



Independent legal & accounting firms

Doing Business in Japan

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Doing business in guide: Japan



MSI's guide on Doing Business in Japan provides current information about the financial, regulatory and legal considerations that could affect business dealings within Japan. For further assistance please contact our MSI member firms.

Country overview

Population

Japan has a total population of 124 million inhabitants (as of September 2023).

Government

Japan is a unitary state with a central government and constitutional monarchy with an Emperor whose role is limited to a ceremonial one. Executive authority is held by the Cabinet which is comprised of the Prime Minister and the Ministers of State, both of which control and instruct the Government of Japan and its civil service employees.

The legislative branch of Japan is the National Diet which is a bicameral legislature consisting of a lower house, the House of Representatives, and an upper house, the House of Councillors. For a bill to become an enforceable law, it needs to be passed by both houses of the National Diet, signed by the Prime Minister and Ministers of State, and then finally promulgated by the Emperor as a formality.

The judicial branch consists of the Supreme Court, and four other lower courts; the High Courts, District Courts, Family Courts and Summary Courts.

Languages

The national language is Japanese. Although there are some people in Tokyo who can speak English, most of the country does not speak English.

Currency

The national currency of Japan is the yen.

Economic summary

GDP: \$4.26 trillion (USD)

Income per capita: \$16,060 (USD)

Inflation: 3.1%

Main sectors of the economy

Japan is the world's third largest economy and a favourite investment destination due to its industrial competitiveness, R&D capabilities, reliable infrastructure, and high standard of living. It is ranked fourth in the world according to the 2022 FDI Confidence Index (Kearney). Japan also ranks fourth in industry competitiveness (UNIDO (2021), CIP Competitive Industrial Performance Index) and first in economic complexity (The Atlas of Economic Complexity 2019).

Japan is also the world's second-largest automobile manufacturing country and is also ranked high in science and technology sectors with a focus on the manufacturing of high-tech and precision goods, such as integrated circuits, hybrid vehicles, and robotics.

The Government of Japan also aims to achieve carbon neutrality by 2050 under its "Green Growth Strategy" by prioritizing various industries of the economy such as energy related industries (windpower, solar, etc.), transport/manufacturing industries (semiconductors, aircraft, carbon recycling, etc.), and home/office related industries (housing and building, lifestyle, etc.).

Setting up a business

In Japan, there are three business structures which are generally established by foreign companies: 1) Representative Office; 2) Branch Office; or 3) Subsidiary Company.

Representative Office

A representative office acts as an activity base to carry out preparatory tasks aimed at enabling foreign companies to engage in future full-scale business operations in Japan.

The establishment of a representative office does not require registration, and it can conduct market surveys, collect information, purchase goods, and implement publicity and advertising activities. However, a representative office is prohibited from engaging in sales activities and cannot, generally, open bank accounts or rent an office in its own name. Therefore, such activities require a representative that can handle them in an individual capacity. The representative does not need to be Japanese and there are no residency requirements.

Branch Office

In order to engage in continuous transactions in Japan, a foreign company can operate as a branch office by securing an office location, determining a branch office representative, and registering the required information. The branch office will belong to the same entity as the foreign parent company and does not have its own legal corporate status.

Therefore, the branch office is usually not expected to engage in independent decision-making, and the parent company is ultimately liable for acts of the branch office. However, the branch office may open its own bank accounts and rent an office in its own name.

Subsidiary Company

A foreign company establishing a subsidiary company in Japan may choose to establish the subsidiary as a joint-stock company (*kabushiki kaisha*, or "KK"), limited liability company (*godo kaisha*, or "GK" or "LLC"), or a similar entity as set forth in the Companies Act in Japan.

Many foreign companies choose a KK as KJs tend to have a stronger presence and perceived reputation in the Japanese local market, but GKs are also attractive due to having less corporate secretarial requirements.

Both of these entity forms provide limited liability of the foreign parent company and can be established by following certain legal and registration procedures.

Process of how to set up a business

The process of setting up a KK or GK is quite detailed and complex and attorneys or judicial scriveners are often used to assist with this process.

Financial year of taxes and financial accounts

The government's fiscal year is from April 1 to March 31, and although legal entities may choose a different financial year, most entities' financial year is from April 1 to March 31.

Individual residents must submit an income tax return for the income earned each year and must pay the tax owed between February 16 and March 15 of the following year.

Corporate tax returns, which includes filing an income statement, balance sheet, change in shareholders equity, and other documents, are due on February 28, and although it is possible to file for a one-month extension to March 31, the owed taxes are due on February 28. Interest will also apply if the company pays corporate tax later than February 28.

Accounting and auditing

An annual audit report is required for the following types of companies:

1. Companies with JPY 500 million or more capital or JPY 20 billion or more total liabilities.
2. Companies which provide an "auditing committee" as defined under corporate law by the articles in corporation.
3. Companies which have internal auditors on a voluntary basis.

Taxation

Economic and fiscal incentives

The Japanese government offers a number of incentive schemes in various sectors to support companies in their business operations.

There are tax incentives for foreign direct investment, or foreign-affiliated companies which relocate their headquarters function from the 23 wards of Tokyo to regions other than the Tokyo Metropolitan Area.

There are also tax subsidies and tax preferential treatment for the following:

1. *Areas recovering from tsunami and nuclear disaster* - Tax subsidies for new business establishment and employment in these areas as well as preferential tax treatment for companies which contribute to maintaining employment opportunities in certain reconstruction industries in Fukushima.
2. *Digital investments* - Tax system that allows companies to receive support measures for digital-related investments using cloud technology necessary to realize Digital Transformation (DX).
3. *Environmental energy* - Tax system which allows special measures of tax credits of up to 10% or special depreciation of 50% for the introduction of (1) production equipment for products with a large decarbonization effect, and (2) equipment that achieves both decarbonization and added value improvement in production processes.
4. *Open innovation and R&D* - A tax credit system that allows companies conducting research and

development to be deducted by 2% to 14% of a company's testing and research expenses from their corporate tax payments.

Other incentives for foreign investors

There are also immigration-related incentives for highly-skilled foreign professionals from foreign countries and foreign nationals who establish startups in Japan"

1. System of preferential treatment for highly-skilled foreigners using a point system in order to promote the acceptance of their visas.

Consumption Taxes

The consumption tax in Japan (also known as VAT, GST or sales tax in some countries) is 10% for all items excluding groceries, drinks, and newspaper subscriptions which are 8% (alcoholic drinks and eating out at a restaurant are 10%).

Income taxes

For tax purposes, people living in Japan are classified into the following three categories (note that tax treaties with certain countries may take precedence over these categories):

1. *Non-resident* - A person who has lived in Japan for less than one year and does not have his main residence of living in Japan. Non-residents pay taxes only on income from sources in Japan, but not on income from abroad.
2. *Non-permanent resident* - A person who has lived in Japan for less than five years and has no intention of living in Japan permanently. Non-permanent residents pay taxes on all income except on income from abroad that does not get sent to Japan.
3. *Permanent resident* - A person who has lived in Japan for at least five years or has the intention of staying in Japan permanently. Permanent residents pay taxes on all income from Japan and abroad.

Corporate income tax

The income calculated for each business year of a corporation is used as the tax

base for determining the corporate taxes to be levied on a corporation's income. Tax rates differ based on the following categories of corporations:

1. *SMEs* – Small and medium-sized enterprises: (i) have paid-in capital of 100 million yen or less; (ii) corporate tax amount is 10 million yen or less per annum and taxable income is 25 million yen or less per annum; and (iii) have offices or factories located in up to two prefectures. An SME will be taxed based on the following progressive rates: (i) 21.37% for taxable income of up to 4 million yen; (ii) 23.17% for taxable income of over 4 million yen to 8 million yen; and (iii) 33.58% for taxable income of over 8 million yen.
2. *Other enterprises* – Are enterprises with over 100 million yen in paid-in capital and have offices or factories located in at least three prefectures. The effective tax rates for these enterprises are calculated using the standard tax rates of 29.74%.

HR/ Labour Law

Employment law

The key statutory laws that govern employment arrangements in Japan are the Labor Standards Act and the Labor Contracts Act. The Labor Standards Act establishes the minimum standards for the terms and conditions of employment and the Labor Contracts Act covers the contractual relationship between the employer and the employee.

Employment Contracts and Work Rules

Employment contracts are typically in writing and contain the terms and conditions regarding the following: (i) term and place of employment; (ii) job description; (iii) work hours, overtime, and vacation period; (iv) wages; and (v) resignation and grounds for dismissal.

Employers who employ 10 or more employees must establish work rules (*shugyo kisoku*) which set forth the details of various items that apply to all employees such as the following: (i) working hours and breaks; (ii) holidays;

(iii) wages; (iv) grounds for termination of employment; and (v) disciplinary actions.

Dismissal

Japan's employment laws are very protective of employees. There is no "at-will" employment concept, and generally, it is difficult to terminate an employee's employment. The general rule is that a dismissal will be considered an "abuse of rights" and invalid unless there are "reasonable grounds" that are "socially acceptable". Typical grounds for dismissal which are considered reasonable and socially acceptable are where: (i) there is a loss of or lack of an employee's ability to perform his/her work duties; (ii) there is employee misconduct, insubordination, or behavioural issues; (iii) the employee significantly performs poorly; and (iv) there is redundancy due to business downsizing, economic reasons, or corporate dissolution (although these reasons will be viewed very strictly and must pass certain conditions, such as employers having put forth an effort to avoid dismissal). All of these grounds for dismissal must be set out in the company's work rules or in the employment contract.

Since it is often difficult to dismiss employees even based on the above "reasonable grounds", Japanese employers typically offer a monetary package of a certain amount to obtain voluntary resignation of the employee.

Social security, Healthcare, and Insurance

Japan has two separate systems for social security: (i) social insurance such as the employee pension insurance and the employee health insurance; and (ii) labor insurance such as the workers' accident compensation insurance and unemployment insurance.

An employer that is a corporation or a sole proprietor with five or more employees has a legal obligation to provide its employees with employee pension insurance and employee health insurance. Also, all employers are obliged to provide employees with the workers' accident compensation insurance and the unemployment insurance.

Freelancers

The number of freelancers who are self-employed and are not subject to the Labor Standards Act and the Labor Contracts Act have been increasing recently. Under such circumstance, the Act on the Improvement of Transactions Pertaining to Specified Entrusted Business Operators was enacted on April 28, 2023 so that the freelancers will be more protected. Although this new act will become enforceable within one and a half years from the enactment, the enforcement date has not been specified as of March 5, 2024. Once enforced, the act requires an offeror who contracts with a freelancer to conform to certain obligations, such as specifying certain terms (e.g., scope of work, delivery date, remuneration etc.) in writing, and the payment date being set within 60 days from the delivery date.

Contact us

The information provided in this guide cannot be exhaustive and we recommend anyone considering doing business in Japan should seek professional advice from our member firms before making any business or investment decision.

Contact our member firms in Japan to discuss your requirements:

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