Japan Tax Bulletin

Group taxation

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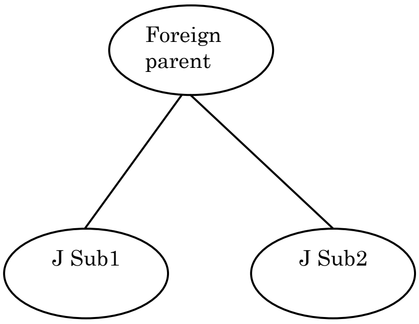
A 100%-controlled group with a domestic parent company is allowed to file a consolidated tax return for national corporate income. The consolidated filing system cannot be used though, when the parent company is a foreign company. Where a 100%-controlled group does not file a consolidated tax return, there are a few special rules on transactions between domestic members.

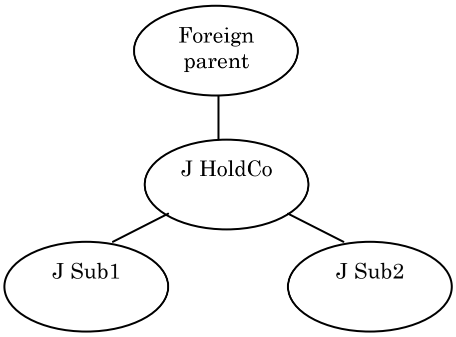
1. *100%-controlled group*

A 100%-controlled group is formed by a direct or indirect parent-subsidiary relationship and a direct or indirect brother-sister relationship. In the diagrams below, the both groups below are 100%-controlled groups; Group 1 is not allowed to file a consolidated tax return as the parent is not a domestic company. In Group 2, J HoldCo, J Sub1 and J Sub2 are allowed to file a consolidated tax return as J HoldCo is a domestic parent. In Group 1, transactions between J Sub1 and J Sub2 are subject to the group taxation rules. In Group 2, transactions among J HoldCo, J Sub1 and J Sub2 are subject to the group taxation rules where a consolidated tax return is not elected..

Group 1



Group 2



2. *Group taxation rules*

2.1 *Transfer of certain assets between group companies*

Where a company in a 100%-controlled group transfers certain assets to another company in the group, the transferor company defers any gains or losses arising from the transfer of the assets. If the transferee company later recognizes any deductions or income or gains on the transferred assets, the deferred gains or losses crystallize and the transferor company must recognize the gains or losses. Assets qualifying for this deferral are fixed assets, land, securities, monetary claims and deferred assets, excluding securities for trading and assets with a book value immediately prior to transfer of less than JPY10 million.

2.2 *Donations between group companies*

The definition of "donation" under Japan tax law is much broader than its dictionary meaning. For a domestic corporation, donations consist of amounts of money, or the value of assets other than money or the value of economic benefits, at the time these were gifted or gratuitously conferred by the corporation.

Where a company sells assets at lower than market value, the difference between the sales price and the market value is treated as donation from the seller to purchaser. Where a company purchase assets at price higher than market value, the difference between the purchase price and the market value is treated as donation from the purchaser to the seller. Donations are wholly or partially non-deductible depending on the status of the recipients i.e. a regular corporation, public interest corporation, foreign related person etc.

Where a company makes donations to another company outside of 100%-controlled group, the donation is wholly or partially non-deductible in the donor company and taxable gains are recognized in the recipient company. Where both companies are in a 100%-controlled group, the entire amount of the donation is non-deductible, but gains are not recognized in the recipient company. Further, the parent company is required to reduce the tax basis of its interest in the donor company and increase the tax basis of the recipient company by the value transferred by a donation.

2.3 *Distribution in kind*

Where a company distributes assets to its shareholders, the transferor company recognizes gains or losses for the difference between the tax basis and market value of assets transferred. Where the transferor company and shareholders are in a 100%-controlled group, gains or losses are not recognized and shareholders inherit the tax basis of the distributed assets in the transferor company.

2.4 *Dividends*

Domestic dividends received from a company in a 100%-controlled group are excluded entirely from taxable income. With domestic dividends, the amount of the dividend that is excluded from taxable income reduces as the shareholding percentage decreases i.e. 50% is excluded where the shareholding is more than 5% but less than 1/3 and 20% is excluded where the shareholding is 5% or less.

Contacts

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