



Financial Services Tax News

Financial Services Tax Group

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Size-based taxation on corporation enterprise tax

A size-based taxation on corporation enterprise tax in which the taxable bases consist of capital basis, added value basis and income basis, applied to a certain corporations for fiscal years commenced on or after April 1, 2004. The size-based taxation is applicable for the fiscal year ending March 31, 2005 for a corporation whose fiscal year ends on March 31 or for the fiscal period ending December 31, 2005 for a calendar-year corporation respectively.

If size-based taxation does not apply, enterprise tax applies on taxable income basis only. Whether it is beneficial for a corporation to manage its capital to fall within or outside of the size-based taxation regime will depends on its own unique set of circumstances. However, corporate with tax losses will be better off outside the size-based taxation regime.

In this News Letter, we summarize the applicability of the size-based taxation and the capital basis tax.

1. Applicability of the size-based taxation

The size-based taxation is applied to a corporation whose capital amount is greater than JPY100 million at the end of the fiscal year, with exclusions for certain corporations such as Investment Corporations and Tokutei Mokuteki Kaisya. The capital amount used for the determination is paid-in capital (Shihon-kin) at every fiscal year end (or the date of liquidation for corporations liquidated during a fiscal year). Accordingly, even if paid-in capital at the beginning of a fiscal year is greater than JPY100 million, if the paid-in capital as of the end of the fiscal year is JPY100 million or less as a result of the capital reduction during the year, the corporation is not subject to the size-based taxation.

Where the capital reduction is made without a cash distribution and the amount of capital reserve is increased instead, so long as the paid-in capital amount after reduction is JPY100 million or less, the corporation is not subject to the size-based taxation. For planning purposes, note that a reduction of paid-in capital may take some time due to procedures required under the Japanese Commercial Code, e.g., protection for creditors arrangements.

The Japan branch of a foreign corporation is also subject to the size-based taxation if its paid-in capital is greater than JPY100 million. Whether a foreign corporation is subject to the size-based taxation is determined using paid-in capital converted to Yen at the TTM rate at the end of the fiscal year. The paid-in capital used for this determination is the paid-in capital of the head office of the foreign corporation, and not the amount of the brought in capital to Japan.

2. Calculation of the capital basis tax

Capital basis tax is basically calculated by multiplying the total amount of paid-in capital and capital reserve at the end of the fiscal year and the applicable tax rate. Corporation under liquidation whose paid-in capital was greater than JPY100 million at the date of liquidation will not be subject to capital basis tax regardless the total amount of paid-in capital and capital reserve, although added value basis tax and income basis tax are imposed.

The tax base of capital basis for a Japan branch of a foreign corporation is the total amount of paid-in capital and capital reserve appropriated to the Japan branch based on the head count, whereas the applicability is determined based on the paid-in capital of the head office of the foreign corporation.

For a corporation which reduces its paid-in capital without cash distribution or the capital reserve in order to mitigate the capital deficiency on or after April 1, 2001, there is a special rule that the amount appropriated for the deficiency is deducted from the total amount of paid-in capital and capital reserve for the fiscal years starting from April 1, 2004 to March 31, 2006.

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