local tax (or 10.147% on or after 1 January 2013) (*Article 212(3) and Article 213(2)(ii), ITA; Article 28, ASMRGEJE; Article 9-3, ASMCT and Article 33(2), the supplementary provision of the 2008 amendments thereto (Law No. 23 of 2008)*). As an exception,

dividends-in-kind paid between Japanese corporations within a 100% Group (*see Question 10*) are not subject to withholding tax (*Articles 212(3), 174(ii) and 24(1), ITA*).

For the taxation on dividends paid to foreign companies, see *Question 7*.

See table, *Withholding tax requirements on dividends or other distributions, and exemptions/reliefs available on a share disposal*.

SHARE ACQUISITIONS AND DISPOSALS

Taxes potentially payable

9. What taxes are potentially payable on a share acquisition/share disposal?

Corporation tax

Corporation tax is generally imposed on capital gains or losses from the disposal of shares (*see Question 4*).

Stamp duty and consumption tax

These do not apply to a share acquisition or share disposal (*see Questions 3 and 5*).

Exemptions and reliefs

10. Are any exemptions or reliefs available to the liable party?

Qualified reorganisations

Taxation on share acquisitions and disposals that are made through a merger, demerger, share exchange (*kabushiki-kokan*), share transfer (*kabushiki-iten*) or capital contribution-in-kind can be deferred, if they satisfy certain requirements (*see Questions 20, 23 and 26*).

Group taxation regime

A group taxation regime, which was introduced in 2010, applies to Japanese corporations in a 100% Group. A 100% Group is a group comprised of corporations having a 100% control relationship. A 100% control relationship is either:

- A relationship in which a person or entity holds directly or indirectly all of the outstanding shares in a corporation.
- A relationship between corporations where all of the outstanding shares in the corporations are held by the same person or entity.

If a Japanese corporation transfers certain assets (excluding an asset whose book value is less than JPY10 million) to another Japanese corporation that is within the same 100% Group, recognition of capital gains or losses are deferred until certain trigger events occur such as re-transfer, depreciation, or revaluation of the transferred assets, or dissociation of the transferee corporation (*Article 61-13, CTA, Article 122-14(1), Order for Enforcement thereto*).

Tax advantages/disadvantages for the buyer

11. Please set out the tax advantages and disadvantages of a share acquisition for the buyer.

Advantages

The tax position of the target company (target), which may be directly or indirectly advantageous to the acquirer, is not changed by the acquisition of the target's shares. For example:

- The unrealised gain or loss in the target is not realised at target level.

- Net operating losses, losses carried forward and built-in losses on target assets remain in the target.

The following taxes do not apply to a share acquisition (see Questions 3 and 5):

- Registration and licence tax.
- Real estate acquisition tax.
- Stamp duty.
- Consumption tax.

Disadvantages

The disadvantages include the following:

- The target cannot step up the tax basis of its assets on the acquisition of the shares in the target.
- The buyer may not recognise goodwill with regard to the acquisition of the shares. As a result, the amortisation cost may not be deductible from the buyer's taxable income (unlike the tax treatment of a merger where it is deductible).

Tax advantages/disadvantages for the seller

12. Please set out the tax advantages and disadvantages of a share disposal for the seller.

Advantages

The advantages include the following:

- The seller can deduct the amount it paid for the shares as a transfer cost from the amount of consideration it receives when selling the shares.
- Separate withholding tax applies on a capital gain by an individual shareholder, at a lower rate.
- Registration and licence tax, real estate acquisition tax, stamp duty and consumption tax, which would otherwise negatively affect the purchase price, do not apply to a share disposal (see Questions 3 and 5).

Disadvantages

The disadvantages include the following:

- Net operating losses, losses carried forward and built-in losses relating to target assets are not available for the seller.
- The seller cannot avoid taxation of capital gains or losses unless it uses a share exchange (*kabushiki-kokan*) or share transfer (*kabushiki-iten*) that satisfies certain requirements (see Questions 25 and 26).

Transaction structures to minimise the tax burden

13. What transaction structures (if any) are commonly used to minimise the tax burden?

Qualified share exchange and share transfer

See Questions 10, 12, 25 and 26.

Dividend payment before transfer (dividend received deduction)

The full amount of a dividend (after deducting interest expenses relating to debt used to acquire the subject shares) received by a corporation that has owned 25% or more of the outstanding shares in the corporation paying the dividend for six months or more before the date of the dividend, is exempt from the corporate tax base of the receiving corporation.

Half of a dividend amount (after deducting interest expenses relating to debt used to acquire the subject shares) received by a corporation other than set out above is exempt from the corporate tax base of the receiving corporation (Article 23, CTA).

For a dividend paid between 100% Group corporations, the amount of the dividend is entirely excluded from its taxable income.

Paying excess cash in the target to the seller as dividends before selling the target's shares reduces the market value of the shares. Therefore, this can reduce the total amount of tax paid on the whole transaction.

ASSET ACQUISITIONS AND DISPOSALS

Taxes potentially payable

14. What taxes are potentially payable on an asset acquisition/asset disposal?

Corporation tax

Corporation tax is imposed on the seller of an asset relating to a capital gain from the sale (see Question 4).

Registration and licence tax

Registration and licence tax is imposed on a real estate buyer on a change in the real estate register (see Question 3).

Real estate acquisition tax

Real estate acquisition tax is imposed on a real estate buyer. The tax base is the assessed value of the real estate (see Question 3).

Stamp duty

Stamp duty is imposed on certain types of asset transfer agreements, including real estate transfer agreements and business transfer agreements (see Question 3).

Consumption tax

Consumption tax applies to a transfer of assets (see Question 5).

Exemptions and reliefs

15. Are any exemptions or reliefs available to the liable party?

Qualified reorganisations

Taxation on asset acquisitions and disposals made through a merger, demerger, share exchange (*kabushiki-kokan*), share transfer (*kabushiki-iten*) or capital contribution-in-kind may be exempted if they satisfy certain requirements (see Questions 20, 23 and 26).

Group taxation regime

Taxation on acquisitions and disposals of certain assets made between 100% Group corporations is deferred (see Question 10).

Real estate acquisition tax is not imposed on a transfer of real estate made by merger or demerger (see Question 3).

Tax advantages/disadvantages for the buyer

16. Please set out the tax advantages and disadvantages of an asset acquisition for the buyer.

Advantages

The advantages include the following:

- The tax base of the transferred asset may be stepped up.
- Goodwill recognised by a buyer can be amortised and the amortisation cost is deductible from the buyer's taxable income.

Disadvantages

The disadvantages include the following:

- The buyer cannot inherit net operating losses and losses carried forward from the seller in an asset acquisition.
- Registration and licence tax, real estate acquisition tax, stamp duty and consumption tax can apply to an asset acquisition.

Tax advantages/disadvantages for the seller

17. Please set out the tax advantages and disadvantages of an asset disposal for the seller.

Advantages

The advantages include the following:

- An unrealised loss on the transferred asset is realised.
- Net operating losses and losses carried forward are available to offset capital gains arising from an asset disposal.

Disadvantages

The disadvantages include the following:

- An unrealised gain on the transferred asset is realised.
- Registration and licence tax, real estate acquisition tax, stamp duty and consumption tax, which negatively affect the purchase price, can apply to an asset disposal (see *Question 3*).

Transaction structures to minimise the tax burden

18. What transaction structures (if any) are commonly used to minimise the tax burden?

Qualified reorganisations or group taxation regime

Tax qualified transactions can be used, and it is especially common to seek them in transactions where the seller or target has large built-in gains on the transferred asset (see *Questions 15, 20, 23 and 26*).

LEGAL MERGERS

Taxes potentially payable

19. What taxes are potentially payable on a legal merger?

A legal merger is generally treated in two steps for tax purposes as follows:

- **Step A.** A target is deemed to transfer all of its assets and liabilities to an acquiring company (acquirer). The acquirer is deemed to pay cash or transfer its assets (for example, its shares) to the target, as consideration for the assets and liabilities transferred from the target.
- **Step B.** The target is deemed to distribute cash or assets received as consideration from the acquirer to its shareholders (target shareholders) immediately after receiving them. The target shareholders are deemed to transfer their shares to the target in exchange for the money or assets distributed by the target.

It is assumed that the shareholders of both companies in the legal merger are corporations.

There are tax consequences at corporate and shareholder level.

Taxation at corporate level

Corporation tax. The target must recognise capital gains or losses on the assets transferred in Step A (whereas the target is not subject to taxes in Step B), unless the requirements for a qualified merger (defined in *Question 20*) are satisfied. Corporation tax is not generally levied on the acquirer for the acquisition in Step A, unless the consideration from the acquirer to the target consists of assets other than the acquirer's shares.

Registration and licence tax/stamp duty. Registration and licence tax may be imposed and the acquirer is liable to pay it (see *Questions 3 and 6*). Stamp duty is also levied on a merger agreement (see *Question 3*).

Other taxes. Consumption tax is not levied on the transfer of the target's assets in a legal merger (*Article 2(1)(iv), Order for Enforcement of the Consumption Tax Act*). Real estate acquisition tax is not levied on the transfer of real estate in a legal merger (see *Question 3*).

Taxation at shareholder level

Corporation tax. A certain part of the fair market value of the consideration that each of the target shareholders receives from the target in Step B is generally deemed to be a dividend (*Article 24, CTA*), unless the requirements of a qualified merger (defined in *Question 20*) are satisfied. The remaining amount is deemed to be consideration for the transfer of shares in the target, which results in a capital gain or loss for the target shareholder (*Article 61-2, CTA*), unless certain requirements (see *Question 20*) are satisfied.

The deemed dividend for each target shareholder is equal to the amount of the fair market value of the acquirer's shares that are received by each of the target shareholders, less an amount roughly equivalent to the total capital and capital reserves of the target multiplied by the percentage of target shares held by the shareholder (the precise formula is set out in the CTA).

Exemptions and reliefs

20. Are any exemptions or reliefs available to the liable party?

Qualified merger: taxation at corporate level

In a merger that satisfies certain requirements set out below (qualified merger), the target is deemed to transfer all of its assets and liabilities to the acquirer at book value and, simultaneously, the acquirer receives them at book value, which results in a deferral of the recognition of capital gains or losses (*Article 62-2, CTA*).

The requirements for a transaction to qualify as a qualified merger vary depending on the capital relationship between the target and the acquirer. This capital relationship is classified into three categories (*Article 2, Item 12-8, CTA*):

- A 100% relationship.
- A less than 100% but more than 50% relationship.
- A 50% or less relationship.

The requirements to qualify generally become more stringent the lower the level of the capital relationship. The requirements for a qualified merger are as follows:

- **100% relationship.** The target or the acquirer must own directly or indirectly all the shares issued by the other party, or all of the shares of both the target and the acquirer must be directly or indirectly owned by the same individual or the same company (100% relationship).

The only requirement is that the consideration from the acquirer must solely consist of shares of the acquirer or shares in the acquirer's parent company that directly owns all its shares (parent company).

- **Relationship of less than 100% but more than 50%.** The target or the acquirer owns directly or indirectly less than 100% but more than 50% of the shares of the other party, or less than 100% but more than 50% of the shares of both the target and the acquirer are directly or indirectly owned by the same individual or the same company. The requirements are as follows:
 - the same requirement for a 100% relationship (*see above, Qualified merger: taxation at corporate level: 100% relationship*);
 - about 80% of the target employees will continue to engage in the business of the acquirer after the merger;
 - the principal target business (or a target business, if it has several) will continue to be conducted by the acquirer.
- **50% or less relationship.** Where the target and the acquirer do not have a 100% relationship or a less than 100% but more than 50% relationship, a merger to jointly conduct a business may still be treated as a qualified merger if all the following requirements are met:
 - the same requirements for a less than 100% but more than 50% relationship (*see above, Qualified merger: taxation at corporate level: Relationship of less than 100% but more than 50%*);
 - a mutual connection between the principal target business and any business of the acquirer (not limited to its principal business);
 - either of the following is met:
 - the sales amount, number of employees, capital amount or other similar characteristics of the target's principal business or a related business of the acquirer is no more than about five times greater than the size of that of the other;
 - at least one of the senior directors or equivalent in the target and in the acquirer before the merger is respectively expected to be appointed as a senior director or equivalent of the acquirer after the merger.
 - the target shareholders who are expected to hold shares of the acquirer (or the parent company) after the transaction must hold at least 80% of the shares of the target before the transaction. This requirement does not apply if the target has 50 or more shareholders.

Qualified merger: taxation at shareholder level

If the merger qualifies as a qualified merger, the target shareholders do not need to recognise deemed dividends (*Article 24(1)(i), CTA*).

If the consideration paid for the merger consists solely of the acquirer's shares or the shares of the parent company, the consideration amount of the shares transferred by the target shareholder is deemed to be their book value, regardless of whether the merger qualifies as a qualified merger. This results in a deferral of the recognition of capital gains or losses for the target shareholders (*Article 61-2(2), CTA*).

Group taxation regime

Recognition of capital gains or losses on certain assets is deferred for mergers between members of a 100% Group regardless of whether or not the merger is a qualified merger (*see Question 10*).

Transaction structures to minimise the tax burden

21. What transaction structures (if any) are commonly used to minimise the tax burden?

Qualified merger

If the target has a lot of properties with built-in gains, it is common to seek a qualified merger to defer recognising capital gains. In many cases the acquirer purchases the majority of the target's shares before the merger in order to be sure that it meets the requirements for a qualified merger.

Non-qualified merger

If the target has a lot of properties with built-in losses, it is common to seek a non-qualified merger (a legal merger that does not meet the requirements of a qualified merger), to realise capital losses.

JOINT VENTURES

Taxes potentially payable

22. What taxes are potentially payable on establishing a joint venture company (JVC)?

The following two methods are commonly used to contribute assets to a joint venture company.

Demerger

In a demerger under the Companies Act, the assets and liabilities of a contributor's business are assumed by a newly established company in an incorporation-type demerger (*shinsetsu-bunkatsu*), or an existing company in an absorption-type demerger (*kyusyu-bunkatsu*). The company typically issues its shares to the contributor in exchange for the assets and liabilities transferred. From a tax perspective, there are two types of demerger:

- Spin-off-type demergers (*bunsya-gata-bunkatsu*).
- Separation-type demergers (*bunkatsu-gata-bunkatsu*).

In a separation-type demerger, consideration for the transferred assets and liabilities is immediately distributed to the contributor's shareholders once the contributor receives it. In a spin-off-type demerger, the consideration is not distributed to the contributor's shareholders. Since it is common to use a spin-off-type demerger to establish a joint venture company, this section focuses on the tax consequences of spin-off-type demergers, which include:

- **Corporation tax.** Capital gains or losses on assets that are transferred by the contributor are recognised for calculating its taxable income (*Article 62(1), CTA*) (*see Question 4*), unless the demerger satisfies requirements similar to those for a qualified merger (qualified demerger) (*see Question 20*). Taxes are only levied on the contributor, provided that the consideration consists solely of the contributed company's shares.
- **Registration and licence tax/stamp duty.** Registration and licence tax may be payable by the contributed company (*see Questions 3 and 6*). Stamp duty is also levied on a demerger agreement (*see Question 3*).
- **Other taxes.** Consumption tax is not levied in a demerger (*see Question 19*). Real estate acquisition tax is not levied on the transfer of real estate in a demerger, under certain circumstances (*see Question 3*).

Contribution in-kind

A contribution in-kind is treated as a transfer of assets from the contributor to a contributed company in exchange for shares in the contributed company for tax purposes.

Corporation tax. Corporation tax is levied on capital gains or losses from a transfer of assets in a contribution in-kind (*Article 22(2), CTA*), unless the contribution in-kind satisfies certain requirements similar to those for a qualified merger or a qualified demerger (qualified contribution in-kind) (*see Questions 4 and 20*).

Other taxes. Real estate acquisition tax is not levied on the transfer of real estate in a contribution in-kind, under certain circumstances (*see Question 3*). On the other hand, unlike a legal merger or demerger, consumption tax is levied on the transfer of certain assets in a contribution in-kind (*see Questions 5 and 20*). Registration and licence tax and stamp duty are also generally levied (*see Questions 3 and 6*).

Exemptions and reliefs

23. Are any exemptions or reliefs available to the liable party?

Qualified demerger or contribution in-kind

Recognition of capital gains or losses from the transfer of assets in a demerger or contribution in-kind is deferred if the demerger or contribution in-kind satisfies the requirements of a qualified demerger or qualified contribution in-kind (*Article 2, Items 12-11 to 12-14, 62-2, 62-3 and 62-4, CTA*) (*see Question 22*).

Group taxation regime

Recognition of capital gains or losses from a transfer of certain assets between Japanese companies in a 100% Group is deferred until certain events occur including, among others, re-transfer, depreciation or revaluation of transferred assets (*see Question 10*).

Transaction structures to minimise the tax burden

24. What transaction structures (if any) are commonly used to minimise the tax burden?

Qualified demerger or contribution in-kind

If contributed property has an unrealised gain, it is common for the contributor to seek a qualified demerger or a qualified contribution in-kind.

Non-qualified demerger or contribution in-kind

If the contributed property has an unrealised loss, it is common for the contributor to seek a non-qualified demerger or a non-qualified contribution in-kind.

COMPANY REORGANISATIONS

Taxes potentially payable

25. What taxes are potentially payable on a company reorganisation?

General

Legal mergers, demergers, share exchanges (*kabushiki-kokan*) and share transfers (*kabushiki-iten*) are all categorised as reorganisations (*Companies Act*).

For the tax consequences of legal mergers and demergers, see *Questions 19 to 24*.

Share exchange and share transfer

In a share exchange under the Companies Act, an existing company (A) becomes a wholly owned subsidiary of another existing company (B) by transferring, by operation of law, all the shares in A to B, in exchange for issuing or transferring shares in B to A's shareholders.

In a share transfer under the Companies Act, a company (C) becomes a wholly owned subsidiary of a newly formed parent company (D) by transferring, by operation of law, all the shares in C to D, in exchange for issuing shares in D to C's shareholders.

Taxation at corporate level

Although no assets are transferred from the company that becomes the wholly owned subsidiary in both cases (unless a share exchange or share transfer is categorised as a qualified share exchange or qualified share transfer (*see Question 26*)), certain assets of the subsidiary must be revalued at fair market value, so that corporation tax is imposed on capital gains or losses that are deemed to arise (*Article 62-9, CTA*).

Taxation at shareholder level

The shareholders of the company that becomes the wholly owned subsidiary are not subject to income tax or corporation tax as long as they receive new shares in the company that becomes the parent company and so on (*Article 61-2(8)(10), CTA*) (*see Question 26*). However, since the shareholders transfer their shares and receive new shares in the company that becomes the parent company, income tax or corporation tax is imposed on the shareholder for capital gains or losses that are recognised in a share exchange or a share transfer (*Article 61-2(1), CTA*), unless certain requirements are satisfied (*see Question 26*).

Exemptions and reliefs

26. Are any exemptions or reliefs available to the liable party?

Taxation at the corporate level

In a share exchange or a share transfer that satisfies certain requirements (similar to the requirements for a qualified merger, *see Question 20*) (qualified share exchange or qualified share transfer) or is otherwise conducted in a 100% Group, the assets of the company that becomes the wholly owned subsidiary need not be revalued at fair market value. Therefore, capital gains or losses on those assets can be deferred (*Article 62-9, Article 2, Items 12-16 and 12-17, CTA*).

Taxation at the shareholder level

At shareholder level, recognition of capital gains or losses from the transfer of shares is deferred, regardless of whether the transaction qualifies as a qualified share exchange or qualified share transfer, if the consideration consists solely of either (*Article 61-2(8)(10), CTA*):

- The acquiring company's shares (for example, B or D in *Question 25*).
- The shares of the acquiring company's parent company that directly owns all of its shares (in the case of triangular reorganisations).

Transaction structures to minimise the tax burden

27. What transaction structures (if any) are commonly used to minimise the tax burden?

Qualified reorganisations

It is common to use qualified reorganisations when the company that becomes a wholly owned subsidiary owns properties that have appreciated in value.

Non-qualified reorganisations

If a company has built-in losses, it is common to use non-qualified reorganisations.

RESTRUCTURING AND INSOLVENCY

28. What are the key tax implications of the business insolvency and restructuring procedures in your jurisdiction?

Tax implications for the business

In restructuring procedures such as those under the Civil Rehabilitation Act and the Corporate Reorganisation Act, a company revalues its assets at the start of the procedures and realises its gains or losses (*Articles 25 and 33, CTA*).

A company in restructuring can use its past net operating losses to offset gains from the procedures, such as income from discharge of debt or revaluation of its assets (*Article 59, CTA*).

Tax implications for the owners

The owner or shareholder of a company in a restructuring or insolvency can deduct as much as all of the amount of the company's shares from income, under certain requirements (*Article 33(2), CTA, Article 68(1), Order for Enforcement thereto and Corporation Tax Basic Circular (CTBC) 9-1-7, 9-1-8, 9-1-9, and 9-1-11*).

Tax implications for the creditors

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

A parent company is permitted to deduct the write-off or release of the loan to the subsidiary if it has to write off or release a loan to its subsidiary in connection with the winding-up or sale of the subsidiary (or a similar reason) and has a material reason to do so (such as if, for instance, the parent company may incur additional losses if it does not write-off or release the loan) (*CTBC 9-4-1*).

In these cases, the borrower is deemed to receive taxable debt-waiver income (that is, it 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 this "debt-waiver" income.

Bad debts reserve. Japanese tax law allows creditors that credit amounts (within a certain limit) to a bad debts reserve account to deduct the credited amount that is reserved (*Article 52, CTA*). However, under the 2011 tax reform, this deduction was limited to:

- Small or medium-sized companies.
- Banks, insurance companies or other similar companies.
- Certain companies that hold certain monetary claims.

In addition, a three-year interim measure was introduced for companies not included in small or medium-sized companies or banks, insurance companies or other similar companies above. Under this interim measure, these companies can credit the following amounts:

- Fiscal years commencing from 1 April 2012 to 31 March 2013: 75% of the pre-amendment allowable limit.
- Fiscal years commencing from 1 April 2013 to 31 March 2014: 50% of the pre-amendment allowable limit.
- Fiscal years commencing from 1 April 2014 to 31 March 2015: 25% of the pre-amendment allowable limit.

SHARE BUYBACKS

Taxes potentially payable

29. What taxes are potentially payable on a share buyback? (List them and cross-refer to Questions 3 to 6 as appropriate.)

Corporation tax

In a share buyback, part of the received money is deemed to be dividends (*Article 24, CTA*) and the rest is deemed to be consideration for the purchased shares, which results in capital gains or losses for shareholders (*Article 61-2(1), CTA*) (see *Question 19*).

Exemptions and reliefs

30. Are any exemptions or reliefs available to the liable party?

Dividend received deduction

Dividend received deduction (see *Question 13*) also applies to a deemed dividend in a share buyback, including, for the avoidance of doubt, when conducted by a Japanese corporation from another Japanese corporation in the same 100% Group.

Transaction structures to minimise the tax burden

31. What transaction structures (if any) are commonly used to minimise the tax burden?

It is unlikely that there is a specific structure that would minimise the tax burden triggered by a share buyback. However, in practice, the parties in a share buyback should carefully confirm whether they meet the requirements of a dividend received deduction beforehand.

PRIVATE EQUITY FINANCED TRANSACTIONS: MBOS

Taxes potentially payable

32. What taxes are potentially payable on a management buyout (MBO)?

Taxation at corporate level

There are complex methods available to bring about an MBO and their tax consequences differ depending on each method.

In one of the most common methods, which allows realisation of capital gains or losses on assets held by the target to be deferred, the following occurs:

- The management buys a controlling stake in the target through a tender offer.
- After this, in a shareholders' meeting of the target, the shareholders, including the management, resolve to convert the target's common stock into classified stock subject to call (*zenbu-shutoku-joukoutsuki-kabushiki*). After that, the target calls the classified stocks subject to call compulsorily from all shareholders and delivers different class shares to the management and cash to the minority shareholders to squeeze the latter out (Wholly Call Scheme). However, if the management does not use this method but instead uses a merger or stock exchange to squeeze out the minority shareholders for cash, the target must recognise capital gains or losses and a corporation tax is imposed on the target's income.

Taxation at shareholder level

Capital gains or losses are, in principle, recognised at the shareholders' level (*see Question 33*).

Exemptions and reliefs

33. Are any exemptions or reliefs available to the liable party?

Management that conducts an MBO and its target can receive the treatment of a tax deferral on capital gains or losses through the Wholly Call Scheme, a common and sophisticated mechanism under certain requirements (*see Question 32*). In other words, by using classified stock subject to call (*zenbu-shutoku-joukoutsuki-kabushiki*) to squeeze out the minority shareholders, the target is not required to recognise capital gains or losses. In addition, the management also does not recognise capital gains or losses as long as it receives stocks when the target squeezes out the minority shareholders.

Transaction structures to minimise the tax burden

34. What transaction structures (if any) are commonly used to minimise the tax burden?

Scheme of class shares subject to a call

This depends on the actual situation, that is, on whether parties want to defer capital gains or realise capital losses. To defer capital

gains or losses, the most common MBO method could be used (*see Question 32, Taxation at corporate level*).

Scheme of cash merger or cash stock exchange

If a party seeks to realise capital gains or losses, the management should buy a controlling stake in the target through a tender offer and a subsequent merger or stock exchange to squeeze out the minority shareholders for cash (*see Question 32*).

REFORM

35. Please summarise any proposals for reform that will impact on the taxation of corporate transactions.

The 2014 tax reform bill (2014 Tax Reform Proposals) was proposed by the Japanese government in February 2014 and enacted in March 2014. The reforms were primarily proposed in an effort to push the revitalisation of the Japanese economy and pull it out of economic deflation. The reforms include an early repeal of the special reconstruction corporation tax, the introduction of a temporary deduction of up to 70% of the investment for certain reorganisations, a change in the basic principle of taxation of foreign corporations in line with the Authorised OECD Approach, and a consumption tax hike from 5% to 8%.

ONLINE RESOURCES

National Tax Agency

W http://www.nta.go.jp/foreign_language/index.htm

Description. The official website of the National Tax Agency. However, the National Tax Agency disclaims any responsibility for any consequences, including damages, that arise out of or in connection with the use of any information available on this website.

Japanese Law Translation Database System

W <http://www.japaneselawtranslation.go.jp/?re=02>

Description. This website is managed by the Ministry of Justice and provides some unofficial English translations of certain Japanese laws and regulations. The translations published on this website need to be used solely as reference material.

Practical Law Contributor profiles



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Areas of practice. Tax advice, tax litigation and disputes; corporate; M&A.

Recent transactions

- Represented multiple taxpayers and successfully defended them in tax lawsuits regarding the issue of whether a foreign business entity falls under the category of a "corporation" or a "partnership" under Japanese tax law at the Tokyo District Court (19 July 2011), Nagoya District Court (14 December 2011) and Nagoya High Court (24 January 2013).
- Successfully and completely defended a client in a tax dispute at the Tokyo National Tax Tribunal. This case involved the issue of deductibility of loss on a valuation of investment securities, the amount of which was JPY5 billion.
- Represented a Japanese corporation at the Tokyo High Court and the Supreme Court of Japan in tax litigation concerning tax assessment of a corporate tax regarding hedge derivative transactions.



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