Japan Tax Bulletin

Family Corporations under Japan tax law

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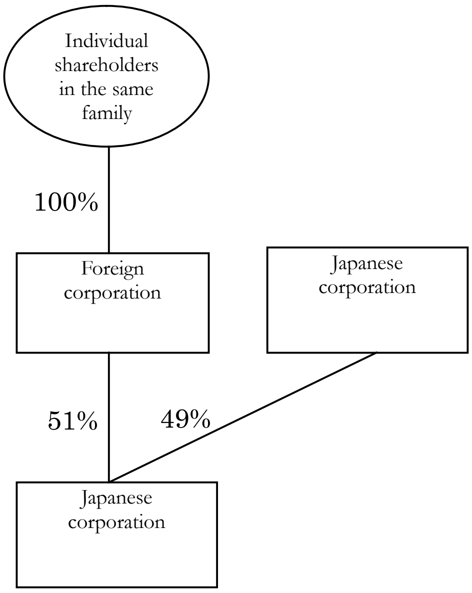
A family corporation is a corporation held by individual shareholders and their related persons. Special rules apply to family corporations which need to be considered when an entrepreneurial foreign business enters the Japan market by setting up a subsidiary.

1. *Definition of a family corporation*

A family corporation is a domestic corporation, where more than 50% of the outstanding shares or the voting rights are owned by three or fewer shareholders and their related persons. Related persons include the shareholder's family relatives and corporations controlled directly or indirectly by the shareholder. Control is measured by having the majority of the outstanding shares or the voting rights. The chart below illustrates this:



2. *Anti-Avoidance Rule relating to family corporations*

Where the transactions or acts of a family corporation reduce the tax liability of the corporation unreasonably, the tax authorities are allowed to correct tax returns or determine the tax liabilities without regard to the legal formality of the transactions or acts in question. As a family corporation is controlled by the small number of shareholders, a family corporation and the shareholders may execute transactions or acts, which unrelated parties usually do not pursue, to reduce their tax liabilities.

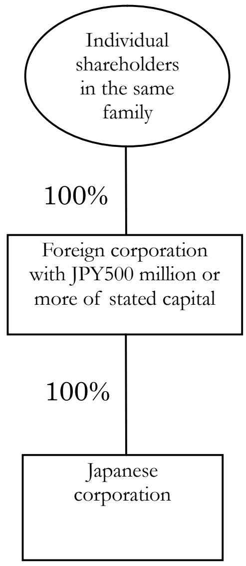
3. *Tax on undistributed profits*

3.1 Specified family corporations

Where a family corporation is a specified family corporation, a special tax on the undistributed profits is imposed to discourage the deferral of the taxation of dividends through retaining profits rather than paying out dividends. A specified family corporation is a domestic corporation, where more than 50% of the outstanding shares or the voting rights are owned by one shareholder and their related persons.

Where the stated capital of a family corporation is JPY100 million or less, the family corporation is not a specified family corporation. However, a family corporation whose stated capital is JPY 100 million or less can be a specified family corporation if it is wholly owned by a large corporation (corporation with the stated capital of JPY500 million or more), or large corporations which are wholly owned by the same persons.

Under the chart below, even if the Japanese corporation's stated capital is JPY10 million, it will still be a specified family corporation as it is wholly owned by the large corporation.



3.2 Undistributed profits

Undistributed profits are any current retained earnings that are not paid out as dividends. The tax is imposed on all current undistributed earnings less the undistributed earnings allowance, which is the greatest of:

(i) 40% of current net income before taxes;
(ii) JPY20 million x the number of months in the tax year / 12; or
(iii) 25% of stated capital minus retained earnings for tax purposes x the number of months in the tax year / 12.

3.3 Tax liability

National corporation tax is assessed on undistributed profits at a rate of 10% for the first JPY30 million, 15% for the next JPY70 million, and 20% for any excess over JPY100 million.

Inhabitant tax is imposed at the appropriate rate as a percentage of the national corporate tax. Enterprise tax is not imposed on the undistributed profits of a family corporation.

4. *Compliance*

The ownership structure chart for a corporate taxpayer needs to be attached to the corporate tax return.

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