

# Managing the Potential Pitfalls of Short-Term Assignments to Japan\*

February 2010



# Table of contents

Introduction

Treaty or Non-Treaty Countries .....1

“Business Trip” vs. “Secondment” .....1

Assignment to a Branch Office .....2

Withholding Tax Obligations for a Branch Office .....2

Permanent Establishment (PE) .....2

Japanese Immigration .....3

Short-Term Assignments and Extended Business Trips Outbound from Japan.....3

Summary .....4

Contacts .....4

## Introduction

Short-term assignments, business trips and cross-border commuting are invaluable ways for multinational companies to meet business needs in foreign locations while avoiding expensive long-term assignments. However, they can also be complicated to structure, implement and track and can entangle companies in unexpected individual income tax, corporate tax and visa and immigration problems if they are not managed properly.

The purpose of this Newsletter is to raise the awareness of potential issues that should be considered in regards to short-term assignments and extended business trips to Japan. What follows is a compilation of these potential issues and related information that will give you a better understanding of the various issues that should be addressed in the planning and managing of the assignments.

## Treaty or Non-Treaty Countries

Questions: Does your company bring many foreign resident employees to Japan on short-term assignments or business trips? Do you know if these employees are residents of countries which have a bi-lateral income tax treaty with Japan or are residents of non-treaty countries?

Under Japanese domestic tax laws, nonresident individuals are subject to income tax on Japan sourced income, such as compensation for workdays in Japan. There is no “de minimis” rule regarding workdays or the amount of Japan sourced income that may be exempt from individual income taxation. Technically, even the income associated with a single workday in Japan is subject to Japan individual income taxation.

However, Japan has entered into tax treaties with many countries for the purposes of avoiding double taxation and to prevent tax evasion. These treaties contain conditional provisions to exempt Japan sourced compensation from Japan taxation for employees who are tax residents of these treaty countries.

One of the conditions to be satisfied for exemption is that the employee must be physically present in Japan for not more than 183 days during an applicable period (commonly referred to as the “183-Day rule”). Unfortunately, this exemption is not available to business travelers to Japan from non-treaty countries and regions (for example, Hong Kong is a region that is not covered under Japan’s tax treaty with China). In such cases, the foreign business traveler is subject to individual income taxes on any compensation earned for services performed in Japan.

Question: Do you know which of Japan’s tax treaty partners count the “183 days” using a calendar year vs. a rolling 12-month period?

It is very important to understand the way the days are counted during the applicable period. The applicable period can be different from treaty to treaty. The older tax treaties generally apply a calendar year period in determining whether the 183-Day test has been met (e.g., Germany, Spain and Italy). However, the tax treaties that have been introduced or revised in recent years increasingly count the days for the 183-Day rule on a “rolling 12-month” period that could span over two calendar years (e.g., Unites States, United Kingdom and Australia).

## “ Business Trip” vs. “Secondment”

Questions: What is the short-term assignee’s employment status? Has he or she been formally seconded to Japan or is the employee on a long-term business trip to Japan?

We often learn of company administrators classifying employees as “business travelers” solely based on the expected number of days in Japan. Are they really “business travelers” or based on the purpose and objectives of their assignment, are they on “secondment” to Japan? This distinction has a bearing on whether they can utilize the 183-Day rule.

An employee “seconded” to Japan (even for a short-term assignment), cannot exempt income earned while working in Japan even if he or she did not spend more than 183 days during the applicable period. The 183-Day rule and the potential to exempt the Japan sourced compensation from Japan individual income taxation is only available to “business travelers.”

A determination must be made, based on the facts and circumstances of the situation, whether a trip should be classified as a business trip (“Shuccho”) or a secondment (“Shukko”). In conducting this analysis, one should consider various facts including the business reporting line, which entity receives the benefit from the employee’s activities in Japan, and the assignment length.

## Assignment to a Branch Office

Questions: Are the employees working for a Japan branch office of the foreign corporation? Where do you report the costs for those “business travelers” from the Head Office? Were the remuneration costs not allocated to the Japan branch assuming that the individuals could be exempted from Japanese income tax, even though their costs should have been allocated to the Japan branch?

As mentioned above, the remuneration paid to “business travelers” can be exempted from Japan taxation if they did not spend more than 183 days in Japan and other treaty criteria are met, including that their remuneration is not borne by a permanent establishment which the foreign employer has in Japan.

Therefore, business travelers from overseas working in the Japan branch would not be able to benefit from the treaty exemption if their costs are (or should have been) allocated to the Japan branch. Cost allocation issues should be addressed as they are critical in determining whether income is appropriately classified as treaty tax-exempt in Japan.

## Withholding Tax Obligations for a Branch Office

Question: Are you aware of the withholding tax requirements for branch offices in Japan on taxable compensation paid by your Head Office to short-term assignees working in Japan?

The Japan branch office of a foreign corporation is required to withhold income tax on the taxable compensation related to a Japan assignment paid to its non-resident employee if it is paid by the same legal entity (e.g., Head Office, a foreign branch of the same entity, etc.).

## Permanent Establishment (PE)

Question: Are you aware of the possible PE risks created by short-term assignees?

It is often difficult to assess whether the activities of short-term assignees have unintentionally created a “permanent establishment” in Japan for the foreign corporation. In situations where an employee of a foreign corporation is physically present in Japan for a continuous period of time or employees are physically present on a rotation basis for a continuous period (even though each employee is present in Japan for not more than 183 days), the foreign corporation could be at risk of creating a PE in Japan. Of course, other underlying PE factors would need to be considered, such as the nature of the activities of the employees. But, if a PE does exist, then the foreign corporation would be subject to Japan corporate tax filings and potentially liable for Japan corporate income tax.

Additionally, if a PE is created, then the assignees are not able to exempt their Japan sourced compensation from Japan individual income tax even if they did not spend more than 183 days in Japan. [Note: The Organisation for Economic Co-operation and Development (OECD) commentary provides that a PE is a concept where the place of business is “fixed” through which the business of an enterprise is wholly or partly carried on. While the commentary cannot be directly applicable like domestic law provisions, it should be respected to some extent. Also, this determination needs to take into account both geographical and time factors. In addition to the length of the short-term assignments to Japan, one needs to also consider whether there is a link between the place of business and a specific geographical point when analyzing the PE concept.]

## Japanese Immigration

**Question: Do you have a clear understanding of the visa and immigration issues with regard to those foreign employees who are in Japan as short-term assignees, business visitors, or frequent travelers?**

Foreigners can generally enter Japan as a Temporary Visitor (a formal visa may be required depending upon the individual's nationality). However, the scope of activities that foreigners in Japan can perform without formal work visas is limited and the Japanese Immigration authorities are increasing their scrutiny of temporary visitors who travel in and out of the country every 90 days or so. After two or three such consecutive trips into Japan, immigration officers may question the purpose of the individual's intended stay in Japan and the frequency of the trips. If appropriate explanations cannot be provided to the satisfaction of the immigration officers, then they may not approve the landing and refuse entry into Japan.

An appropriate work visa should be obtained for individuals who expect to be in Japan for longer than the typical business trip. This will help reduce the risks of denied entry for these visiting foreign employees.

## Short-Term Assignments and Extended Business Trips Outbound from Japan

**Question: Does your Japan company send employees on short term assignments or extended business trips out of Japan? Are you aware of the potential foreign tax issues for these employees?**

Employees on short-term assignments outbound from Japan may encounter tax issues in the destination countries that are likely to be similar to the ones outlined above for assignees inbound to Japan. If treaty exemptions are not available, taxation may be applicable and corresponding compliance obligations may arise. In addition, because the employees are likely to be residents of Japan while on their short-term assignments abroad, and therefore remain subject to taxes in Japan in such cases, employees risk double taxation on the same income. In this situation, tax credit relief might apply to alleviate the double taxation, but not necessarily. Therefore, the better alternative is for Japan companies to properly plan ahead for these short-term assignments to avoid or reduce any additional tax costs.

## Summary

As demonstrated above, careful planning and consideration is crucial in order to manage the many complex issues that accompany short-term work assignments. We hope that this document has been helpful in highlighting some of the potential pitfalls and we recommend that you take the necessary time to review your current Short-Term Assignee population to determine whether any improvements can be made. If you require any assistance or more detailed information, please do not hesitate to reach out to one of our specialists listed below.

## Contacts

For more information, please consult your international assignment services representative or contact any of the following members listed below.

### Office

---

Zeirishi-Hojin PricewaterhouseCoopers  
(<http://www.pwc.com/jp/tax>)  
International Assignment Services  
Tokyo Club Building 5F, 2-6 Kasumigaseki 3-chome  
Chiyoda-ku, Tokyo 100-0013, Japan  
Tel: [81] (3) 3539 6300, Fax: [81] (3) 3539 6400

### Contacts

---

#### **Nasir Majid, Partner**

Tel: [81] (3) 3539 6310

Email: [nasir.majid@jp.pwc.com](mailto:nasir.majid@jp.pwc.com)

---

#### **Mitsuko Ushida, Director**

Tel: [81] (3) 3539 6409

Email: [mitsuko.ushida@jp.pwc.com](mailto:mitsuko.ushida@jp.pwc.com)

---

#### **Ichiro Kawakami, Director**

Tel: [81] (3) 3539 6369

Email: [ichiro.kawakami@jp.pwc.com](mailto:ichiro.kawakami@jp.pwc.com)

---

#### **Naomi Homma, Manager**

Tel: [81] (3) 3539 6332

Email: [naomi.homma@jp.pwc.com](mailto:naomi.homma@jp.pwc.com)

---

#### **Stephen Kang, Manager**

Tel: [81] (3) 3539 6374

Email: [stephen.kang@jp.pwc.com](mailto:stephen.kang@jp.pwc.com)

---

#### **Yasuyo Numajiri, Manager (Visa and Immigration)**

Tel: [81] (3) 3539 6393

Email: [yasuyo.numajiri@jp.pwc.com](mailto:yasuyo.numajiri@jp.pwc.com)

