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THE NEW JAPANESE APPROACH TO THE TAXATION OF FOREIGN INDIVIDUALS AND ENTERPRISE

GRiffith Way*

It is only partly true that the lack of materials on Japanese taxation which are available to the foreign lawyer in English is the result of difficulties of language or a lack of familiarity with the legal and tax systems. Rather more it seems to reflect the Japanese bar’s own lack of interest in the subject, a large part of which is occasioned by the lack of tax litigation. The tax field has been long and well occupied by the government tax economist on the one hand and the ordinary accountant on the other; the lawyer’s role has been peripheral.

It is not the purpose of this brief treatment to do more than cover those aspects which are of general interest to most foreigners and foreign firms as a result of the extensive 1962 amendments; and to do so in a very tentative fashion, since only a year has elapsed since passage. So much remains to be understood that even a brief outline of the law and the regulations can be rather misleading in terms of practice. Japanese administrative procedures are unique and it is well at the outset for foreign lawyers to bear in mind that in Japanese tax practice the administrative appeal and litigation in court is not the reasonable alternative in planning or in settling disagreements that it is in the United States. Thus the study of tax law is not a prelude to possible litigation but rather a means of understanding and measuring official attitudes and performance.

The body of tax law consists predominantly of the codes and regulations. Although there are court decisions, they are so few as

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2 See Nihon Kempo Ho Shiho no ni Okeru Gyosei Soshou no Gaikyo (Outline of Administrative Litigation after the Enforcement of the Constitution of Japan) by the Administrative Bureau, Supreme Court of Japan, in 13 Hoso Jiho (Lawyer’s Ass’n J.) 164 (February, 1961), and in particular the statistics regarding tax litigation. On an average less than 200 tax cases of all kinds were commenced annually between 1947 and 1959. It would also appear from the statistics that taxpayer victories were extremely rare.

2 These exist in several English translations, none of which are complete. Eibun-Horei Sha, Inc., Tokyo is the most complete and has published most of the tax laws as Volume IV of its “Law Bulletin Series.” The Central Publishing Co. Ltd., Tokyo is in the process of publishing both the laws (under the title “1962 Tax Code of Japan”) and regulations, but of the latter only the Corporation Tax Law Enforcement Regulations have been translated and published to date.

3 A one volume summary of leading tax cases entitled Sogeizanrei (Nakagawa ed.), is published by Sanko Sha, Kyoto (in Japanese).
to be of little practical benefit and of course under the civil law system they carry relatively little weight with either the tax official or a subsequent court. There are, however, a good number of tax magazines; but with one exception they are aimed at neither the foreigner nor the lawyer. As many of the articles are written by the Ministry of Finance officials, however, they are an invaluable source of informal comment.

The new patterns of taxation of foreign individuals and business brought about by the amendments to the tax laws and regulations, effective April 1, 1962, contrast markedly with the provisions, or lack of provisions, which they replaced. Prior to the new law there was only the barest mention of jurisdictional limits. A foreign firm was subject to tax if it had its "business" or "assets" in Japan. The meaning of "business" and "assets" was never very satisfactorily developed.

With the new tax law the problem has changed. There is now extensive coverage both in the law and the regulations of those areas of concern to foreign business which formerly were relatively neglected. The changes are so great that it may be some time before they are fully appreciated and absorbed in practice.

Many of the concepts adopted were the result of a study of European experience and cooperative efforts in eliminating double taxation. The basic approach which Japan took was to tax all residents (corporate and individual) on their world-wide income but to restrict the taxation of non-residents to income from "sources" in Japan. Double taxation of residents is eliminated by allowing a foreign tax credit for tax which the resident pays to foreign countries on income from foreign sources.

Both the law and the regulations define in considerable detail the

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4 The Japan Tax Guide is published in English monthly by the Central Publishing Company, Tokyo. Two Japanese monthly publications of interest are Kokuzei Soko no published by the Okura Zaimu Kyokai, Tokyo, and Zeikai Tsushin, published by Zeimu Keiri Kyokai, Tokyo.


6 See Reports, Fiscal Committee of the OEEC (Organization for European Economic Co-operation, Paris) entitled The Elimination of Double Taxation (1958-61), particularly the First Report published in 1958 which deals extensively with the concept of the "permanent establishment."
source of various types of income and the conditions under which foreign business will be considered as localized for tax purposes. The criteria for determining when a foreign entity is doing business is similar to the criteria used to determine whether a permanent establishment exists for treaty purposes. Here, however, the concept goes beyond the U.S.-Japan Tax Treaty of 1954 but does not go quite as far as the European recommendations of the OEEC. The U.S.-Japan Tax Treaty has been amended by a Protocol which brings the new provisions in line.

**Taxation of Foreign Enterprise**

There are basically three alternatives which a foreign firm engaging in business with Japan faces with respect to Japanese tax. It may remain completely outside the orbit of tax. It may become partially taxed through withholding on certain types of income. Or it may become a resident taxpayer.

Considerable income arising from business and trade with Japanese markets and firms may be earned without becoming involved with Japanese tax at all. As we shall see, the sale of foreign goods to Japanese customers, directly or through independent agents, or the purchase of Japanese goods, are possible under certain circumstances without incurring liability for Japanese tax. Short trips of less than a few months to Japan will usually involve neither employee nor company in tax. Limited activity in fields of advertising, promotion and research, when these are of an auxiliary nature, may be carried on without tax consequence. Likewise construction work or installation and assembly of equipment and machinery for a limited period may be undertaken free of Japanese tax particularly where it is incidental to the sale of equipment.

There are also various types of income from Japanese sources which are taxed solely by withholding at rates of 10, 15 or 20 percent. For example, interest, dividends, royalties, rents, compensation for personal services, and contributions in kind to Japanese corporations are

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7 Convention With Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Apr. 16, 1954 (effective Apr. 1, 1955). It is published in English and Japanese in *Tax Agreements With Japan*, at 3 (Tax Bureau, Ministry of Finance, Japanese Government). In this article it is referred to as the U.S.-Japan Tax Treaty or simply as the tax treaty.

separately taxed by withholding when the recipient is not otherwise engaged in business in Japan.

Only when a foreign firm’s operations require some kind of local Japanese facility or it acquires certain types of property in Japan does it become subject to the Japanese corporation tax. While Japanese corporate rates vary considerably depending upon the applicability of various special provisions, the effective rate and the pattern of tax is generally comparable to that found in the United States.9

**Resident or Non-Resident?**

The tax difference between the fully taxable resident and the non-taxable or partially taxable non-resident foreign firm is much greater than the width of the line which separates them. And it is understandably still a difficult line to define, despite the extensive efforts to do so in the new law.

“*Fixed Place of Business.*” The concept of a “fixed place of business” as the basis for resident taxation of foreign business was one of the major reforms introduced by the 1962 tax law amendments. It was patterned from European models.10 A foreign enterprise is taxed in Japan as a resident if it carries on its business at some fixed place in Japan. This includes an office of any kind in Japan, whether a branch office, field office, or whatever it may be called.11 It probably includes as well any place which functions in a relatively permanent fashion as a place of business, including an employee’s home, apartment or hotel room. Factories, warehouses (as to those in the warehousing business only), mines, quarries and other places where natural resources are extracted are also considered to be fixed places of business.12

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9 The Ministry of Finance of Japan publishes an excellent overall annual summary of Japanese taxation in English, the most recent edition of which is entitled *Outline of Japanese Tax—1962.*

10 See First Report, Fiscal Committee of the OEEC entitled *The Elimination of Double Taxation* 45-47 (1958). The OEEC in its model draft of tax treaty provisions adopted the “fixed place of business” as the general criteria for determining whether or not a foreign enterprise had a “permanent establishment” in another country. In earlier discussions there had been considerable support for a criterion based on the existence of a “productive character” to the business concerned. This was dropped by the OEEC in favor of the simpler “fixed place of business” as the general criterion and from this various exceptions were made.

11 *Hōjinzei Hō* (Corporation Tax Law) Law No. 28 (Mar. 31, 1947), art. 1-3 defines income from sources within Japan as including that realized from any business carried on within Japan, and Corporation Tax Law, art. 1-4 defines business within Japan as being that carried out at a fixed place or through certain agents.

12 *Hōjin Zei Ha Shikō Kisoku* (Corporation Tax Law Enforcement Regulations) Imperial Order No. 111 (1947), art. 1-(3) reads as follows:
It is the fairly continuous use of facilities for business purposes which identifies a taxable place of business, and not the formal aspects of the establishment.

*Residence by Reason of Construction, etc., Projects.* The new tax law adopts the provisions, now almost standard in the more recent international tax conventions,\(^3\) which treat as a taxable permanent establishment the resident business activity of a foreign enterprise related to construction, installation or assembly operations only when it lasts for more than one year.\(^4\) Such operations may thus be conducted in Japan for less than a year without a taxable residence being acquired, whether the work is performed in a direct or in a supervisory capacity. If an office must be maintained, contracts sublet, and employees hired locally, however, it may be advisable to register under the *Commercial Code,\(^5\)* and in this event a withdrawal within one year may be rather difficult. The practical value of this exclusion will generally lie in operations which do not involve a heavy degree of direct local participation, but rather are limited to supervisory and technical services.

Furthermore, under the new law the overall tax implication of having a resident business by reason of a construction or assembly operation lasting for more than one year is not as great as in the case

\(^3\)See First Report, Fiscal Committee of OEEC entitled *The Elimination of Double Taxation*, 33 (1958). The U.S.-Japan Tax Treaty, does not presently contain this exemption but Article II (1) (c) has been amended by Article I of the 1962 Protocol to provide that a construction, installation or assembly project established for over a year will be considered a permanent establishment.

\(^4\)Corporation Tax Law, art. 1-4-(2).

\(^5\)COMMERCIAL CODE, arts. 479-485.
of an ordinary business. Normally once a business is established in Japan all income, whether or not related to the local office or place of business, is taxable at resident rates. But a foreign firm which has only a construction or assembly project in Japan will remain taxable as a non-resident on all income earned apart from the construction work, for example, income from royalties or dividends.16

Residence Through Local Agents. A taxable residence may also be acquired by the employment of agents. The new law and regulations provide that if the agent has a general authority which he regularly exercises to conclude contracts on behalf of the foreign business, or maintains a stock of goods in Japan on behalf of a foreign seller from which he makes delivery at the request of customers, the foreign principal will be considered as doing business in Japan as a resident.17

The foregoing criteria are fairly traditional and relatively easy to understand. But the new regulations go further and provide that if the agent acts exclusively, or even principally, for one foreign firm and plays any significant role in the business activity in Japan, such as being instrumental in negotiating and obtaining orders, he may involve the foreign principal in tax, even though he has no authority to conclude contracts.18 The regulations state that this includes those agents in Japan who have a "special relationship" to their foreign principal, which presumably means a relationship involving owner-

16 Corporation Tax Law, art. 5-(4) and see further consideration under heading "Special Type of Business," infra.
17 Corporation Tax Law, art. 1-4-(3) and Corporation Tax Law Enforcement Regulations, art. 1-(4), which read as follows:

"An agent having authority to conclude contracts on behalf of a corporation, and other agents to be designated by Order as provided for in Article 1, paragraph 4, item 3 of the Law, shall be as follows:

"1. A person who has authority to conclude contracts on behalf of a foreign corporation in connection with its business (except contracts concerned with the purchase of assets for the foreign corporation, which applies equally to item 3 below), and in addition regularly exercises such authority. (Excluded, however, is a person who carries on an identical or similar type of business as that of the foreign corporation and, out of a necessity which arises from the nature of the business, assists in the conclusion of contracts on behalf of the foreign corporation).

"2. A person who on behalf of a foreign corporation regularly maintains a volume of goods in sufficient quantities to meet the normal requirements of customers, and in addition makes deliveries of said goods upon request of the customer.

"3. A person who exclusively or principally on behalf of a particular foreign corporation (including those persons with a special relationship to the foreign corporation) obtains orders, negotiates, or performs other important acts in connection with the business of the foreign corporation."

18 Corporation Tax Law Enforcement Regulations, art. 1-4-(3).
A Japanese subsidiary engaged in its parent’s business in Japan is thus to be carefully watched as well as agents performing any substantial role in an income-producing activity.

The tax effect of having a fully authorized resident agent has been limited under the new law. The activities carried on through the agent are taxed at resident rates, but income unrelated to the agent’s activities remains separately taxed on a non-resident basis.

Japanese civil and commercial law contain a variety of relationships which fall generally within the area of what is called “agency” in Anglo-American law. The analysis of these is not an easy task since various levels of statutory definitions are involved and the patterns that appear in practice are not faithfully reflected in statutory law, in the tax regulations, or even in descriptions of law that appear in scholarly commentaries or in recorded judicial decisions. Some difficulty also is to be expected from the fact that civil and common law agencies are far from parallel.

The tax regulations and the tax treaties adopt the term “commercial agent” (dairinin) from the Commercial Code to describe an agent in the broadest sense. The commercial agent is defined as one who is not an employee but who habitually acts on behalf of a particular trader, as a representative or intermediary, in transactions falling within the kind of business carried on by such trader.

In the tax treaties certain special types of agents are excluded from the category of agents who will bring the foreign principal into Japan for tax purposes. These might be termed the “safe” agents for a foreign firm to employ. The distinguishing characteristics of these agents are their independence and bona fides. They are the commission agent (tonya), the broker (nakadachinin), the custodian (kanrinin), and other “independent agents” (dokuritsu no dairinin).

A “commission agent” (tonya) is defined as one who, as a matter of business, buys and sells in his own name but for the benefit of other persons. Such a person may resemble a “factor” in English usage in that there can be an open and apparent dealing by the agent

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10 Ibid.
20 Corporation Tax Law, art. 5-(4), and for further consideration see discussion under heading “Special Type of Business,” infra.
22 COMMERCIAL CODE, art. 46.
23 See e.g., U.S.-Japan Tax Treaty, art. II(1)(c).
24 COMMERCIAL CODE, art. 551.
in his own name, but differs in that there is no element of financial involvement or financing by the agent such as is inherent in the concept of a "factor."

A "broker" (nakadachinin) is a person who makes it his business to act as an intermediary in commercial transactions between other persons. While a commercial agent (dairinin) may also act as an intermediary (baikyu), he does so only on behalf of a particular trader. A broker acts as an intermediary on behalf of many different parties.

A "custodian" (kanrinin) is not specifically defined in the civil or commercial law, but is a term generally used to denote anyone who manages, administers or cares for the property or affairs of another. It is similar to the position of a "manager" (kanrisha), as defined in the Civil Code (art. 697) as one who takes over the management of affairs on behalf of another and by law is bound to conduct the management in a manner most advantageous to the principal. A trust company, a management firm, an executor or administrator are examples of custodians.

Exemptions from Resident Status. Under certain limited circumstances a foreign company may maintain a fixed place of business in Japan and engage in limited business activity without acquiring a resident status for tax purposes. The new tax law regulations provide that these are:

a. A fixed place used by a foreign corporation exclusively for the purchase of its assets.

b. A fixed place used by a foreign corporation exclusively for the storage of its property.

c. A fixed place used by a foreign corporation exclusively for advertising, promotion, the supply of information, market survey, basic research, or for conducting other business activities which are auxiliary to the business being carried on.

The purpose of the exemptions for purchasing, storage, and auxiliary activity would appear to be to enlarge the local activity in which a foreign firm can engage in Japan without becoming a taxable resident, but it would probably be more accurate to say that they clarify far more than they enlarge. These activities do not directly produce income; they are all antecedent to it. And yet perhaps for the lack

25 Id., art. 543.
26 Corporation Tax Law Enforcement Regulations, art. 1-(3).
of something specific in the law exempting such local activity, assessments have occasionally arisen in the past.

The exemption for purchasing would seem to have two limitations which may not be readily apparent. The exemption will not apply to the extent that the property is further processed, manufactured, assembled or converted prior to leaving Japan. And the exemption will probably be limited to the purchase of property in Japan for the purchaser's own use or account, or property which he takes from Japan prior to sale to others. The sale within Japan or prior to leaving Japan will generally be considered taxable.

While "auxiliary" activity such as advertising or research contribute to the profitability of an enterprise, the exemption seems to recognize the difficulty of measuring its relative value to the overall profit of the enterprise. Until a profit is made the value is uncertain. Furthermore, the profit itself when realized will not necessarily be taxed in Japan despite the fact that the auxiliary activity takes place there. It will be taxed in Japan only if its source in a tax sense is in Japan.

The exemption for auxiliary activity applies not only to the specific types of activity listed but also to "other business activities which are auxiliary to the business being carried on." It is obviously impossible to list exhaustively all activities which would fall into this category because what is auxiliary to one business may be central to another. In general, however, the underlying principle is that the activity taking place in Japan is not sufficiently complete to constitute a taxable unit. It would be incumbent upon the foreign firm to show affirmatively that it was auxiliary.

The delivery of technology under a licensing or technical assistance agreement through a fixed place of business in Japan, such as a resident office, may now be considered exempt, if the European interpretation is applied. Prior to the current amendments to the law the Tax Office is understood to have taken the position that the establishment of an office for the purpose of delivering technology was doing business for tax purposes through a permanent establishment under the U.S. tax treaty. The tax treaty, however, has no exemption for "auxiliary activity," so the new law may well be intended to

27 Ibid.
29 Id., at 50.
change this, and to permit an office to be maintained without thereby rendering the royalty income taxable on a net basis under the corporation tax.

The exemption applies only as long as the conditions are completely satisfied. A research office which engaged in manufacturing or in the licensing or sale of its research would undoubtedly not be exempt. An office used to solicit sales, display merchandise, service or repair equipment sold, and perform other acts closely related to the sale process, would probably not be allowed exemption. Promotion and advertising would be exempt only as long as they did not become directly involved with sales.

Despite the apparent value of these exemptions, there are certain dangers inherent in doing business in Japan without registering, though they are not usually considered very seriously. The Commercial Code requires registration whenever a foreign firm intends to engage in commercial transactions on a continuing basis. Personal liability of the representative in Japan for all acts performed by a non-registered business is provided for in the Code. There are also civil penalties assessable against the representative. Foreign exchange control problems will also be present.

These difficulties pose a minor dilemma. If, to reduce the risks under the Commercial Code, a foreign firm chooses to register a branch in Japan, then a tax return must be filed. Once a return is filed, past experience has shown that it substantially increases the difficulty of qualifying for a tax-free or exempt status. This may change with the new law so that exemption will not have to be established and defended each year when the tax return is filed.

The value of these exemptions, then, would seem to lie chiefly in two areas. First, no income will be attributed to purchasing, storage or auxiliary activity conducted in Japan, whether a registered branch office exists or not. Second, where a firm is just beginning to be established in Japan, the exemptions may provide some assurance of a non-resident tax status during the introductory period.

"Special Type of Business." One of the most important recent innovations which has already been briefly alluded to permits a foreign firm to be taxed as resident on some income and as a non-resident on other income at one and the same time. This was no doubt inspired

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30 Commercial Code, art. 479.
31 Id., art. 481.
32 Id., art. 498.
33 Corporation Tax Law, art. 5-(4).
by the provision in recent treaties\(^8\) which limits resident taxation of permanent establishments to the profits attributable to the permanent establishment rather than, as in the older treaties, to the entire income of the enterprise.\(^9\) Prior to the amendments a foreign firm with any business activity whatsoever, whether through an agent or otherwise, was automatically subject to resident tax treatment on all income from Japanese sources.

A "special type of business" is one carried on through an agent in Japan, or through a construction, installation or assembly project lasting for more than a year. Income arising from a "special type of business" is separately taxed at resident rates. Thus a foreign firm which is doing business in Japan through an agent, but is also receiving dividends, royalties, interest, or other types of income from Japanese sources which are unrelated to the business carried on by the agent, will be taxed at regular resident rates only for the business which is carried on by the agent; the other income will remain taxable at the lower non-resident withholding rates. A certificate must be filed claiming these benefits; they are not automatic.\(^8\)

**Source Rules for Business Income**

Under the new amendments a corporation which has neither its head office nor its principal place of business in Japan is taxed only on income from Japanese sources.\(^5\) Certain types of income such as interest, dividends, wages, royalties, rentals, etc., are presumed to be from Japanese sources when paid by a Japanese firm or individual.\(^8\) Income derived from the conduct of business operations of various types present special problems which the new regulations have attempted in part to resolve.\(^8\)

**Personal Property—Place of Sale.** Income realized from the sale of personal property (limited to inventory property) is regarded as arising at the place where the transfer or sale occurs, assuming that no further manufacturing, processing, rearing, cultivating, or other act which adds value to the property, takes place after the seller has acquired the property. When such further acts do take place in one

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\(^8\) See e.g., the recent tax treaty concluded between Japan and the United Kingdom on September 4, 1962, Article II(1)(a) in *TAX AGREEMENTS WITH JAPAN* (Tax Bureau, Ministry of Finance) 204, *supra* note 8.


\(^5\) *Shotoku Zei Ho* (Income Tax Law), Law No. 27 (1947), art. 41-3.

\(^8\) *Corporation Tax Law*, art. 1.

\(^8\) *Income Tax Law*, art. 1-3, items (2) to (9).

\(^8\) *Corporation Tax Law Enforcement Regulations*, art. 1-(2).
country and the sale takes place in another country, the income realized from the sale will arise from sources both within and without Japan, and an allocation for tax purposes is necessary. The allocation is based on the assumption that the work is performed by independent entities rather than by the seller himself and arm's length criteria is used to determine the proper allocation. ¹⁰

The "place of sale (or transfer)" is defined more sharply. A sale of goods or merchandise will be deemed to arise from sources within Japan when any one of the following three factors are present:

a. Immediately prior to the transfer to the buyer the seller held the property in connection with its business in Japan.

b. The contract of sale was concluded in Japan.

c. An important part of the negotiations leading up to the conclusion of the contract of sale, such as securing the order, was performed in Japan. ¹¹

These still leave some administrative flexibility in determining when a sale takes place in Japan, particularly the last provision, but is far more definite than the situation which preceded the new regulations. ¹² It may not always coincide, however, with foreign source rules. ¹³

Construction, Installation and Assembly Work. Generally income from construction, installation or assembly projects which are carried out in Japan will be treated as income from sources within Japan regardless of the fact that the contract is concluded, and labor or materials procured, outside of Japan. ¹⁴

Ship and Aircraft Operations. Income from the operation of ships and aircraft in international trade and travel is allocated between Japan and the other countries involved. In the case of ships there will be allocated to Japan that part of passenger and cargo income related to loadings within Japan. In the case of aircraft the allocation

¹⁰ Id., art. 1-(2), items (1) and (2). But for American firms see U.S.-Japan Tax Treaty, Article XIII (d) where allocation is on the basis of relative sales and property.
¹¹ Corporation Tax Law Enforcement Regulations, art. 1-(2)-3.
¹³ Under the U.S.-Japan Tax Treaty, Article XIII(c), income from sales is treated as derived from the country in which the property is sold. In the U.S. the country in which property is sold is generally said to be the country in which title to the goods pass. U.S. v. Balanovski, 236 F.(2d) 298 (2nd Cir. 1956), cert. den. 352 U.S. 968 (1957).
¹⁴ Corporation Tax Law Enforcement Regulations, art. 1-(2), item (3) and OUTLINE OF JAPANESE TAX—1962 (Tax Bureau, Ministry of Finance) 262, supra note 9.
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is more indefinite and may be based on receipts or expenditures, as well as upon the value of fixed assets used in Japan and "other factors" which may serve the purpose of estimating the extent to which operations in Japan contribute to the overall income. 45

Insurance. Where a corporation operates a casualty or life insurance business both within and without Japan the income attributed to Japan will be based upon the amount of business written in Japan or through an agency located in Japan. 46

Publishing or Broadcasting. Where a publishing or broadcasting business is carried on both within and without Japan and has advertising revenues, the portion of the overall income allocable to Japan will be based upon the portion of the receipts for advertising derived from Japan in connection with the business. 47

Auxiliary Activities. Where a foreign corporation carries on auxiliary activities in Japan such as advertising, publicity, gathering of information, market surveys, basic research, etc., no income will be attributed to these activities, nor will any deductions be allowed for the expenditures in connection with them. 48

Investment. A corporation which puts money, industrial property rights, such as patents, trademarks, know-how, etc., or other business assets to the use of its own business carried on in Japan, will not be regarded as realizing any income from sources within Japan solely on account of so utilizing its assets. 49

Miscellaneous. When a foreign corporation carries on business both within and without Japan, the income from activities not specifically covered by the code and regulations will be allocated as to source by taking account of receipts and expenditures. The business activity will be regarded as carried on by independent entities dealing with each other at arm's length in the normal course of the business. 50

Taxation of the Non-Resident

A foreign firm or individual whose income from Japan consists only

45 Corporation Tax Law Enforcement Regulations, art. 1-(2), item (4). But for American firms an allocation is unnecessary under the U.S.-Japan Tax Treaty, Article V, which mutually exempts income from the operation of ships and aircraft.
46 Corporation Tax Law Enforcement Regulations, art. 1-(2), item (5).
47 Id., art. 1-(2), item (6).
48 Id., art. 1-(2), item (7).
49 Id., art. 1-(2), item (8). This apparently has no application to the contribution of industrial property rights to a Japanese corporation which is subject to the "contributions in kind" tax. This provision would apply to a branch in Japan or to a domestic Japanese company establishing a branch abroad.
50 Id., art. 1-(2)-2.
of interest, dividends, royalties, compensation for personal services, or the consideration received for contributing property to a business in Japan (contributions in kind), may be taxed as a non-resident under the Income Tax Law rather than the Corporation Tax Law. The tax is withheld at rates which vary from 10 to 20 percent depending upon the nature of the income, the residence of the recipient and special concessions granted with respect to certain income.

Of these limited types of income subject to withholding, one was considerably expanded in scope by the 1962 amendments. This related to compensation for services paid to a foreign business.

Compensation paid to foreign non-resident individuals for services performed in Japan in the form of wages and salary has been subject to the 20 percent withholding tax for some time. But income received by a corporation or other business for performing services in Japan has not been taxed until the recent amendments.

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51 Income Tax Law, art. 1-3, items 2, 3 and 7 and art. 41. Under Sozei Tokubetsu Sochi Hō (Special Taxation Measures Law), Law No. 26 (Mar. 31, 1957), art. 7-2 interest on bonds or debentures issued by Japanese firms in foreign currencies to non-residents are temporarily (to March 31, 1963) subject to a reduced tax rate of 10%.

52 Income Tax Law, art. 1-3, item 4 and art. 41 provide that domestic Japanese corporations or securities investment trusts which distribute earnings, gain or surplus in any form, are required to withhold 20% when payment is made to a non-resident shareholder. But Article XIV of the U.S.-Japan Tax Treaty exempts American shareholders not resident in Japan from tax on dividends from Japanese corporations, although Articles IV and IX (3) of the 1962 Protocol amending the treaty will, when and if ratified, gradually raise the Japanese rate up to 15% over a period of five years, except for a special rate of 10% applicable to certain corporations. Also at present Article XIV(c) of the tax treaty gives an American shareholder a special tax credit equal to 25% of the dividend, provided he takes the dividend itself into income. Corporate shareholders will generally fare better under INT. REV. CODE OF 1954 § 902, if applicable.

53 Income Tax Law, art. 1-3, item 6 and art. 41 provide for normal 20% withholding rate. Special Taxation Measures Law, art. 28, however, provides for application of a reduced 15% rate with respect to all contracts involving "important foreign technology" concluded by March 31, 1963. Prior to April 1, 1961 the rate for important technology was 10%. All licenses concluded prior to that time continue to enjoy the 10% rate during their entire term. The renewal of a license probably commences a new period, however, and the rate applicable at the time of renewal applies. For a current list of important foreign technology, see OUTLINE OF JAPANESE TAX—1962 (Tax Bureau, Ministry of Finance) 278, supra note 9. American licensors also enjoy a 15% rate under Article VII of the U.S.-Japan Tax Treaty, but Article V of the Protocol amends Article VII of the tax treaty to provide for a rate of not more than 10% and broadens the definition of "royalties." A special "Memorandum" accompanying the Protocol also makes important distinctions between "royalties" and "services." There has been considerable confusion over the nature and character of income from various types of license and know-how agreements involving technology. The confusion is not confined to Japan.

54 Income Tax Law, art. 1-3, item 9 and Shotoku Zei Hō Shikō Kisoku (Income Tax Law Enforcement Regulations) Imperial Order No. 110 (1947), art. 1-6(3) provide that a non-resident firm which contributes or sells industrial property rights, such as patents, trademarks, technology or know-how to a Japanese company will be subject to the withholding tax (at 15 or 20% of the gross value, depending on whether "important foreign technology" as defined in Special Taxation Measures Law, art. 28 is involved) whether shares are received on the contribution or not.

55 Income Tax Law, art. 1-3, item 5 and art. 41. Income produced by a business
Thus a foreign corporation or business which has as one of its principal purposes the rendering of personal services will be subject to the 20 percent withholding tax. The various types of businesses included are set forth in the implementing regulations. Three classes of business are covered. First are those businesses related to the entertainment industry, including athletics. Second are those businesses related to the professions, including legal and accounting firms. Third are businesses which are principally concerned with rendering technical and management services, except as those services are auxiliary or incidental to the sale of machinery, equipment, etc.

The tax base is the gross income paid except for rather limited deductions permitted under the regulations. These deductions are limited to: (1) salaries paid by the business involved to residents in Japan, (2) salaries paid to non-residents for services in Japan, and (3) travel and other miscellaneous expenses incurred in Japan.

The non-resident may also be taxed on income from other types of property apart from those just discussed. Income which a non-resident receives which is related to the use, possession, transfer or sale of property is subject to the corporation tax. Unlike the withholding tax generally applicable to non-residents on a gross basis where no return is required, the corporation tax is based on the net income, and a return must be filed.

There is one notable exception to the taxability of the transfer or

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which is engaged in rendering personal services is not considered as necessarily giving rise to business income, or in the language of the tax treaties, to "industrial and commercial profits." Thus in the 1962 Protocol to the U.S.-Japan Tax Treaty, Article I amends the definition of "industrial and commercial profits" to exclude this type of personal service income.

66 Income Tax Law Enforcement Regulations, art. 1-(4) which reads as follows:

"Businesses which are mainly for the rendering of personal services as provided for in Article 1, paragraph 3, item 5 of the Law shall be those businesses operated within the enforcement area of the law as follows:

1. Businesses consisting principally of the rendering of services by motion picture and stage actors, musicians, professional athletes and other performers.

2. Businesses consisting principally of the rendering of services by lawyers, public accountants, architects, and other professional people.

3. Businesses consisting principally of the rendering of services by those who have specialized knowledge or skill in scientific, technical, management and related fields (except for those businesses in which the services are auxiliary to the sale of machinery or equipment, or are incidental to the business itself)."

67 Income Tax Law, art. 41 and Income Tax Law Enforcement Regulations, art. 46-(2).

68 Corporation Tax Law, art. 1-3(1), and Corporation Tax Law Enforcement Regulations, art. 1.

69 Income Tax Law, art. 29-7.
sale of property. The profit or gain realized on the sale of stock in Japanese corporations is generally not taxed to the casual investor.\(^6\)

**Resident Taxation**

Foreign firms which engage in business activity beyond that regarded as non-resident activity are taxed essentially in the same manner as Japanese business. Whether the business is conducted through a branch or domestic subsidiary the manner of taxation will be similar, the branch being subject to tax only on its income from Japanese sources. Certain aspects of resident taxation as changed by the recent law may be of interest to foreign firms generally.

Corporations are subject to the national corporation tax, the prefectural enterprise tax and the prefectural and municipal inhabitants taxes. While the latter are local taxes they are assessed on the authority of national law and are also assessed as is the national tax, \(i.e.,\) on net income,\(^61\) with the exception of the inhabitants tax, which is a percentage of the national corporation tax.\(^62\)

Corporate net income is determined by normal accounting methods with special treatment for certain items of income and expense. Capital gains are included as ordinary income, and capital losses are fully deductible.\(^63\) There are several optional methods for valuing inventories\(^64\) and taking depreciation.\(^65\) Loss carry-overs and carry-backs are allowed for a corporation which files a "blue return."\(^66\) Limited reserves are allowed for bad debts,\(^67\) price fluctuations,\(^68\) retirement allowances,\(^69\) special repairs,\(^70\) unusual risks,\(^71\) and export losses.\(^72\)

**Special Concessions.** A Japanese domestic corporation under the new law is entitled to a foreign tax credit.\(^73\) The credit applies to foreign taxes which are similar to the Japanese tax, including local

\(^6\) Corporation Tax Law Enforcement Regulations, art. 1-3(2).
\(^61\) Chih5 Zei Hô (Local Tax Law) Law No. 226 (1950), arts. 72-(12) and 72-(14).
\(^62\) Id., arts. 32 and 313.
\(^63\) In contrast the individual is taxed on only 50\% of his capital gains and gains from securities transactions are usually non-taxable.
\(^64\) Corporation Tax Law, art. 9-(7) and Corporation Tax Law Enforcement Regulations, art. 20.
\(^65\) Corporation Tax Law, art. 9-(8) and Corporation Tax Law Enforcement Regulations, art. 21, \(et seq.\) Also refer to Article 5 of the Ministry of Finance Ordinance No. 50 of 1951.
\(^66\) Corporation Tax Law, art. 9, paras. 5-6.
\(^67\) Corporation Tax Law Enforcement Regulations, art. 14.
\(^68\) Special Taxation Measures Law, art. 54.
\(^69\) Corporation Tax Law Enforcement Regulations, art. 15-(7).
\(^70\) Id., art. 15.
\(^71\) Id., art. 14-(14).
\(^72\) Special Taxation Measures Law, art. 54.
\(^73\) Corporation Tax Law, art. 10-(3).
taxes, or which constitute a tax in lieu of an income tax. A domestic Japanese corporation which owns more than 25 percent of the stock of a foreign subsidiary is entitled to a foreign tax credit for taxes which its foreign subsidiary is "deemed" to have paid from dividends received from the subsidiary. The new law and regulations have considerably expanded the foreign tax credit.

A special measure, renewed again by the new law, which has substantially assisted exporters and those manufacturing for export is the special deduction from taxable income of one percent of the value of export contracts available to the trading firm, and three percent of the proceeds of export sales contracts for the manufacturer. Also a five percent deduction is available for the export of a complete plant. The maximum amount of the deduction is limited to 80 percent of income arising from exports. There is also a similar deduction for the export of know-how equal to 50 percent of the proceeds, or 50 percent of net income, whichever is the lesser. Since these deductions are figured on a gross sale price or value the benefits of the deduction are quite substantial, in fact so substantial that it seems to serve its purpose of encouraging exports rather well.

In order to encourage greater investment in equity capital, a special concession has recently (1961) been granted which substantially reduces corporate tax rates applicable to that part of a corporation's taxable income which equals the excess of dividends paid out to its shareholders over dividends received by it.

Dividends received by a corporation are non-taxable unless they exceed the dividends paid out. In the latter case 25 percent of the excess of dividends received over dividends paid out is includible in gross income.

The "Family" Corporation. As its name implies, the "family" corporation is one in which the stock and investments in the company are closely held. In determining whether a company is subject to the penalties of the family company, stock held by relatives and partners will be attributed to a single shareholder.

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74 Corporation Tax Law Enforcement Regulations, art. 23-(4).
75 Id., art. 23-(5).
76 Special Taxation Measures Law, art. 55 to 57-(4).
77 Id., art. 55-(3).
78 Id., art. 42. See "Corporate Tax Rates," infra.
79 Id., art. 42-(2).
80 Corporation Tax Law, art. 7-(2) provides that a family corporation results whenever: (a) 3 shareholders hold 50% or more of the total "stock and investments," or (b) 4 shareholders hold 60% or more, or (c) 5 shareholders hold 70% or more.
81 Corporation Tax Law, art. 7-(2)-(1).
The family corporation has two disadvantages. First, retention of a surplus is discouraged by a heavy additional tax, presently running from 10 to 20 percent of the adjusted surplus. Second, all transactions between shareholder and corporation are closely scrutinized on audit and the net income of the two is subject to reassessment. Income or expense may be shifted from one to the other.

A subsidiary is treated as a family corporation for the purpose of allowing the tax office to reallocate income and expense between parent and subsidiary, but a Japanese subsidiary is not subject to the penalty tax on accumulated surplus as long as its parent is widely held.

A branch of a foreign corporation would seem technically subject to the family corporation provisions but the practical difficulties of administering the tax has apparently dissuaded the tax office from attempting to apply it.

Corporate Tax Rates. The corporate tax rates on net income for a domestic or resident foreign corporation for 1962 were:

(a) National Corporation Tax

   (i) Ordinary Income

      the first ¥2,000,000 ($5,560) 33%
      in excess of ¥2,000,000 ($5,560) 38%

   (ii) On that part of ordinary income which is the excess of dividends paid over dividends received

      the first ¥2,000,000 ($5,560) 24%
      in excess of ¥2,000,000 ($5,560) 28%

   (iii) Liquidation Income

      that part of the liquidation income which is composed of reserves and other non-taxable income 20%
      all other liquidation income 43%

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82 Id., art. 17-(2). The rate is 10% when the adjusted surplus retained does not exceed 30,000,000 yen per annum, 15% for over that amount, and 20% on amounts over 100,000,000 yen per annum. See also, OUTLINE OF JAPANESE TAX—1962 (Tax Bureau, Ministry of Finance) 116-17, supra note 9.
83 Corporation Tax Law, art. 7-(3). See also, OUTLINE OF JAPANESE TAX—1962 (Tax Bureau, Ministry of Finance) 94-95, supra note 9.
84 Corporation Tax Law, art. 17-(2). The language of this article is rather confusing but it means that a family corporation shall be restricted to those corporations which may prove to be family corporations without recourse to the inclusion of any employee or shareholder, which, although a legal person, is not itself a family corporation.
85 UENO AND FUKUYAMA, TAX IN JAPAN ON CORPORATIONS 19 (The Institute of Foreign Exchange and Trade Research 1961). The uncertainty of application to the branch is noted by the authors, who are officials of the Ministry of Finance, with the comment that in fact no attempt has been made to apply the family company provisions to a branch of a foreign corporation.
86 Corporation Tax Law, art. 17.
87 Id., art. 42.
88 Id., art. 17.
(b) Enterprise Tax

On the first ¥1,000,000. ($2,780) 6%
On the next ¥1,000,000 to ¥2,000,000 ($2,780 to $5,560) 9%
On the next ¥2,000,000 and over ($5,560) 12%
(This tax is deductible as an expense in the National Tax for the following year.)

(c) Prefectural and Municipal Inhabitants Tax

There are separate prefectural and municipal taxes. The per capita amount is relatively small (for prefectures ¥600 and for municipalities from ¥1,200 to ¥2,400), but the percentage amounts to about 6 per cent of the national corporation tax in the case of the prefecture and 8 or 9 percent in the case of the municipality. In Tokyo, which is both a city and prefecture, one combined tax is assessed as follows:
Per capita ¥3,000
Percentage of national corporation tax 13.5%

Taxation of the Foreign Individual

Foreign individuals residing in Japan are subject to one of the highest individual income taxes in the world. Apart from the high rates the Japanese income tax is similar to American and European progressive net income taxes. Deductions, credits and exemptions available to a foreigner with respect to his salary are so minor, however, as to be of little practical benefit in reducing the tax burden.

Because Japanese rates are so high and most foreign residents have tax responsibilities to their home countries, the overall tax burden plus the high cost of western living in Japan is such that it either discourages employees from working and living for any extended period in Japan, or it encourages various forms and degrees of evasion. Until 1960 the foreign resident was given a substantial tax concession which materially reduced his tax, but since this has been eliminated the magnitude of the problem is such that basic policies are often involved for both company and employee in determining how to deal realistically with this tax.

While these problems are not shared in the same degree by Japanese employees because of a considerable difference in salary scales, in

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89 Local Tax Law, art. 72-(22).
90 Corporation Tax Law, art. 9, para. 2.
91 Local Tax Law, art. 52.
92 Id., art. 312.
93 Id., art. 51.
94 Id., art. 313, para. 7.
living costs, and in the general nature of the employment relationship, more and more Japanese executives are experiencing the same problem as salaries and benefits increase.

An American resident's tax position is further complicated by the fact that he remains subject as well to United States tax.\(^9\) He is required to file a United States income tax return and report his foreign employment and earnings, even though his entire earnings are earned in and taxed in Japan. This must be done whether any tax is actually due the United States or not.\(^9\)

**Classes of Individual Taxpayers**

*Treaty Benefits.* An exemption from Japanese tax is available under the income tax treaty\(^9\) to officers and employees of an American employer who are in Japan for less than 180 days.\(^9\) This provision does not apply to an American citizen or resident employed by a foreign subsidiary of an American parent corporation.

For those who cannot qualify for the foregoing exemption there is a more limited 90-day exemption for income earned in Japan up to $3,000.\(^9\) It is available to American residents who are employed by other than American employers. It apparently applies also, however, to those employed by an American employer whenever the American employer is reimbursed by a Japanese company. The latter is regarded as the true employer.

While regulations in Japan spell out the manner in which these two exemptions are to be claimed and which forms are to be used,\(^10\) most American and other treaty-country employees have ignored them since

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\(^{9}\) *Int. Rev. Code of 1954, § 6012 and Treas. Reg. § 1.6012-1 (a) (3)* which requires filing of Form 2555 with return.

\(^{9}\) Article IX (a), U.S. - Japan Tax Treaty. This article has been amended by Article VI of the Protocol to provide that in certain cases involving the performance of personal services by closely-held corporations and their shareholders the benefits of the treaty shall not apply.

\(^{9}\) The benefits would appear to be available only to employees actually resident in the U.S. at the time of coming to Japan. The treaty would not seem to apply to an American citizen, for example, who is resident in Hongkong, Switzerland, or any other foreign country at the time of arrival in Japan.

\(^{9}\) U.S. - Japan Tax Treaty, Art. IX(b).

\(^{10}\) Nihonkoku to America Gasshūkoku to no aida no Nijū Kasei no Kaihi oyobi Datsusei no Bōshi no tame no Jōyaku no Jisski ni Tomona n Shotokuzei Hō no Tokurei nado ni Kansuru Hōritsu (Law Concerning Special Measures in Respect of the Income Tax Law, etc. for the Purpose of the Enforcement of the Convention Between Japan and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income) Law No. 194 (June 23, 1954) and the Ministry of Finance Ordinance No. 13, April 1, 1955 which implements the law and sets forth the procedures and information to be filed prior to the time any payment is made.
no check on arrival or departure of aliens has been maintained by the
tax authorities. There is some indication that this may soon change
and employees in Japan may thereupon find it necessary to claim the
treaty benefit prior to the time payments are made.

Similar benefits are available to residents from the other countries
which have concluded tax treaties with Japan: United Kingdom,
Austria, Singapore, India, Denmark, Norway, Pakistan, and Sweden.101

Non-Residents. An American or other foreign individual who comes
to Japan with the intention of staying for less than one year is classified
as a non-resident.102 He is taxed at the rate of 20 percent of the gross
income which he earns in Japan.103 No deductions, credits or ex-
emptions are allowed. If paid in Japan the tax is withheld; otherwise
the individual reports it himself, or through a representative.104

Non-Permanent Resident. An American or other foreign individual
who resides in Japan for less than five years and has no intention of
becoming permanently domiciled in Japan is classified as a “non-
permanent” resident.105 As such he receives temporary relief from
tax on income from sources outside of Japan. The non-permanent
resident is taxed in Japan only on (a) income from Japanese sources
(which includes, of course, all income attributed to his employment
in Japan regardless of where, when, or how it is paid), and (b) income
from sources outside of Japan which is paid in or remitted to Japan.
Income which is attributed to services, employment, or to capital out-
side of Japan, and which is paid and kept outside of Japan is not
included in the individual’s taxable income in Japan. Thus dividends,
interest or capital gains paid and retained in the United States, or
income for services performed while outside of Japan, will not be
taxed in Japan during the individual’s first five years of residence in
Japan.

Resident. A resident is an individual who is domiciled in Japan or
has resided in Japan for over one year but is not a non-permanent
resident.106 A foreign individual who has no intention of residing per-
manently in Japan and is thus a non-permanent resident for his first
five years, becomes a resident after five years. A resident is taxable
on his entire world-wide income, including in the case of an American

101 Tax Agreements with Japan (in Japanese and English), supra note 7, author-
ization of the Ministry of Finance, contains all of the treaties.
102 Income Tax Law, art. 1-2.
103 Id., arts. 2-3 and 17.
104 Id., arts. 23, 26 and 29.
105 Id., art. 2-2.
106 Id., arts. 1 and 2.
citizen resident in Japan any income from United States sources. A foreign tax credit is available, however, which allows credit for taxes paid to foreign countries. A resident who is an American citizen and has income from the United States may thus be compelled to use foreign tax credits in both countries to avoid double taxation since both countries may, with limited exception, tax his entire income.

Determination of Resident Status. The new regulations set forth the basic rules for determining an individual's resident status. A person who comes to Japan with the intention of remaining for over a year, or whose occupation or position is such that it will require continuous residence in Japan for more than one year, is presumed to be domiciled in Japan and taxable immediately as a resident unless:

(i) he is not a Japanese national and has not received permission from the Japanese government to reside permanently in Japan, or

(ii) he is a foreign national and informs the chief of the tax office where he pays his tax that he has no intention of residing permanently in Japan.

In the usual case a foreign individual who comes to Japan for an indefinite but not permanent period of residence will from the outset, and thereafter for five years, be taxed as a non-permanent resident.

Rates and Burden of Tax

Income taxes are assessed at both national (the income tax) and local (the municipal and prefectural inhabitant's taxes) levels. In Tokyo which is regarded as both a municipality and a prefecture, a combined single tax is assessed. The prefectural enterprise tax applies only to individuals who are in business; it does not apply to employees.

The rates of tax are progressive and steeply graduated. The following examples are approximate and are illustrative of the total tax cost to a married foreign employee with three children, living in Tokyo:

107 Id., art. 15-(9) and Income Tax Law Enforcement Regulations, art. 13-(2).
108 See Owens, op. cit. supra note 94.
109 Income Tax Law Enforcement Regulations, 1-(9) and (10).
110 Through 1962 foreigners were taxed as non-residents at the rate of 20% on gross for the first year regardless of their intention. In almost all cases this amounted to far less than the normal rates on net income.
111 Local Tax Law, art. 734.
112 Id., art. 72.
JAPANESE TAXATION OF FOREIGNERS

Total Tax Burden on Individual Employee
(National and Local Taxes only)

<table>
<thead>
<tr>
<th>Taxable Income in Japan</th>
<th>Total Tax Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥2,000,000 ($5,500)</td>
<td>¥432,000 ($1,200)</td>
</tr>
<tr>
<td>3,000,000 (8,340)</td>
<td>926,100 (2,572)</td>
</tr>
<tr>
<td>4,000,000 (11,120)</td>
<td>1,446,100 (4,018)</td>
</tr>
<tr>
<td>5,000,000 (13,900)</td>
<td>2,003,300 (5,565)</td>
</tr>
<tr>
<td>7,000,000 (19,460)</td>
<td>3,200,500 (8,890)</td>
</tr>
<tr>
<td>9,000,000 (25,020)</td>
<td>4,460,500 (12,390)</td>
</tr>
<tr>
<td>12,000,000 (33,360)</td>
<td>6,497,700 (18,049)</td>
</tr>
<tr>
<td>15,000,000 (41,700)</td>
<td>8,597,700 (23,882)</td>
</tr>
<tr>
<td>20,000,000 (55,600)</td>
<td>12,097,700 (33,605)</td>
</tr>
</tbody>
</table>

Some indication of the exceedingly high tax burden on individuals in Japan when compared to the United States and other industrial European countries can be seen in the following analysis of comparative effective income tax burdens: 113

<table>
<thead>
<tr>
<th>Amount of Salaries</th>
<th>Japan</th>
<th>U.S.A.</th>
<th>U.K.</th>
<th>West Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 1,375.............</td>
<td>2.3%</td>
<td>3.7%</td>
<td>3.9%</td>
<td></td>
</tr>
<tr>
<td>2,750................</td>
<td>10.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5,500................</td>
<td>21.6</td>
<td>7.1%</td>
<td>16.3</td>
<td>12.1</td>
</tr>
<tr>
<td>13,900...............</td>
<td>39.0</td>
<td>15.6</td>
<td>25.4</td>
<td>24.2</td>
</tr>
<tr>
<td>27,800...............</td>
<td>50.7</td>
<td>24.1</td>
<td>37.7</td>
<td>33.3</td>
</tr>
<tr>
<td>55,600...............</td>
<td>60.2</td>
<td>38.1</td>
<td>59.0</td>
<td>41.5</td>
</tr>
<tr>
<td>139,000...............</td>
<td>72.4</td>
<td>57.8</td>
<td>68.9</td>
<td>48.4</td>
</tr>
</tbody>
</table>

Manner of Taxing Employment Income

A foreign employee resident in Japan is liable for tax on his entire salary from Japanese sources. The source of the employee’s earnings for Japanese tax purposes (as well as United States tax purposes) is the place where the services are performed, not where the employer is located or the salary paid. 114 If all of the services during the year are performed in Japan then the entire salary is taxable in Japan. If part of the services are performed in the United States or in another country, the salary applicable to that part is theoretically not taxable in Japan as long as the employee is still a non-permanent resident (less

113 Adapted from OUTLINE OF JAPANESE TAX - 1962 (Tax Bureau, Ministry of Finance) 32, supra note 9.
114 U.S.-Japan Tax Treaty, Art. XIII(f), and Article VII of Protocol which amends Article XIII(f) slightly.
than five years in Japan).\textsuperscript{115} When he becomes a full resident his salary is taxed in Japan regardless of where the services are performed, but a foreign tax credit is available for foreign taxes paid on this income.

There is apparently no provision in the Japanese tax law which exempts from tax amounts paid by either the employee or his foreign employer for foreign retirement plans, pensions, annuities, medical insurance, or other foreign fringe benefits. Theoretically these are taxable to the American employee in Japan. Because of foreign exchange controls there is no convenient way in which American social security benefits or retirement plan benefits can be integrated with Japanese systems or plans.

The value of property and services provided by the employer to an employee, whether in lieu of salary or not, is likewise taxable to the employee at fair market value. There has been an increasing amount of attention paid by the tax agents to the many forms of indirect and fringe benefits in recent years. This includes housing, automobiles, servants, etc., although in some cases the practice has been to value the property under a formula which generally produces a fairly low value.

\textbf{Conclusion}

The relative success of a tax system is seldom measured by its popularity with foreign resident taxpayers and corporations. Nonetheless there is evident in the new amendments a desire to accommodate the Japanese tax gradually to the current standards of international tax comity. That there are such standards has become apparent as the European countries begin to treat one another's taxpayers with a refreshing degree of consideration. Unfortunately the United States lags far behind, apart from its tax treaty program.

Whether these new provisions are interpreted with strictness or liberality, they amount to a considerable, and for the most part welcome, change in approach.

\textsuperscript{115} Income Tax Law, art. 2-2.