PANORAMIC

TAX ON INBOUND INVESTMENT 2026

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LEXOLOGY

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Panoramic guide (formerly Getting the Deal Through) enabling side-by-side comparison of local insights into acquisitions (from the buyer's perspective), post-acquisition restructuring, and disposals (from the seller's perspective), including stock versus asset/liability transactions; domicile of acquisition company; company mergers and share exchanges; tax benefits of issuing stock as consideration; transaction taxes; treatment of deferred tax assets; interest relief; protections for acquisitions; spin-offs; migration of residence; interest and dividend payments; tax-efficient extraction of profits; methods of disposal including for tax mitigation and deferral purposes; and recent trends.

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Japan

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Summary

ACQUISITIONS (FROM THE BUYER'S PERSPECTIVE)

Tax treatment of different acquisitions

1 What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

In general, an acquisition of stock in a company does not affect the tax attributes of the target company. For example, the target company's net operating losses (NOLs) will remain intact and can be carried forward after the acquisition, subject to tax avoidance rules. Similarly, the basis of the target's business assets will generally remain the same. Furthermore, no goodwill is recognised by the acquirer even if there is a difference between the purchase price of the stock in the target company and the aggregate value of the assets minus liabilities of the target company.

An acquisition of stock in the target company is not subject to consumption tax (Japanese value added tax), stamp duty, real estate acquisition tax and licence and registration tax.

On the other hand, an acquisition of the assets and liabilities of the target company does not make the acquirer inherit the tax attributes of the target company. The acquirer cannot inherit and use the NOLs of the target company, even if the acquirer acquires and takes over the business previously conducted by the target company. The acquirer is entitled to a step-up in basis in the target's business assets. The acquirer may recognise goodwill to the extent of any difference between the purchase price and the aggregate value of the assets minus liabilities of the target company.

The transfer of assets other than land is generally subject to consumption tax, and if the assets transferred are real estate, real estate acquisition tax and licence and registration tax are also payable. Stamp duty on transaction documents may be imposed as well. Please be advised that different rules and tax rates regarding these taxes would apply if the asset transfer is conducted by means of mergers or demergers as opposed to a single asset transfer or business transfer.

Law stated - 30 July 2025

Step-up in basis

2 In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

In an asset purchase transaction, a purchaser of the business assets of the target company is entitled to a step-up in basis of the business assets purchased. The acquired intangible assets can be amortised over certain statutory years under Japanese tax law. The purchaser can and must amortise the goodwill (ie, the difference between the purchase price and the aggregate value of the assets minus liabilities of the target company) over five years on a monthly basis in the case of an acquisition of a business.

On the other hand, a purchaser of the stock in the target company is not entitled to a step-up in basis of the underlying assets of the target company. The purchaser does not recognise any goodwill on the purchase of the stock in the target company; therefore, the purchaser is not entitled to amortise any goodwill.

Law stated - 30 July 2025

Domicile of acquisition company

3 | Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

If an acquisition is through the purchase of stock in the target company, this question depends in part on how the acquirer finances the acquisition. If the acquirer is a strategic buyer, it often borrows funds for the acquisition by way of a corporate loan. In this case, it is preferable to buy the stock in the target company outright, which allows the acquirer to offset its own operating income against the interest on such a loan without any subsequent procedures or reorganisations. On the other hand, if the acquirer is a financial buyer, it is preferable to establish an acquisition company in Japan. While a merger or tax consolidation (the Group Aggregation System) between the acquisition company and the target company makes it possible to offset the target company's operating income against the interest on the acquisition finance borrowed by the acquisition company, a merger and tax consolidation can only be carried out between Japanese companies under Japanese law.

If an acquisition is made by way of the purchase of assets and liabilities of the target company, using an acquisition company established in Japan is preferable in order to avoid the permanent establishment risk that may arise if the acquisition company established in a foreign jurisdiction directly purchases the assets and liabilities of the target company.

Law stated - 30 July 2025

Company mergers and share exchanges

4 | Are company mergers or share exchanges common forms of acquisition?

Mergers and share exchanges are common forms of acquisitions when companies involved in such mergers or share exchanges are only Japanese companies. However, we are not aware of any mergers and share exchanges under the Companies Act of Japan directly conducted between a foreign company and a Japanese company since such cross-border mergers or share exchanges are not feasible under the Companies Act of Japan. Instead, similar consequences can be achieved through triangular mergers or triangular share exchanges. In a triangular merger or triangular share exchange, a Japanese acquisition company and a Japanese target company are the parties to the merger or share exchange under the Companies Act of Japan, and the stock in the foreign parent company of the Japanese acquisition company is used as the consideration for

the merger or share exchange. Reverse triangular mergers do not exist under Japanese corporate law.

Law stated - 30 July 2025

Tax benefits in issuing stock

5 Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

It is generally more beneficial for the acquisition company to issue stock as consideration rather than to pay cash in a corporate reorganisation from a tax law perspective. Cash consideration in a corporate reorganisation such as a merger or share exchange generally prevents the corporate reorganisation from being treated as a tax-qualified one, where the target company does not recognise any unrealised gain or loss on its assets (in the case of a merger) or on its assets subject to mark-to-market valuation (in the case of a share exchange).

However, the issuance of stock as the consideration in a merger or share exchange does not automatically mean that the merger or share exchange is tax-qualified. If the acquisition company is a special purpose company (SPC) and does not own more than 50 per cent of the stock in the target company or control the target company, the merger or share exchange is unlikely to be treated as a tax-qualified corporate reorganisation because the acquisition company does not carry on any business and such a merger or share exchange is unlikely to meet the 'related business requirement', which requires one of the acquisition company's businesses to be related to the main business of the target company. Accordingly, if the acquirer wishes to use stock as consideration while satisfying the requirements for tax-qualified corporate reorganisations, it is worth considering whether the SPC acquisition company first acquires control of the target company and then the acquisition company enters into a merger or share exchange with the target company using stock of the acquisition company or its parent company as consideration. The related business requirement does not need to be satisfied for a corporate reorganisation between a controlling company and a controlled company.

Law stated - 30 July 2025

Transaction taxes

6 Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Stamp duty is levied on the types of documents listed in the Stamp Duty Act. Although stock purchase agreements are not taxable, taxable documents include, among others, stock certificates, real estate or intellectual property purchase agreements, business transfer agreements, loan agreements and merger agreements. Stamp duty is levied only on the

documents that are physically prepared in Japan. Electronic copies are not subject to stamp duty even if they are prepared in Japan.

The amount of stamp duty on a taxable document is determined based on the type of document and the stated contract amount (if any). The amount of stamp duty ranges from ¥200 to ¥600,000. Stamp duty is payable by the person who prepares a taxable document (ie, describes the required taxable information in a taxable document and uses the taxable document as intended). For example, in the case of a stock certificate, the issuing company is liable for stamp duty, and in the case of a real estate transfer agreement, all parties to the agreement are jointly liable for stamp duty.

Domestic transfers of assets other than land, including a transfer of a business, are generally subject to consumption tax (Japanese value-added tax) at the rate of 10 per cent. In addition, if the assets transferred are real estate, the transferee is also subject to the following:

- real estate transfer tax at a rate of up to 4 per cent of the registered taxable value for the acquisition and
- licence and registration tax at a rate of up to 2 per cent for the registration.

Please be advised that different rules and tax rates regarding these taxes would apply in the case of mergers and demergers as opposed to a single asset transfer or business.

Law stated - 30 July 2025

Net operating losses, other tax attributes and insolvency proceedings

7 Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Generally, a company's NOLs may be carried forward for the following 10 fiscal years (nine fiscal years, for the fiscal years commencing before 1 April 2018) if the company files a Blue Return, which is a preferential tax return. A company may offset all such NOL carry-forwards against its taxable income if the company's amount of registered stated capital is ¥100 million or less, and the company is not wholly owned (directly or indirectly) by a large company with the amount of registered stated capital of ¥500 million or more. Otherwise, a company may offset such NOL carry-forwards against its taxable income, but only up to 50 per cent of its taxable income.

There are some exceptions to the above in the event of a change of control or insolvency. For example, if more than 50 per cent of stock in a company (ie, control) is acquired and one of the statutory events occurs within five years of the acquisition, then the company will no longer be able to use the NOL carry-forwards. Such statutory events include:

- where the company is dormant, and the company commences a business after the acquisition; and
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where the company ceases the business carried on before the acquisition and receives a significant amount of investment or loan in relation to the scale of the business that has ceased.

This is a tax avoidance rule for transactions primarily motivated by the acquisition of NOLs. On the other hand, if a company is subject to corporate rehabilitation proceedings, civil rehabilitation proceedings, or certain other similar out-of-court proceedings, the aforementioned 10-year limitation on the NOL carry-forwards does not apply to certain taxable income, such as income arising from debt forgiveness by certain statutory creditors. In addition, the 50 per cent limitation on the use of NOL carry-forwards does not apply.

Law stated - 30 July 2025

Interest relief

8 Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility generally or where the lender is foreign, a related party, or both? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Generally speaking, interest paid by an acquisition company is deductible from its taxable income. However, there are restrictions on the interest deduction: the thin capitalisation rules and the earnings stripping rules.

Under the thin capitalisation rules, if the amount of debt owed to its foreign controlling shareholders exceeds three times the amount of equity held by the foreign controlling shareholders, the deduction of any interest payment corresponding to the excess amount of debt is denied.

Under the earnings stripping rules, the deduction of net interest payments (as defined in the rules) to any third parties, whether related or unrelated, in excess of 20 per cent of adjusted taxable income (as defined in the rules and close to earnings before interest, taxes, depreciation, and amortisation (EBITDA)) is disallowed. The disallowed amounts may be carried forward for the following seven fiscal years. This 20 per cent threshold is analysed and tested on a domestic corporate group basis rather than on an individual corporate entity basis. In this regard, the amount of dividend income eligible for either the domestic or foreign dividends received deduction is disregarded in the calculation of adjusted taxable income. Accordingly, even if the acquisition company and the target company remain separate entities after the acquisition, this will not necessarily result in a higher amount of the adjusted taxable income on a domestic corporate group basis.

Finally, there are no capitalisation rules specifically designed to prevent the pushdown of excessive debt.

Law stated - 30 July 2025

Protections for acquisitions

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> What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient? Is tax indemnity insurance common in your jurisdiction?

In an M&A agreement such as a stock purchase agreement or a business transfer agreement, it is common practice to set forth representations and warranties made by each party, and representations and warranties made by the seller often include, among other things, those relating to contingent liabilities and tax matters of the target company and (in the case of a business transfer) the sufficiency of the assets transferred.

Indemnity payments made for a breach of such representations and warranties by the seller will generally constitute taxable income to the buyer because they are characterised as compensation for a loss suffered by the buyer. However, if the relevant M&A agreement expressly provides that the indemnity payments are to be treated by the parties as an adjustment to the purchase price for tax purposes, then the indemnity payments will be treated as such and will not constitute taxable income in the hands of the buyer. The inclusion of this type of provision is common practice in Japan. Indemnity payments are not subject to Japanese withholding tax.

Last, warranty and indemnity insurance has become common in recent years, but tax indemnity insurance is still uncommon in Japan.

Law stated - 30 July 2025

POST-ACQUISITION PLANNING

Restructuring

10 | What post-acquisition restructuring, if any, is typically carried out and why?

Assume that an acquisition company has acquired a target company with two businesses (A and B) and no longer needs the business B. With respect to the post-acquisition restructuring involving the transfer of the business B to a third party through a negotiated transaction, there are two types of methods:

- a corporate demerger or a direct transfer of the business B as a whole; and
- a stock transfer, whereby the target company creates a new subsidiary with the business B and transfers its shares to the third party.

However, if it is not possible to sell the business B to anyone (eg, the necessary merger clearance cannot be obtained), a spin-off of the business B by the target company may be an option: the company establishes a new company with the business B (SpinCo) and distributes SpinCo's shares to the existing shareholders. In principle, only 100 per cent spin-offs are tax-qualified in Japan, although there are some temporary statutory measures for tax-qualified 'partial' spin-offs. Recently, Sony Group Corporation (SGC) has announced a tax-qualified partial spin-off of its wholly owned financial services subsidiary,

Sony Financial Group Inc (SFGI), to be executed as of 1 October 2025, distributing over 80 per cent of SFGI's shares to SGC's shareholders as a dividend in kind.

Last, if the target company wishes to raise funds from new shareholders while retaining some of its equity in the business B, it should consider an initial public offering (IPO) of its subsidiary with the business B.

Law stated - 30 July 2025

Spin-offs

11 Can tax-neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

There are two methods of spin-offs under the Corporation Tax Act of Japan:

- a pro rata distribution of all the shares of the wholly owned subsidiary (SpinCo) of the parent company to its shareholders (a share distribution); and
- a spin-off of the business by way of a corporate demerger.

In both cases, one of the requirements for tax-qualified (ie, tax-free) spin-offs is that all the shares of the SpinCo are distributed pro rata. However, in 2023, Japanese tax law set forth a tax-qualified partial spin-off by way of a share distribution in which the parent company retains less than 20 per cent of the SpinCo's shares as a temporary tax measure. Using this exception, Sony Group Corporation (SGC) has recently announced a tax-qualified partial spin-off of its wholly-owned financial services subsidiary, Sony Financial Group Inc (SFGI), to be executed as of 1 October 2025, distributing over 80 per cent of SFGI's shares to SGC's shareholders as a dividend in kind.

In principle, the accumulated net operating losses (NOLs) of the business to be spun off cannot be used subsequently by the SpinCo in the case of a demerger, whereas in the case of a share distribution, the accumulated NOLs of the SpinCo are, in principle, preserved.

No accumulated capital gains or losses are recognised as long as the spin-off qualifies as a tax-qualified one. If the SpinCo and the parent company use the tax consolidation system (the Group Aggregation System), accumulated gains and losses on SpinCo's assets subject to mark-to-market valuation may, in limited circumstances, be recognised upon the SpinCo's degrouping from the parent company's tax consolidation as a result of the spin-off. Such a degrouping charge is not triggered if the spin-off qualifies as a tax-qualified one.

There is no transfer tax in the case of a share distribution, whereas in the case of a demerger, transfer taxes, such as real estate acquisition tax and registration and licence tax, are generally imposed on the transfer of the assets in the demerger, although the real estate acquisition tax may be exempt.

Law stated - 30 July 2025

Migration of residence

12 Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

The Companies Act of Japan provides that a corporation is incorporated upon registration with a registration office of the Japanese government at the address of its head office. In addition, the Corporation Tax Act of Japan stipulates that the tax residence of a corporation is the address of its head office. Consequently, it is impossible to migrate a corporation itself established under Japanese corporate law to another jurisdiction from a corporate law and tax law perspective.

Law stated - 30 July 2025

Interest and dividend payments

13 Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Interest and dividends paid by a domestic corporation to a non-resident person or a foreign corporation without a permanent establishment are subject to withholding tax. Interest on a loan and dividends from an unlisted asset are generally subject to withholding tax at the rate of 20.42 per cent, whereas interest on a bond of a domestic corporation and dividends from a listed asset are, in general, withheld at the rate of 15.315 per cent. Both rates include income tax and the Special Reconstruction Income Tax.

In the context of post-acquisition planning, there are no noteworthy domestic exemptions from the withholding tax. Any applicable tax treaties may modify the domestic rules and tax rates described above.

Law stated - 30 July 2025

Tax-efficient extraction of profits

14 What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Under Japanese tax law, management fees paid to non-residents are taxable only if the relevant service falls within certain types of business and is performed in Japan. In addition, management fees paid by a Japanese corporation are, in principle, treated as deductible expenses for tax purposes. Consequently, management fees are generally a tax-efficient means of shifting profits from a Japanese subsidiary to its non-resident parent company.

Royalties are also a tax-efficient means for extracting profits. Although royalty payments are subject to withholding tax at the rate of 20.42 per cent under Japanese tax law, such taxation is usually mitigated or waived by applicable tax treaties.

Law stated - 30 July 2025

DISPOSALS (FROM THE SELLER'S PERSPECTIVE)

Disposal methods

15 How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

In Japan, the following two methods of transferring a business to a third party are commonly used:

- a corporate demerger or a direct transfer of the business as a whole; and
- a stock transfer, whereby the seller company creates a new subsidiary with the business and transfers its shares to the third party.

Both methods are commonly used for various reasons, including not only tax efficiency but also regulatory requirements.

Law stated - 30 July 2025

Disposals of stock

16 Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Might a disposal of stock in a foreign holding company trigger taxes in the local company in your jurisdiction? Are there special rules dealing with the disposal of stock in real-property, energy and natural-resource companies?

Under the Corporation Tax Act of Japan, a non-resident company that owns a permanent establishment (PE) in Japan is taxed on all income that is attributable to the PE, including capital gains from a disposal of stock of a Japanese company.

Capital gains from the disposal of stock of a Japanese company realised by a non-resident company that does not own a PE in Japan are generally not subject to Japanese income tax, with the following notable exceptions.

- A disposal of stock of a Japanese company similar to a business transfer: where the non-resident company, together with its specially related shareholders, owns or has owned 25 per cent or more of the stock of the Japanese company at any time within three years before the last day of the fiscal year in which the date of disposal falls, and disposes of 5 per cent or more of the stock of the Japanese company (the '25/5 rule').
- A disposal of stock of a real estate holding company: a company, whether Japanese or foreign, is a real estate holding company if 50 per cent or more of its total assets consist or have consisted of real estate located in Japan or stock of other real estate holding companies at any time within one year before the date of disposal. If the non-resident company disposing of stock of a real estate holding company, together

with its specially related shareholders, held more than 2 per cent of the stock of such real estate holding company (or more than 5 per cent if such real estate holding company is listed on a stock exchange) on the day preceding the first day of the fiscal year in which the non-resident company disposes of the stock, the capital gain arising from such disposal is subject to Japanese income tax.

While the 25/5 rule is not triggered by the sale of stock of a foreign holding company, a foreign holding company may itself fall within the definition of a real estate holding company.

Law stated - 30 July 2025

Mitigating and deferring tax

17 If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or mitigating the tax?

Generally, a direct transfer of shares in a Japanese company by a non-resident company that does not have a permanent establishment in Japan is taxable only if the non-resident company, together with its specially related shareholders, owns 25 per cent or more of the shares in the Japanese company and sells 5 per cent or more of the shares in the Japanese company. This capital gain taxation may be exempt under some tax treaties (if applicable). In addition, an indirect transfer (i.e., transfer of shares in the foreign parent company) can be used to avoid this capital gain taxation.

If the requirements for a tax-qualified demerger or contribution in kind are met, it is possible for a Japanese company to transfer its business assets tax-free. However, as the consideration must be, in principle, shares and cannot be cash, the Japanese company will end up holding shares in the other Japanese company that acquired the business assets. Therefore, it is not possible to divest the business assets completely and receive cash tax-free.

Law stated - 30 July 2025

UPDATE AND TRENDS

Key developments of the past year

18 Are there any emerging trends or hot topics relating to tax on inbound investment?

The size-based taxation system (*gaikei-hyojun-kazei*) of enterprise tax (*hojin-jigyo-zei*) has been significantly reformed. This tax reform could significantly impact inbound investment in Japan, requiring more careful consideration of optimal capital structures of Japanese corporate vehicles for such purposes.

Enterprise tax is a kind of local tax imposed on corporations residing in Japan and is composed of three components: an income levy (*shotoku-wari*), a value-added levy (*fukakachi-wari*), and a capital levy (*shihon-wari*). The latter two levies are imposed even

if the taxpayer is in the red. Previously, a Japanese corporation was subject to all three types of levies only if the amount of its 'stated capital' (*shihonkin*), a part of shareholders' capital of the Japanese corporation, exceeded ¥100 million at the end of the fiscal year. This taxation of a value-added levy and a capital levy is called the size-based taxation.

To avoid the size-based taxation, many small and medium-sized companies in Japan reclassified their stated capital to 'capital reserve' ('*shihon-junbikin*') or 'other capital surplus' ('*sonota-shihon-joyokin*'), and reduced the amount of stated capital to no more than ¥100 million. The trend of this reclassification had accelerated since the outbreak of the covid-19 pandemic. Against this background, the requirements for the size-based taxation were updated to prevent this circumvention.

First, a company subject to the size-based taxation in a certain fiscal year will remain subject to the size-based taxation in the following fiscal year if the aggregate amount of stated capital, capital reserve, and other capital surplus exceeds ¥1 billion at the end of the following fiscal year, even if the amount of stated capital does not exceed ¥100 million at the end of the following fiscal year.

The aggregate amount of stated capital, capital reserve, and other capital surplus is called 'the amount of paid-in capital' ('*haraikomi-shihon-no-gaku*') under the new rule. This new rule is effective from 1 April 2025, under which Japanese corporations can no longer avoid the size-based taxation by simply reclassifying their stated capital to capital reserve or other capital surplus and reducing the amount of stated capital to no more than ¥100 million.

In addition, whereas the applicability of the size-based taxation had previously been determined on an entity-by-entity basis, a new rule has been introduced which takes into account the parent company's shareholders' equity as well. If a company is, directly or indirectly, wholly owned by a (domestic or foreign) corporation with more than ¥5 billion of the amount of paid-in capital, such a company with more than ¥200 million of the amount of paid-in capital will be subject to the size-based taxation, regardless of the amount of its stated capital. This additional rule will come into effect on 1 April 2026. However, there is a transitional rule already in place to prevent hasty circumvention through a reduction of the amount of paid-in capital by way of a distribution of capital surplus to its shareholders by that date.

Other miscellaneous, technical rules and adjustments have been introduced in relation to this reform on the size-based taxation system. Meanwhile, it should be noted that most of the other corporate tax rules linked to a company's stated capital remain unchanged. Before determining the initial capital structures of Japanese corporate vehicles for inbound investment purposes, it is advisable to consult tax experts.

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