

Business Start Up in Osaka, Japan

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Introduction

In this brochure, we outlined the general terms, but not specify the detail. Since accounting and tax treatment would vary by individual situation, please forward any specific questions to Osaka Business and Investment Center (OBIC). We will refer you to an appropriate professional firm.

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I. ENTERING THE JAPANESE MARKET

Ordinarily, a foreign enterprise enters the Japanese market using one of the following 3 corporate structures:

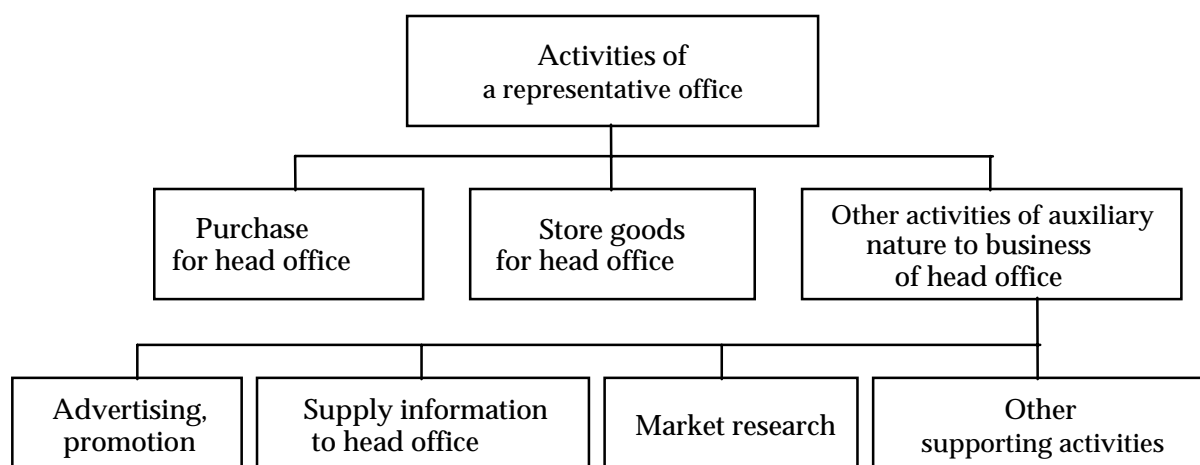
1. Representative office
2. Branch office
3. Corporation (Subsidiary)

1. Representative office

In general, the foreign enterprise is free to establish a representative office in Japan for the purpose of collecting and providing information. As such, no permission, notification or registration is required for the establishment of such an office under the Foreign Exchange and Foreign Trade Control Law. Since the representative office can not conduct business activities under the Foreign Exchange and Foreign Trade Control Law, it is not regarded as permanent establishment (“PE”), and therefore not subject to Japanese corporate tax.

Chart 1

Ordinary Activities of a Representative office



If any representative office in Japan intends to conduct activities other than those listed in the above chart, it must, regardless of its title, implement the procedures necessary to establish a branch.

2. Branch office

To establish a branch office in Japan by a foreign enterprise as its base for business is considered to be a “Direct Domestic Investment” under the Foreign Exchange and Foreign Trade Control Law. As such, the branch office is required, in principle, to report to the Minister of Finance and occasionally to other relevant Minister(s) after its commencement, and to register as a foreign company under the provisions of the Corporate law.

Under the Foreign Exchange and Foreign Trade Control Law, it is necessary to report the commencement of branch office by filing a “Report Concerning the Commencement of Branch, etc.” shortly after its commencement.

Once the branch office receives the approval for its commencement report, both the office and its legal representative in Japan (the branch manager) are considered to be registered with the corporate registry authorities. At this point, the branch formally comes into effect. The registered branch manager then becomes authorized under the Japanese law to represent the branch office in all capacities, and to conclude contracts with third parties without any additional internal corporate authorization. You must register each change of branch manager.

Under the corporate law, the branch office may engage in any approved corporate activity. It is used primarily for liaison, technical servicing, purchasing, and less frequently for importation and sales.

3. Corporation (Subsidiary)

If the foreign enterprise incorporates a Japanese corporation, it is treated as a “Direct Domestic Investment” under the Foreign Exchange and Foreign Trade Control Law, as is the “establishment of branch”. The enterprise must notify its incorporation shortly after the establishment (prior notification may also be required in some instances).

A new law entitled the “Corporate law” (*Kaisha Ho*) passed the Diet on June 2005 and become effective on May 1, 2006, which replace and significantly modify the current provisions of the Commercial Code.

Under the new Corporate law, the company is broadly classified into two types according to the shareholders’ responsibility and governance. One is Kabushiki Kaisha (joint-stock company) and the other is Equity Companies (joint-name company/ joint-fund company/ limited partnership company).

- A joint-stock company (Kabushiki Kaisha, KK) consists of shareholders whose liabilities to creditors of the company are limited to the amount of stock purchased in the company.
- A joint-name company (Gomei Kaisha) consists of partners whose liabilities to creditors of the company are unlimited.
- A joint-fund company (Goshi Kaisha) consists of limited and unlimited partners. Limited partners’ liabilities to the creditors of the company are limited to the amount of their contribution to the company.
- A limited partnership company (Godo Kaisha, GK), which is newly introduced, consists of partners whose liabilities to creditors of the company are limited. A GK is similar to an LLC in the US as it combines limited liabilities for its members with flexible management structure.

Limited liability company (Yugen Kaisha, YK), which is a simplified joint-stock company used for small businesses, is abolished and no new YKs can be established under the new

Corporate law. All existing YKs have two choices (i) automatically becoming an ordinary KK or (ii) continuously existing as a so-called Special YK (*Tokurei Yugen Kaisha*) keeping almost all of the characteristics of a YK.

4. **Kabushiki Kaisha (KK)**

Factors such as limited liability, management participation and other relevant matters mean that a Kabushiki Kaisha is usually the most suitable structure for foreign enterprises to adopt when establishing an operation in Japan. Indeed, nearly all the subsidiaries and joint ventures set up in Japan by foreign businesses have taken the form of Kabushiki Kaisha.

The steps which a foreign corporation establishing a Kabushiki Kaisha must take are as follows:

- (1) The articles of incorporation of the Kabushiki Kaisha should be prepared.
- (2) A “Report on the Acquisition of Shares” should be filed with the Minister of Finance and other Ministers to obtain approval, as required by the Japanese Foreign Exchange Control Law.
- (3) The articles of incorporation should be notarized.
- (4) The shares should be purchased up by the promoters and subscribers.
- (5) A constituent general meeting must be held to elect directors and the statutory auditors. The directors elect a representative director(s) at the directors’ meeting.
- (6) The formation of a Kabushiki Kaisha must be registered with the local office of the Legal Affairs Bureau of the Ministry of Justice no more than two weeks after the constituent general meeting.

Because of the legal issues associated with the formation and registration of a Kabushiki Kaisha, legal advice and assistance should be sought.

The new Corporate law does not require minimum capital for a KK at the time of incorporation. Accordingly, KK can be established even at ¥1 capital. On the other hand, new Corporate law prohibits dividends distribution unless its net assets are more than ¥3,000,000.

A KK is classified into Large/Small-Medium company and Open / Closed company by its amount of capital and liability and transferability of stock

Large Company (LC): The capital is ¥500 million or more

Or total liability is ¥20 billion or more

Small-Medium Company (SMC): Other than Large Company

Open Company: The shares are, in principle, transferable without the company's consent despite some restrictions.

Closed Company: Transfer of every-class of share requires the company's consent

Under the new Corporate law, the internal organization structure such as director/representative director, board of directors, statutory auditors and accounting counselor can be more flexibly designed depending upon a type of KK

Image projected by a "Branch" versus a "Corporation" is as follows:

Image Comparison

	<u>Branch Office</u>	<u>Corporation</u>
Image -	Small	Large
	Temporary	Permanent
	Short sighted	Long sighted
	Weak	Strong
	Negative	Positive
	Untrustworthy	Trustworthy
	Not independent	Independent
	Tough employment terms	Reasonable terms
	Employment insecurity	Employment security
	Tough bank borrowing	Easy bank borrowing
Capital -	No	Yes
Retained earnings -	No	Yes
Dividend -	No	Yes
Nationality -	Foreign company	Japanese company
Top management -	Branch manager	President

II. BUSINESS START UP

1. Opening a bank account

(1) Foreign bank vs. Japanese bank

Foreign companies generally prefer to open a bank account at a Japanese branch of foreign bank that deals with their headquarters. However, it is advisable to have at least one bank account at a Japanese bank, because foreign banks do not have many local branches in Japan (even in Tokyo), and if they do, the locations are usually inconvenient for daily transactions etc. Furthermore, they may not handle payment of various taxes and social insurance premiums.

(2) Checking account vs. Ordinary account

In the US, checking accounts are commonly used for general cash disbursements, as a check is the primary means of payment there. On the contrary in Japan, we make most payments with cash remittance through ordinary bank accounts rather than checks. Therefore, it is advisable to open an ordinary account at a Japanese bank.

(3) “Hanko” (Seal)

It is not common to register a signature of authorized company representative at a bank for the purpose of verifying identification. Instead, we register a company’s seal (called “Hanko”) at the bank. We make cash withdrawals with this registered Hanko and a passbook. We should keep the Hanko separately from the passbook to avoid unauthorized withdrawals.

(4) Automatic transfer arrangement

It is quite popular in Japan to make automatic bank transfer arrangement for such periodical payments as rent, utilities (electricity, gas and water) and telecommunication. When implemented, pre-notice for automatic withdrawal is sent to the company for verification purpose together with receipt of prior month’s charge.

2. How to find an office location

(1) Bilingual real estate agencies

Generally speaking, it is not easy to find an office location without experienced assistance, as it is quite difficult to understand the terms and conditions of lease agreements. And in some cases, office owners are still reluctant to lease their offices to foreign companies, despite the decline in office rent due to the slowdown of Japanese economy. Consequently, bilingual real estate agencies that deal specifically with foreign tenants to overcome these problems have appeared in major cities as Tokyo, Osaka and Nagoya.

(2) Leasehold deposit and key money

A leasehold deposit, and occasionally a key money, are required by a landlord for renting an office. Key money, a charge that is very common, especially in Western Japan, is nonrefundable. If a lease agreement states that some or all of the leasehold deposit is also nonrefundable, the non-refundable portion of the leasehold deposit, as well as the key money, can be treated as a deferred charge and can be amortized in accordance with Japanese tax law.

(3) Sub-lease and social insurance registration

Newly established companies often lease offices from other tenants under sublease agreements. In such cases, a social insurance office usually requests that you should register both the main leasing contract and the sub-lease agreement for social insurance purposes.

3. VISA

A foreign investor can enter Japan with a Short-Term Stay Visa obtainable at Japanese diplomatic establishments abroad, for preparatory work in connection with operating a representative office (such as procuring office space and employing staff) so long as such person does not engage in business activities. However, it is advisable to obtain an Investment/Management Visa to stay longer in Japan as a representative of representative office. For this purpose, a foreign investor must apply for a “Certificate of Eligibility” at an Immigration Office in Japan, and after obtaining the Certificate, leave Japan to apply for an Investment/Management Visa at a Japanese diplomat establishment abroad.

Some countries have executed reciprocal visa exemption agreements with Japan, yielding the position that the citizens of those countries need not obtain visas, if their period of stay is to be within the designated period (except when they obtain employment or engage in business activities to receive payment in Japan).

A visa is also not required when a foreigner departs temporarily from Japan during the period of his/her stay, if such person files an application to the Immigration Office for a reentry permit prior to his departure.

4. Recruiting

(1) Regular employees

There are several ways to recruit a new staff, including:

- An Employment Service for university graduates, training schools etc.
- Public employment security office
- Private employment agency
- Advertisement in newspapers or magazines
- Direct recruiting through personal contact

If you seek a candidate with business experience, professional expertise or English language ability, private agencies and English media, e.g. daily English newspapers, are effective means.

(2) Temporary staff

It has become popular in Japan to use private agencies to hire temporary or part-time staffs. Some agencies specialize in recruiting staffs from specific professions, e.g. secretarial, clerical, accounting and engineering. One particular benefit of using the staffing service provided by such agencies is that an employer who uses temporary staff does not have to handle the social insurance and withholding income tax matters, which are taken care of by the agencies. Therefore, to hire temporary staffs from the agencies can be extremely beneficial in the start-up stage of company, when its payroll function has not been established.

III. ACCOUNTING & TAX

1. Notification

Please note that K.K. in the following sentences means both K.K. and Branch unless otherwise stated separately.

Reporting and Elections

Reporting and elections for tax purposes are required after a K.K. (*Kabushiki Kaisha*) is established or a Branch is commenced for legal purposes. Following is a list of documents to be filed with the tax offices.

National Tax Office	Filing due
1. Report on establishment of company (KK only) A copy of articles of incorporation and a certified copy of company register must also be submitted	Within 2 months after establishment
2. Report on the establishment of a foreign corporation (Branch only)	Within 2 months after commencement
3. Application for approval of filing a blue tax return	Within 3 months after the date of establishment or the first fiscal year-end, whichever is earlier
4. Application for extension of filing due date for corporate tax return - if needed	The end of the fiscal year
5. Report on commencement of payroll payment	Within 1 month after establishment of office
6. Application for approval of paying withholding tax by every July 10 and January 10	Anytime if the number of employees is less than 10
7. Report on depreciation method of depreciable fixed assets	Filing due date for the first tax return
8. Report on method of evaluation of inventory assets	Same as 7 above

Local Tax Office	Filing due
1. Report on commencement of business A copy of articles of incorporation and a certified copy of company register must also be submitted	Within 15 days after starting business
2. Application for extension of filing due date for enterprise and inhabitant tax return - if needed	Same as 4 above

Blue tax return system

(1) Blue tax return system

Largely due to several privileges associated with blue tax returns, such as carry-forward of net operating loss, special measures for depreciation etc., a large number of companies presently file a blue tax return.

(2) Approval by NTA

A newly established company wishing to file a blue tax return must apply to the appropriate National Tax Office by the earlier of the following dates: 3 months after its establishment or the end of the company's first fiscal year.

(3) Bookkeeping and maintaining accounting records

Under the blue tax return system, a company is required to keep proper accounting records, to maintain accounting books and reports for its income for 7 years at an office in Japan, based on the proper records and double-entry accounting in Japanese yen.

(4) Japanese Yen based bookkeeping

It is sometimes observed that Japanese Yen transactions are booked in foreign currency by applying applicable exchange rate. Then, the foreign currency base financial statements are retranslated into Japanese Yen at year-end for Japanese tax reporting purpose. As a result of this, cumulative translation adjustment account would be recognized in the Japanese Yen base financial statement.

However, such foreign currency base bookkeeping and retranslated financial statement are NOT allowed for Japanese tax purpose. As long as the business activities are conducted in Japan, functional currency must be Japanese Yen and Yen base bookkeeping is mandatory requirement for tax reporting purpose.

(5) Japanese GAAP vs. Other GAAP

Books and records should be maintained in accordance with the Japanese GAAP. If different GAAP such as US GAAP and/or IFRS is adopted, appropriate reconciliations between GAAPs must be made and the supporting documents should be maintained in Japan.

Although there is no significant difference in Japanese GAAP and others, typical differences at small foreign start-up companies would be:

- a) Length of useful life for depreciation
- b) Capitalization rule for properties
- c) Capital lease accounting
- d) Accrued vacation expense
- e) Deferred tax

(6) Accounting system

In case that the company uses foreign made accounting package system, it may not process consumption tax properly. The company may need to make an extra effort to segregate consumption tax portion with all transactions.

On the other hand, the Japanese accounting package system automatically segregates consumption tax and generates the analysis and reconciliation of consumption tax.

Generally speaking, using Japanese accounting package facilitates both bookkeeping process and consumption tax return preparation process.

2. Tax Return

Reports	Due date	To be filed with
<ul style="list-style-type: none">• Interim corporate tax return• Interim consumption tax return• Interim enterprise and inhabitant tax returns	Within 2 months after the end of the first 6 months	<ul style="list-style-type: none">• National tax office• National tax office• Local tax office
<ul style="list-style-type: none">• Final corporate tax return (see *1)• Final consumption tax return• Final enterprise and inhabitant tax returns (see *1)	Within 2 months after the fiscal year-end	<ul style="list-style-type: none">• National tax office• National tax office• Local tax office
Depreciable assets return	January 31	<ul style="list-style-type: none">• Local tax office

*1 Within 3 months, if one-month extension is applied.

3. Consumption tax

(1) Outline

Consumption tax is categorized as an indirect taxation to which almost every domestic transaction and every transaction for the import of foreign goods is subject at the rate of 5%, except for financial transactions, capital transactions, medical services, welfare services and educational services. The basic formula to calculate the tax due from the company is as follows:

$$\text{Tax due} = \begin{array}{l} \text{Total amount of} \\ \text{consumption tax on sales} \\ \text{(5\% of taxable sales)} \end{array} - \begin{array}{l} \text{Total amount of} \\ \text{consumption tax on purchases} \\ \text{(5\% of taxable purchases) (Note)} \end{array}$$

(Note) A prerequisite for the application of purchase tax credit is the keeping of books and bills, etc. with respect to purchase tax credits in the taxable period.

(2) Timing of application for election to be a taxable enterprise

(i) Choice of taxable enterprise status

If a company's taxable sales during a "base period" are more than ¥10 million, the company must file a consumption tax return. A company's "base period" is a fiscal year before last.

- A newly established company with capital of ¥10 million or more is not exempt from tax during its first and second fiscal years.
- A newly established company, except for a company whose capital is ¥10 million or more as mentioned above, is not required to file a consumption tax return for its first two fiscal years. However, this does mean that newly established companies, except for the taxable company mentioned above, are disadvantaged in that they cannot claim a consumption tax refund during the first two fiscal years, even if the consumption tax paid on purchases is greater than the consumption tax received on sales. To compensate this disadvantage, the law allows a company to make an election to be a taxable enterprise during its first two years.

Generally speaking, if a company invests heavily in its business before starting substantial operations, i.e. in its first two fiscal years, electing to be a taxable enterprise to enable it to claim consumption tax refunds can be beneficial.

The decision to elect to be a taxable enterprise also depends on the cost of filing to obtain the refund. If the filing cost exceeds the potential net tax refund, it is clearly better for a company not to elect to be a taxable enterprise, and to therefore avoid filing.

(ii) Timing of application

If a newly established company with capital of less than ¥10 million wants to elect to be a taxable enterprise, it must submit a necessary application by the end of the first fiscal period.

(3) Interim returns

In some cases, the monthly, quarterly or semiannual interim return is required.

5. Net operating losses (NOL)

Most newly established companies are unlikely to make profits in their initial operating periods. For corporate tax purposes, a company that files a blue return may carry back losses to the previous fiscal year or carry forward losses to subsequent years, up to a maximum of seven years.

6. Audit requirement

In Japan, you must hold a regular shareholders' meeting of a company no later than 3 months after the company's fiscal year end. The financial statements (balance sheet, profit and loss statement, statement of change of shareholders' equities and statement of explanatory notes) of the company must be approved by the regular shareholders' meeting.

It is possible to hold the regular shareholders' meeting on paper only, subject to the size and the approval of the company. In this case, the minutes of the meeting will be prepared by an attorney.

Under the new Corporate law, a statutory auditor (so called *Kansa-yaku*) is not mandatory required for a Small-Medium Closed company. On the other hand, once the statutory auditor is elected, he/she is responsible for not only accounting matters but also operational issues, unless his/her responsibility is restricted to the accounting audit by the articles of incorporation. In case that the responsibility is limited to accounting audit, the wording of statutory auditor's report might be:

"I, Statutory auditor, have examined the balance sheet of [Company Name] as of d/m/y, the related income statement, business report and statement of change of shareholders' equity for the period ended d/m/y.

In my opinion, such financial statements present legally and fairly the financial position and results of operation of [Company Name]."

The auditor's report should be dated in accordance with legal guidelines.

External Audit

There is no external independent audit (CPA's independent audit) requirement for Medium-Small Corporation (capital amount less than ¥500 million and total liabilities less than ¥20 billion)

If a foreign Parent company wants an external audit for its small Japanese subsidiary or branch, a voluntary audit arrangement (or agreed upon review arrangement) can be made between the Parent auditor and a local audit firm in Japan.

7. Comparative chart between Branch and Corporation (K.K.)

The following shows the Japanese taxation and related matters comparing a branch and a corporation.

Item	Branch	Corporation
1. Scope of taxable income	Japanese source income	Worldwide income

2. Entity Tax Rates		
(1) Corporate tax	30%	30%
(2) Enterprise Tax (Note 2)	9.6% (Note 1)	9.6% (Note 1)
(3) Inhabitants Tax on Corporate tax Due	17.3%	17.3%
(4) Total (1) ~ (3)	44.8%	44.8%
Effective Tax Rate (4) x 1/(1+ (2))	40.9%	40.9%
3. Dividend to a parent company, or Remittance of Profit to a home office		
(1) Withholding tax	N/A (Remittance)	20% (Dividend) This tax rate is reduced to 0%, 5% or 10% by most tax treaties.
(2) Remittance guarantee	Guaranteed	Guaranteed
4. Expense Allocation between the Home Office and a Branch, or Parent and Subsidiary	Expenses paid by the home office or a parent on behalf of a branch or a subsidiary is deductible in Japan as far as such expense can be identified specifically. However, it is easier for a branch to deduct general administrative type of expenses than for a subsidiary. This is because most treaties allow the deduction. Any expense incurred for a specific service is deductible by the company who receives the service.	
5. Tax Credit		
(1) Interest	Creditable	Creditable
(2) Dividends received from Japanese companies	Not creditable	Creditable
6. Scope of Financial Statements to be attached to the Corporate Tax Returns	The combined financial statements are required to be filed.	Only financial statements of a subsidiary are required to be filed.
7. Legal Audit under the Japanese Commercial Code	N/A	Necessary if a subsidiary meets at least one of the following conditions. <ul style="list-style-type: none"> • Amount of paid in capital exceeds ¥500 million yen • Amount of the total liabilities exceeds ¥20 billion

		yen
		• Listed in Stock Exchange
8. Compensation		
• Bonus to a director of the branch or subsidiary	Not deductible (deductible if reported to tax authorities in advance) The company should minimize the number of the board members.	Not deductible (deductible if reported to tax authorities in advance) The company must have at least 1 director.
• Regular compensation	Deductible	Deductible
9. Accounting Report	Not as strict as a subsidiary	Japanese accounting standards must be strictly followed.

(Note 1)

The tax ratio is applied to a company whose capital is less or equal to ¥100 million yen.

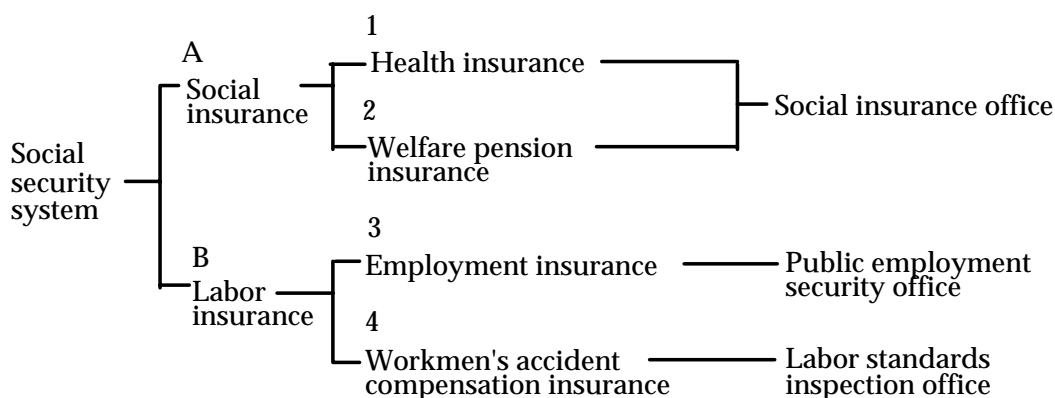
(Note 2)

A company with capital exceeding ¥100 million yen is subject to the Factor-Based Enterprise Tax. In such circumstances, a certain amount of enterprise tax will be imposed based on the value added factor and capital factor, even if the company has no taxable income. Please refer to a tax specialist for details.

IV. SOCIAL INSURANCE

1. Outline of Social Security System in Japan

The social security system in Japan is composed of (A) Social Insurance (in a limited sense) and (B) Labor Insurance administered by the Ministry of Health, Labor and Welfare. The system encompasses four major schemes as outlined below.



- (1) **Health Insurance** entitles employees (Insured persons) and their family members to receive medical treatment at 30% of the actual costs. There are also other cash benefits for events such as childbirth, death, etc. Employees aged 40 – 64 years covered by health insurance are required to contribute to Nursing Care Insurance, which is one of governmental welfare plans.
- (2) **Welfare Pension Insurance** provides pension benefits when employees reached 65 years of age or become disabled. Lump-sum benefits and pension benefits for survivors are also provided. An employer who is qualified for the scheme is obliged to contribute to the Children's Welfare Fund.
- (3) **Employment Insurance** provides cash benefits when employees become unemployed, for the purposes of supporting their life and promotion for new employment.
- (4) **Worker's Accident Compensation Insurance** entitles employees to be compensated for sickness, injury or death while working or commuting to/from a working place.

Almost all companies registered in Japan must become "covered offices" by law, and are required to register with district insurance offices at the time of their establishment. All employees employed at "covered offices" are qualified as "insured persons" under the scheme and must register with their respective offices as well. This regulation covers foreign nationals regardless of their nationality, visa status, or length of stay in Japan.

2. Timing of registration

(1) Social insurance

As mentioned above, a company is required to register with the local social insurance office within 5 days of its establishment. In practice, the social insurance office may accept an application from a newly established company after due date. However, considering any disadvantages that may be caused to employees by the late registration, it is preferable to prepare for the completion of the registration within 1 month of its establishment.

(2) Labor insurance

A company is required to register for labor insurance scheme within 10 days from the following date when the company is established and its first employee is hired. As the social insurance scheme, the local labor insurance office will accept an application submitted after due date in practice, however the registration will be retroactively effective from its establishment as well.

After the registration has been accepted, the estimated insurance premium for the period from the date of registration to the following March 31 must be paid within 50 days of the registration date.

3. Determination and payment of insurance premiums

(1) Social insurance

By every July 10, the employer is required to report to the social insurance office the amount of remuneration paid to each employee during the three-month period from April to June. The office determines the appropriate level of social insurance premiums, which applied from the period of September to August of the following year, based upon the information from employers, and informs it to employers.

The monthly premium determined will be applied through the year in principle. However, if a significant change occurs in an individual's remuneration, the monthly premium will be adjusted prior to the following annual review in July.

The employee's portion of the social insurance premiums is withheld from salary and paid, along with the employer's portion, to the social insurance office in the following month.

(2) Labor insurance

The year for labor insurance purposes starts on April 1, and ends on March 31 of the following year. An employer is required to pay the estimated annual premium by May 20 every year. Once the actual premium has been determined on March 31, the balance to be paid is adjusted with the payment of the following year's premium. The employee's portion is then withheld from salary on a monthly basis.

In addition, from April 2007, an employer is required contribution to the governmental aid plan for asbestos-caused health damage. The contribution amount is the 0.005% of the total salary paid from March to April, and is paid together with labor insurance premiums by May 20 every year. The estimated contribution is not required.

4. Coverage of foreign nationals

(1) Social insurance

The treatment of expatriates is the same as for Japanese employees. However, there is a case that an expatriate, who is not paid by a Japanese branch but by an overseas headquarters, and has no payroll relationship in Japan, will not be covered. You should consult with the social insurance office in each case. Since health insurance and welfare pension insurance are combined, it is not possible for an expatriate to participate only in health insurance. Foreign nationals hired locally are treated in the same manner as the Japanese.

Lump-sum withdrawal benefits for expatriates

Lump-sum withdrawal benefits will be provided to foreign nationals who leave Japan and have been insured under the social insurance schemes for a certain period. Benefits are paid to those who satisfy some criteria. The benefit amount is determined by the length of the insured period and the average standard remuneration (monthly standard remuneration + standard bonus).

(2) Employment insurance

In principle, the coverage is extended to foreign nationals.

(3) Worker's accident compensation insurance

Expatriates are covered by this insurance as long as they work at an insured company in Japan, and under the direction of the company in Japan. However, coverage is not extended to those who work under the direction of the headquarters outside Japan, even if their work place is within Japan.

(4) Social security totalization agreement with foreign countries

An expatriate who participates in the social security system in Germany, U.K., US, South Korea, Belgium can be exempted from paying a premium in Japan, to avoid paying a double premium. The agreement with France is to be implemented in June 1, 2007.

5. Treatment of a representative of a branch office

(1) Social insurance

Social insurance legislation treats an employer as an employee who works at an insured business office. Therefore, the treatment of a representative of a branch office is the same as that for employees.

(2) Labor insurance

In principle, labor insurance does not cover an employer. A representative for a Japanese branch office is not treated as a board member only for that position under the Corporate law, but he/she is regarded as an employer for labor insurance purposes. Therefore he/she is not covered by workman's compensation and unemployment insurance. The local authorities will determine his/her eligibility on a case-by-case basis depending on the individual situation.

6. The future prospect of social insurance premiums

(1) Social insurance

The outlines of the prospect of social insurance premiums are as follows.
For details to be amended, please inquire at professional firms.

Welfare Pension Insurance

The premiums started to increase by degrees beginning October 2004 and will be 18.3% (employer-and-employees halving) by 2017.

National Pension Insurance

The premiums increased by ¥ 280 from ¥ 13,300 per month every year from April 2005.

The welfare pension amount will be reduced for employees who is 70 years or older, according to income in April 2007.

The social security agreement with foreign countries is mentioned above; Agreement has been signed with Canada and Australia, to be signed with Netherlands, and under negotiation with Italy, Spain, Czech and Sweden. In addition, offer for discussion was given by Brazil, Luxembourg and the Philippines.

V. SALARY AND TAXES

1. Monthly salary

The conventional salary system in Japan includes such components as basic salary and other allowances such as transportation, position, professional, housing, family and meal allowances. On the other hand, foreign companies usually have a pre-determined annual salary from which the monthly salary is calculated simply by dividing the annual salary by 12.

2. Bonus

It is popular in Japan to pay a semi-annual bonus, in June and December, in a fixed amount, such as 1 - 3 times monthly basic salary. Japanese employees may ask to receive their fixed bonus when they are offered the annual salary system. In this case, many foreign companies determine the monthly salary by dividing the annual salary by 14 or 16 to reserve 2 - 4 months' salary for semi-annual bonuses.

Some companies, particularly foreign-based companies, pay incentive or discretionary bonuses depending on an individual's performance, in addition to fixed seasonal bonuses.

For tax purposes, income tax for salaried workers is levied on the total monthly salary and bonus payment.

3. Retirement allowance

When an employee resigns from a company, a retirement allowance is paid. The amount to be paid is usually determined by the length of employment and monthly salary of the employee.

4. Employment costs

The employer's portion of the contribution to social insurance must be considered as personnel expenses. Approximately 13.5% of remuneration is employer's portion under the current rule.

5. Year-end adjustment of income tax

Individual income tax for salaried workers is withheld from their monthly salaries according to tax rate tables. An employer is obliged to pay the withholding income tax to the local national tax office by the 10th of the following month.

The balance between the tax withheld throughout the year and the final amount due is adjusted with the December salary every year. This procedure, called year-end adjustment of income tax, is obligatory for employers as withholding agents.

In order for this procedure to be put into practice, an employee must submit a Declaration Form for Dependents' Deduction "Fuyo Kojo tou Shinkokusho" by the first salary payment each year.

If an employee's total taxable income exceeds ¥20,000,000 in one calendar year, tax cannot be adjusted by this procedure. The employee must file an individual tax return by March 15 of the following year and adjust the final amount due.

6. Individual inhabitant tax

Individual inhabitant tax is a form of local tax, consisting of a prefectural inhabitant tax and a municipal inhabitant tax. These are imposed on a resident who has a domicile in Japan as of January 1 of each year. Unlike the national income tax, the individual inhabitant tax is levied on the income earned in the previous year.

There is a large time lag between salary receipt and inhabitant tax payment. Even if an employee becomes unemployed and has no income for the whole of the current year, he/she must pay the inhabitant tax etc.

7. Economic benefit

(1) Legal rent system

Many companies provide housing to their employees and directors as a fringe benefit. Principally, this benefit is treated as a taxable income to the individuals. However, if an employee or a director pays an appropriate portion of the fair market rent (so-called "legal rent") to the employer, the rest of economic benefit (i.e., the fair market rent minus the legal rent) is treated as non-taxable income. In order to adopt this beneficial tax treatment, the lease agreement must be directly between the landlord and the employer.

The amount of legal rent varies according to whether you are an employee or a director of the company.

(2) Utilities (Water and electricity)

If a company pays the utilities for the benefit of its employees or directors, income tax is imposed on it as an economic benefit. Therefore the company needs to withhold taxes. However, if such withholding is not made upon mutual agreement between the company and employees/directors, such tax withholdings become subject to gross-up calculation as an economic benefit.

(3) A part for social-insurance-premiums of individual burden

If a company pays an employee's portion of social insurance premiums for the benefit of employees/directors, income tax is imposed on it as an economic benefit. Same as explained above, if appropriate withholding is not made on such benefit, it becomes subject to gross-up calculation.

(4) Income Taxes

When a company pays the income taxes for the benefit of employees/directors in order to fix the net take-home pay, taxes are imposed on that income taxes as an economic benefit. Same as explained above, it become subject to gross-up calculation.

(5) Home leave

If a company pays traveling expenses of an employees' or an officer's private trip, income tax is imposed on it. However if a company pays home leave expense for the foreign employee (expatriate), it is not subject to tax under certain conditions, i.e., periodical home leave once a year, and most rational trips through reasonable routs and economical fairs.

(6) Japanese language training

If a company pays Japanese language training expense for the benefit of its foreign employee, its spouse or children residing in Japan, it is not subject to tax as long as such training is deemed mandatory to live in Japan.

(7) School tuition

If a company pays the tuition of the child's school in Japan, an income tax is imposed on it as an economic benefit. However, when a company makes a donation to the school according to the scholarship plan to get exemption of tuition, such benefit is not subject to tax. The donation can be deducted from corporate tax.

8. Vacation

(1) Annual paid vacation

The Labor Standards Law regulates that an employee who has worked for the first six months of a year qualifies for 10 days paid vacation if his/her attendance rate is 80% or more during that period.

In addition to the annual paid vacation, increasing numbers of companies offer paid summer vacation. The number of days varies according to the size of the company or industry. Despite an increase in the trend for offering summer vacation, offering vacation as long as one month is not common yet among Japanese companies.

(2) Special paid leave

As part of an employee's welfare benefits, most Japanese companies make rules for paid leave and/or a cash gift for special occasions in an employee's private life.

9. Company's work rules

In accordance with the Labor Standards Law, a company which continuously employees 10 or more employees is required to prepare and submit work rules to the local Labor Standards Inspection Office. A document stating an opinion of an employee representing a majority of all employees must accompany the work rules.

The same procedure is required where there is a change in the rules. Submission of the work rules is not mandatory for companies employing fewer than 10 employees. However, it is recommended that such companies make basic rules, in order to establish mutual understanding of working conditions.

Standard work rules include:

- General rules
- Duties
- Employment, appointment and probation
- Working hours, intervals and holidays
- Overtime and holiday work
- Salary, bonus and allowances
- Vacation, special leave and other absence
- Retirement, resignation and discharge (including reasons for discharge)
- Safety and sanitation
- Commendation and punishment
- Supplementary provisions

10. Director's Remuneration, Bonus and Retirement Allowance

Under current Japanese law, any portion of a director's remuneration and retirement allowances which exceeds a reasonable level is disallowed as expenses. Therefore, when a company appoints directors, the total salary package for the directors should be planned carefully beforehand. In order to save corporate tax, remuneration for directors should be paid in equal amounts on a regular basis. Director bonus can be deductible if remuneration amount and timing of payment are fixed and reported to the tax authorities in advance.

Please refer to a tax specialist for details.