

Japan Tax Bulletin

The treatment of donations (kifukin) under Japan tax law

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The subject of donations is a complicated topic under Japan tax law, and their scope and deductibility can have an extensive impact certain transactions. The deductibility of a donation (kifukin) depends on the nature of the recipient and its definition under tax law is much broader than its literal meaning.

1. Donation

The definition of a donation is provided by Article 37(7) and (8) of the Corporation Tax Law.

Regardless of whether a transfer is described by the parties as a donation, contribution, gift of money etc, the amount of a donation is the amount of money, the value of other assets than money or the value of economic benefits when transferred or provided where a domestic corporation makes gift of money, other assets or economic benefits. A donation does not include providing assets or economic benefits in the nature of advertizing expenses, sample expenses, entertainment expenses or welfare expenses etc.

Where a domestic corporation transfers assets or provides economic benefits at a price lower than the value when the transaction made, the difference between the consideration received and the transaction value is treated as donation where the transaction is in substance a gift or free provision.

2. Deductibility of donations

The deductibility of a donation depends on the nature of the recipient.

2.1 Governments

Where the recipient is a national government or a local government, the entire amount of a donation is deductible.

2.2 Foreign related persons

Where the recipient is a foreign related person, the entire amount of a donation is disallowed.

2.3 Specified public interest promotion corporations

Donations to specific types of public interest entities that are used for certain activities are partially deductible using the following formula:

Maximum deductible amount = (Share capital x 0.375% x (no. of months in the tax period / 12) + (taxable income x 6.25%)) x 1/2

The recipient must be a public interest corporation, public interest foundation, or other corporation or association which is operated for public interest. The appeal for the donations must be made publicly, and the donated funds used only for expenses in relation to promoting science, cultural advancements, contributions to social welfare or the promotion of public interest.

Where donations exceed the deductible limit for specified public interest promotion corporations, the limit for others can be used instead.

2.4 Others

For recipients not mentioned above, the maximum deductible amount is:

Deductible amount = (Share capital x 0.25% x (no. of months in the tax period / 12) + (taxable income x 2.5%)) x 1/4

3. Transfer pricing rules and Donation rule

Where a domestic corporate taxpayer pays higher consideration or receives lower consideration than the fair value of assets or services it purchases or sells, both the transfer pricing rule and the donation rule appear to be applicable. Chapter 2-19 of the transfer pricing administrative guidelines distinguishes between the applicability of the transfer pricing rule and the donation rule as follows:

“In cases where the below-listed facts are found in examination, it shall be noted that the provisions of Article 66-4 (3) of ASMT shall apply:

- (a) In cases where the corporation sells assets to, lends money to, provides services to, and conducts other transactions with the foreign-related party (hereinafter referred to as “sales of assets”), and it does not record the income concerning the sales of assets, the sales of assets fall on a donation or gratuitous provision of money and other assets or economic interests.
- (b) In cases where the corporation receives payment of compensation concerning the sales of assets from the foreign-related party, there exists an amount substantially deemed to be a donation of assets or gratuitous provision of economic interests to the foreign-related party in the amount payable to the corporation from the foreign-related party.
- (c) In cases where the corporation conducts payment of compensation concerning the sales of assets to the foreign-related party, there exists an amount deemed to be a donation or gratuitous provision of money and other assets or economic interest to the foreign-related party in the amount payable to the foreign-related party from the corporation.”

However, in practice, the distinction between the applicability between the transfer pricing rule and the donation rule is not always clear. Further, the tax authorities sometimes prefer to rely on the donation rule for correcting the taxable income of a small taxpayer. It should be noted that there is an interpretation that taxation by the donation rule does not qualified as “taxation not in accordance with the provision of a tax convention” and therefore relief by mutual agreement of the competent authorities is not available.



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