Grant Thornton
An instinct for growth™

Japan Tax Bulletin

Tax implications of closing down a Permanent Establishment

May 2018

Foreign companies sometimes close down their Permanent Establishment ("PE") in Japan when withdrawing from the country, transferring their PE business or due to corporate reorganizations. The introduction of the AOA principle into Japan tax law, created new rules about mark to market valuation and tax losses for when a PE is closed down. These rules are applicable to closing down a PE or transfers of a PE in tax years beginning after March 31, 2016.

1. *Tax Year*

Where a foreign company closes down a permanent establishment in Japan, the tax year of the foreign company is from the beginning of its business year through to the day when the PE is closed down[1]. Therefore, corporate income tax returns and a consumption tax return for the tax year must be duly filed.

2. *Mark to market valuation of assets attributed to PE*

Assets attributed to PE are evaluated at mark to market and gains or losses arising from the valuation are taxable or deductible in calculating the income attributable to the PE[2]. Mark to market valuation does not apply where a PE is transferred to others, or involved in a tax-free qualified merger as a merged company or a tax-free corporate division as a dividing company[3]. The value is the market value of assets in use in ordinary transactions[4].

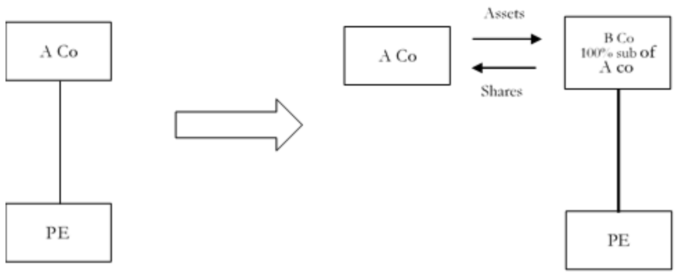
3. *Transfer of a PE*

Where a PE is transferred to others, the mark to market valuation is not required. Transfer of a PE includes the following for example:

(1) Transfer of the entire business the PE is engaged in to others,

(2) Transfer of the entire business of the PE through a qualified corporate split-off type corporate division or a qualified capital contribution-in-kind where a foreign company with a PE is involved as a transferor

One of the examples can be depicted as follows:



Where a foreign company transfers the entire business of a PE to others, taxable gains or deductible losses are realized as attributable to the PE, although the mark to market valuation is not applicable[5].

4. *Carry back of tax losses*

After the AOA principle was adopted into Corporation Tax Law, the tax losses of a foreign company are now classified separately as tax losses related to PE attributable income and those related to non-PE attributable Japan source income. They are deductible from PE attributable income and non-PE attributable Japan source income respectively[6].

If a foreign company closes down its PE in Japan, the foreign company is deemed to be dissolved on the date when the PE is closed down and the PE can claim a carry back of tax losses incurred in the closing down year and tax year ended one year before the closing down date[7].

If a foreign company closes down a PE holding tax losses and sets up a new PE in Japan at a later date, the foreign company is deemed to be incorporated on the date when the new PE is set up. As such, tax losses related to PE attributable income that the PE held prior to being closed down expire unless they are carried back and do not carry over to the new PE[8].

[1] Article 14(1)(24) of Corporation Tax Law ("CTL")
[2] Article 142-8(1) of CTL
[3] Article 142-8(1) of CTL, Article 190(1) of Corporation Tax Law Enforcement Ordinance ("CTLEO")
[4] Corporation Tax Law Basic Circular 20-5-32, 12-3-2-1

[5] Article 138(1) of CTL
[6] Article 141, Article 142(2), Article 184(1)(17) of CTLEO, Article 142-10 of CLT, Article 191 of CTLEO
[7] Article 10-3(3) of CTL
[8] Article 10-3(4) of CTL

Contact us for any enquiry on our services;

tax-news@jp.gt.com

Disclaimer

The aim of this newsletter is to provide information relating to recent Japanese tax and business. The information is general in nature and it is not to be taken as a substitute for specific advice. Accordingly, Grant Thornton Japan accepts no responsibility for any loss that occurs to any party who acts on information contained herein.

太陽グラントソントン税理士法人
Grant Thornton Taiyo Tax Corporation

www.grantthornton.jp