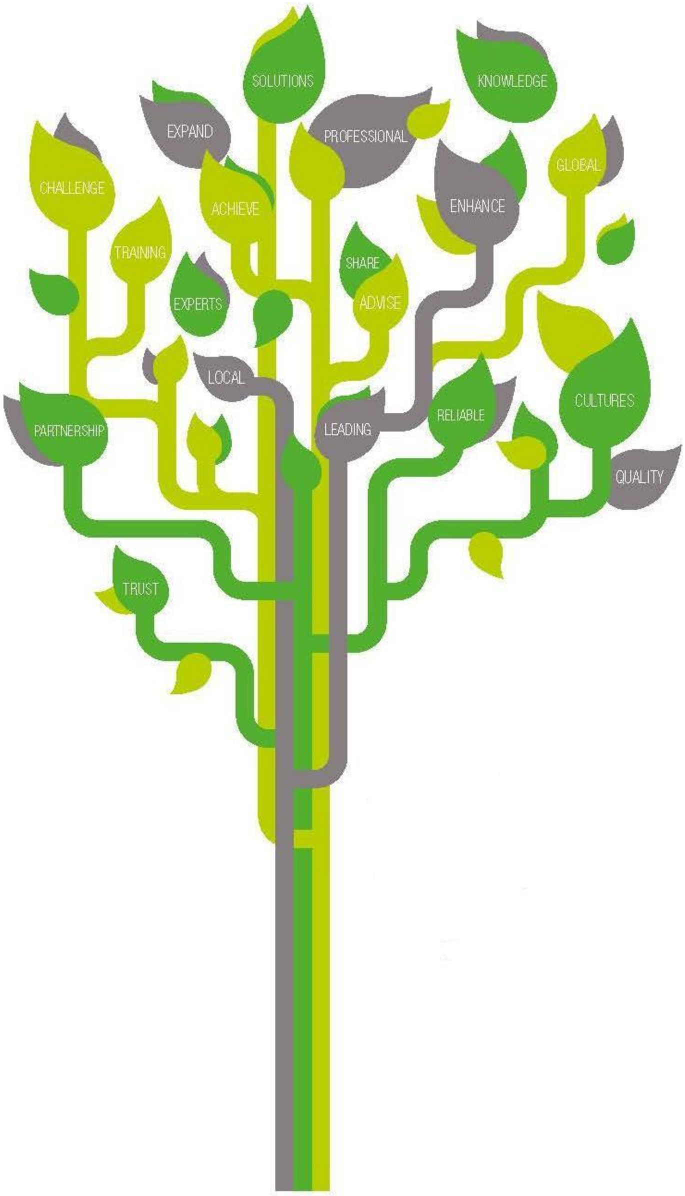
DOING BUSINESS IN JAPAN



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DOING BUSINESS IN JAPAN

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Japan.

1 BACKGROUND

1.1 Country Overview

Japan is situated in north-eastern Asia between the North Pacific and the Sea of Japan. The area of Japan is 377,835 square kilometres, nearly equivalent to Germany and Switzerland combined or slightly smaller than California. Japan consists of four major islands, surrounded by more than 3,000 smaller islands.

Japan is a temperate region with four seasons. Because of its great length from north to south, its climate varies from region to region.

Japan's population is around 127 million. Most Japanese reside in densely populated urban areas. Japan's capital city is Tokyo. The population of the Tokyo Metropolitan Area including the city, some of its suburbs and the surrounding area is approximately 12 million.

There is only one official language spoken in Japan, which is of course Japanese. However, many Japanese are able to understand English to a certain extent.

All of Japan is in the same time zone, 9 hours ahead of GMT. No Daylight Saving Time is practiced in Japan.

1.2 Economic Overview

The economy of Japan is the third largest after the United States and the People's Republic of China, after maintaining itself as the second largest economy in the world from 1968 until 2010.

After achieving one of the highest economic growth rates in the world from the 1960s through the 1980s, the Japanese economy slowed dramatically in the early 1990s, when the "bubble economy" collapsed. Japan endured periods of recession around the turn of the millennium, but from 2003 began to grow again. Subsequently, the global financial crisis and a collapse in domestic demand saw the economy shrink in 2008 and 2009.

1.3 Transport Infrastructure

Japan enjoys an advanced logistics network. The land, sea and air logistics infrastructure is well organized throughout Japan.

Also, its geographic proximity to East Asian countries makes it an excellent choice for locating regional headquarters in East Asia.

2 CHOICE OF LEGAL FORM

2.1 Branch / Representative Office

Representative offices are established as locations for carrying out preparatory and supplemental tasks aimed at enabling foreign companies to engage in full-scale business operations in Japan. These offices may conduct market surveys, collect information, purchase goods and implement publicity/advertising efforts, but they are not permitted to engage in sales activities. The establishment of representative offices does not require registration.

Foreign companies wishing to engage in business operations in Japan must establish a branch office or a subsidiary company. The simplest means for a foreign company to establish a base for business operations in Japan is to set up a branch office. The branch office can begin business operations as soon as an office location is secured, the branch office representative determined, and the necessary information registered. It is a business location that provides services in Japan decided upon by an organization authorized by the foreign company, and ordinarily is not expected to engage in independent decision making. A branch office does not have its own corporate status, and instead is legally deemed to be encompassed within the corporate status of the foreign company. Consequently, the foreign company is ultimately responsible for all debts and credits generated by the activities of its Japanese branch office.

2.2 Subsidiary Company

A foreign company establishing a subsidiary company in Japan must choose either a Joint-Stock Corporation (Kabushiki-Kaisha (K.K.)) or a Limited Liability Company (Godo-Kaisha (G.K.)), as stipulated by the Japanese Corporate Law.

	Limited Liability Company	**Joint-Stock Corporation**
Amount of Capital	Without restriction	
Relationship between the Company's Representative and Members	Members represent the company.	The representative of the company need not be a member.
Liability of Members to Creditors of the Company	Liability of members is limited to their respective contributions of capital.	
Transfer of Equity	Subject to the approval by other members.	Transfers of shares may be made freely, unless the articles of incorporation of the company provide that such transfers shall be subject to approval by the board of directors.

3 AUDIT REQUIREMENT

3.1 Requirement and Thresholds

<u>Auditing under the Financial Instruments and Exchange Act</u>

- Companies that issue shares listed on a financial instruments exchange or are in the process of listing;
- Companies that filed a registration statement; and
- Companies with a specified number of shareholders

<u>Auditing under the Corporate Law</u>

- Large companies : Capital stock of JPY 500 million or more, or liabilities of JPY 20 billion or more, as of the latest fiscal year-end;
- Companies which adopt a “Company with Committees” corporate governance system; and
- Other companies which appoint an accounting auditors (Kaikeikansanin) on a voluntary basis

3.2 Audit requirements for foreign companies

Foreign companies which offer or have offered their shares, investment trusts and / or bonds publicly in Japan are not required to have their financial statements audited by a Japanese CPA or an audit corporation, if the case where financial statements of foreign companies are audited by a professional accountant who is the equivalent of a Japanese CPA or an audit corporation.

4 TAXATION

4.1 Corporation Tax

Both the branch office and the companies are subject to corporation tax, inhabitant tax and enterprise tax on their income. The rates of these taxes are decided by its capital, income and location of the company.
All corporations except those specifically exempt by the law are subject to corporate income taxes imposed by both the national and local governments.

4.1.1 Corporate Income Tax (national tax)

The corporate income tax is generally a flat 25.5% of taxable income. Taxable income is based on net income before income taxes per the corporation’s financial statement; this is adjusted to take into account a multitude of tax rules. To calculate taxable income, for example, non-taxable items included in the financial statement as net income (such as dividends paid from a 25% or more owned Japanese corporation) are subtracted, while others, such as excess entertainment expenses considered non-deductible, are added to net income.

<table>
<tr><th></th><th>Paid in capital of JPY 100 million or less</th><th>Paid in capital in excess of JPY 100 million</th></tr>
<tr><td>Taxable income up to JPY 8 million in a year</td><td>19%</td><td rowspan="2">25.5%</td></tr>
<tr><td>Taxable income in excess JPY 8 million</td><td>25.5%</td></tr>
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The restoration surtax is levied at 10% of tax liabilities for the period beginning from April 1, 2012 to March 31, 2014.

Local corporation tax will be levied at 4.4% of tax liabilities for the period beginning on or after October 1, 2014.

As a temporary relief, the corporation tax rate for small and medium-sized companies will be reduced from 19% to 15% for the period beginning from April 1, 2012 to March 31, 2015 in respect of annual taxable income of up to JPY 8 million.

4.1.2 Inhabitant Tax (local tax)

The inhabitant tax, levied by the local prefecture and municipality, is computed as a percentage of the corporate income tax liability. The combined prefectural and municipal tax rate may not exceed 20.7% of the national tax, and some offer rates considerably lower than this. The rate will be reduced to 16.3% for the period beginning on or after October 1, 2014

4.1.3 Enterprise Tax (local tax)

Each prefecture levies an enterprise tax, the maximum rate of which is set at 6.36%. The maximum rate will be increased to 8.04% for the period beginning on or after October 1, 2014

However, for the purposes of local enterprise tax, taxable corporate income is calculated different from that used for the national corporate income tax. The amount of enterprise tax is deductible from the corporate income taxes when paid.

The following example is for the corporation whose capital amount is JPY10 million. Its annual taxable income is JPY25 million and located in Tokyo.

Business year beginning from October 1, 2008 to September 30, 2014

Annual profit	up to JPY4million	………	2.7%
	From JPY4million to JPY8million	………	4.0%
	over JPY8million	………	5.3%

Business year beginning on or after October 1, 2014

Annual profit	up to JPY4million	………	3.4%
	from JPY4million to JPY8million	………	5.1%
	over JPY8million	………	6.7%

For corporations with capital of JPY100million or more, this tax is levied by the size of their business. This is designed to cover 1/4 of corporation enterprise tax revenue. Tax base consists of profit, capital and other value-added items such as wages, interest and rentals.

4.1.4 Local Corporate Special Tax (national tax)

Local special corporate tax was introduced as a temporary measure pending integrated tax reform including consumption tax from 2008. Local special corporate tax is separated off the specified portion of enterprise tax. Local special corporate tax is levied on all corporation who is liable to pay corporation enterprise tax. The tax amount is computed on the basis of income or gross proceeds. Local Corporate Special Tax must be paid to the local government.

Taxable base	Type of corporation	Tax rate (business year beginning before September	Tax rate (business year beginning on or after October
Taxable income × rate	Company whose paid in Capital is More than 100 million	148%	67.4%
	Company whose paid in Capital is 100 million or Less	81%	43.2%

4.1.5 Blue Returns

Any corporation, including a newly established Japanese corporation and a local branch of a non-Japanese corporation, may apply for permission to file a blue return. The blue return offers a variety of tax privileges. With respect to the first business year of a new corporation, the application for approval must be made by the day within three months from the date of incorporation or by the last day of the first business year, whichever is earlier. Approval to use the blue return is generally granted provided the corporation's bookkeeping system accords with certain accepted procedures.

Privileges granted to blue return corporations include:

a) Carried-over net losses for nine years, which are incurred from business years for which blue returns have been filed, can be deducted as expenses in the accounting period.
b) Carried-back losses incurred within one year before an accounting period qualify for a refund of corporation tax provided the tax office accepts the calculation.
c) Most of the special depreciation allowances and the special tax credits provided for in the Special Taxation Measure Law apply to blue return corporations only. Therefore, a start-up company that expects loses in the first few years will generally benefit from using the blue return.
d) The various tax-free reserves provided for in the Special Taxation Measures Law are permitted to be deducted as expenses on condition that a blue return is filed.

e) The tax authorities cannot make corrections unless any mistakes made by the corporation in the calculation of income and other matters are ascertained from an audit of books and documents. Corporations that file the alternative white return are not accorded this privilege.

4.2 Branch Profits Tax

A foreign company having a certain fixed place of business ("permanent establishment"), such as a branch in Japan, is subject to tax on all domestic source income or domestic source income attributable to the permanent establishment based on a tax treaty and must file a tax return.

4.3 Personal Income Tax (Pay as you earn)

4.3.1 Income tax (national tax)

Income tax is composed of withholding income tax and assessment income tax. Withholding income tax is withheld at source from payments to individuals as well as to corporations. The tax rate is usually a flat 20.42% or less. However, tax withheld from the salaries, wages, bonuses, retirement allowances, etc. paid to resident individuals is often higher than 20.42% because the amount of tax is computed by applying a progressive rate.

Assessment income tax is levied on individuals, only at progressive rates. Non-resident taxpayers are subject to assessment income tax only in certain cases (for example, if they possess a permanent establishment or real estate in Japan, etc.).

4.3.2 Progressive tax rates

Following tax rates applied to the taxable ordinary income amount and the taxable retirement income amount separately:

Rate of Income Tax

Taxable income		Tax rate applicable to taxable income band	Deduction
From	But not over		
—	1,950,000	5.105%	—
1,950,000	3,300,000	10.210%	99,578
3,300,000	6,950,000	20.420%	436,478
6,950,000	9,000,000	23.483%	649,356
9,000,000	18,000,000	33.693%	1,568,256
18,000,000	—	40.840%	2,854,716

4.4 Capital Gains Tax

Capital gains are not given preferential treatment. They are included in corporate taxable income and are subject to tax at the ordinary corporate income tax rate.

4.5 Fixed Assets Tax

4.5.1 Tax Payers

The registered owner as of January 1 of each year pays fixed assets tax on land, buildings, ships, aircraft or any other kind of depreciable assets. "Registered owner "means the person registered as the owner of the property in the registration book maintained by a national juridical office.

4.5.2 Taxable fixed assets

Fixed assets tax is levied on all kinds of land, buildings, and depreciable assets.

4.5.3 Tax base

The tax base for fixed assets tax is its fair market value. In practice, land or buildings are taxed on the basis of their value assessed by the municipality. Municipalities appraise the fair market value of land and buildings every three years.

4.5.4 Tax rate

The annual tax rate is 1.4%. Municipalities may levy tax at a rate higher than 1.4%, but no higher than 2.1% in any case. Fixed assets tax is not levied if a taxpayer owns less than the following amount of fixed assets located in the same municipality.

Land:	JPY 300,000
Buildings:	JPY 200,000
Depreciable assets:	JPY 1,500,000

4.6 Consumption Tax

A tax of 8% is imposed on non-exempt goods and services. When business enterprise purchase goods and services in Japan, it pays this tax to the supplier or the customs office. When a business sells goods or services, it is required to collect this tax from the consumer. Export transactions, international communications and international transportation services are exempt from consumption tax (export tax exemption).

Basic formula for calculating the tax is as follows:

Tax due =	total amount of consumption tax on sales (8% of taxable sales)	—	total amount of consumption tax on purchases (8% of taxable purchases)

Measures to facilitate calculation of tax

a) Allowing for tax-exempt enterprise:

An enterprise whose taxable sales amount is not more than JPY10 million for the base period is tax-exempt enterprise except the enterprise making the election to be a taxable enterprise.

b) Simplified tax system:
An enterprise whose taxable sales amount is not more than JPY50 million for the base period can make election to apply the simplified tax system in which the tax liability is calculated on the basis of taxable sales amount only.

4.7 Other Taxes

4.7.1 Registration Tax

The tax for registration of a Kabushiki Kaisha (Japanese corporation) is generally levied at 0.7% of the company's paid-in capital is taxed at the same rate.

4.7.2 Real property acquisition tax (prefectural)

Real property acquisition tax is levied on the acquisition of land or buildings (inclusive of rebuilding).The tax is not levied on the acquisition of depreciable assets other than buildings.

The tax base is market value of the acquired land or buildings, usually substantially lower than the purchase price. The tax rate is 3%.

The tax is not levied if the tax base is less than:

(a) JPY100,000 in the case of land;
(b) JPY230,000 in the case of a new building constructed by the taxpayer himself; or
(c) JPY120,000 in the case of other buildings.

5 ALLOWANCES

5.1 Income Tax Credit

Income tax withheld at source from a payment to a corporation may be credited against the tax on ordinary income and on undistributed profits, unless such payment is excluded from gross income.

5.2 Credit for Foreign Taxes

In order to eliminate international double taxation on income, the foreign taxes levied on a Japanese domestic corporation may be credited against Japanese corporation tax. This is called an ordinary foreign tax credit. A corporation has the opinion of crediting foreign taxes or of treating them as deductible expenses. The opinion should be exercised on the total amount of foreign taxes on income.

6 EMPLOYMENT

6.1 Social Insurance

6.1.1 Health insurance and employee's pension insurance

The social insurance program in Japan consists of medical care insurance, pension insurance and labour insurance.

6.1.2 Premiums

Premiums of Health Insurance and the Employees' Pension Insurance systems are determined by multiplying the "monthly standard remuneration" of the insured person by the prescribed premium rate. The premium rate for Hearth Insurance varies with prefectures, from the lowest 98.5/1,000 to the highest 101.6/1,000 of the monthly standard remuneration. The premium rate of Tokyo is 99.7/1,000. The premium rate for Employees' Pension Insurance is 171.20/1,000.
The employers and employees in equal proportions share premiums.

6.2 Labour Insurance

Labour Insurance is a general term for “Workmen’s Accident Compensation Insurance” and “Employment Insurance”. For the purposes of both of them, all undertakings which employ workers are, in principle, compulsorily “applicable undertakings”.

6.3 Payment of premiums

At the beginning of the insurance year, employers are to pay the premiums as estimations. At the beginning of the following year, they should report the definite amount of premiums on the basis of the total amount of wages actually paid during the past year, and adjustments are made accordingly.

7 WITHOLDING TAXES

7.1 Interest

Interest income paid to domestic corporations is subject to withholding tax at a rate of 20.42%. Some special concessions for interest paid to non-Japanese residents are granted under tax treaties.

7.2 Royalties

Royalties paid to domestic corporations is subject to withholding tax at a rate of 20.42%. Some special concessions for royalties paid to non-Japanese residents are granted under tax treaties.

7.3 Dividends

Dividend income paid to domestic corporations is subject to withholding tax at a rate of 20.42%. Some special concessions for dividends paid to non-Japanese residents are granted under tax treaties.

8 MISCELLANEOUS

8.1 Bonuses paid to directors

Bonuses paid to directors and similar highly ranked persons are not deductible in the calculation of National Corporate Income tax. When a person has a dual status as an employee and a director of a corporation, that part of the bonus which can reasonably be attributed to that person's status as an employee is deductible.

This document is provided as a general overview of matters to be considered when setting up an overseas business in Japan. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided

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