KPMG

# Film Financing and Television programming

## A Taxation Guide

Now in its eighth edition, KPMG LLP's ("KPMG") Film Financing and Television Programming: A Taxation Guide (the "Guide") is a fundamental resource for film and television producers, attorneys, tax executives, and finance executives involved with the commercial side of film and television production. The guide is recognized as a valued reference tool for motion picture and television industry professionals.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps producers and other industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including film and television development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in the financing of film and television productions, the Guide includes a robust discussion of relevant tax incentive programs in each country.

The primary focus of the Guide is on the tax and business needs of the film and television industry with information drawn from the knowledge of KPMG International's global network of member firm media and entertainment Tax professionals.

Each chapter focuses on a single country and provides a description of commonly used financing structures in film and television, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

*Introduction*
A thumbnail description of the country's film and television industry contacts, regulatory bodies, and financing developments and trends.

*Key Tax Facts*
At-a-glance tables of corporate, personal, and value-added (VAT) tax rates; normal nontreaty withholding tax rates; and tax year-end information for companies and individuals.

*Financing Structures*
Descriptions of commonly used financing structures in film and television production and distribution in the country and the potential commercial tax implications for the parties involved. The section covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

*Tax and Financial Incentives*
Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

*Corporate Tax*
Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

*Personal Tax*
Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

*Digital Media*
For the first time, we have included a discussion of digital media tax considerations recognizing its growing role in the distribution of film and television content.

*KPMG and Member Firm Contacts*
References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business of identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

Thank you and we look forward to helping you with any questions you may have.

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# Japan

## Introduction

Film-related industries are expanding in Japan. As this occurs, many types of transactions are becoming increasingly common. It is necessary for overseas investors to consider the Japanese tax implications carefully before beginning their business.

## Key Tax Facts

| | |
|---|---|
| Highest national corporate income tax rate | 23.2% |
| Local corporate tax rate | 4.4% |
| Highest local income tax rates<br>Inhabitant tax (levied on corporation income tax amount) | 16.3% |
| Business tax (deductible for corporate income tax purposes) | 0.88% |
| Special local corporate tax | 2.89% |
| Effective tax rate | 30.62% |
| Consumption tax rate | 8% (The rate will increase to 10 percent on 1 October 2019. Furthermore, a multiple tax rate system will be introduced on 1 October 2019 along with the increase in the consumption tax rate. Under the multiple tax rate system, a reduced tax rate of 8 percent will apply to sales of food/beverages [excluding alcoholic beverages] and certain newspapers under subscription contracts.) |
| Annual consumption tax registration threshold | 10 million |
| Normal nontreaty withholding tax rates: Dividends | 20.42% |
| Interest | 15.315% or 20.42% |
| Royalties | 20.42% |
| Tax year-end: Companies | Generally, the accounting year-end |
| Tax year-end: Individuals | December 31 |

The business tax rate shown above is applied on its taxable income for a company with paid-in capital of more than ¥100 million. A size-based business tax is also levied on the company, in addition to the income-based business tax. The highest size-based business tax rates applicable to a company based in Tokyo are 1.26 percent on the added-value component tax base (total of labor costs, net interest payments, net rent payments, and income/loss of the current year) and 0.525 percent on the capital component tax base (total paid-in capital and capital surplus).

For small and midsize companies with paid-in capital of ¥100 million or less, the highest business tax rate applicable to a company based in Tokyo is 7.18 percent and the highest special local corporate tax rate applicable to a company based in Tokyo is 2.894 percent. Therefore, the effective tax rate is 33.59 percent with no size-based business tax imposed.

The Consolidated Tax Filing System for National Corporate Tax was implemented on April 1, 2003. No consolidated tax filing system is applied for local income tax.

## Film Financing

### Financing Structures

#### *Co-production*

A Japanese resident investor may enter into a Japan-based co-production joint venture (JV) with a foreign investor to finance and produce a film in Japan. Although this JV is sited in Japan, the transaction would need to be reviewed from each investor’s viewpoint to determine precisely the tax position of each party.

As long as the foreign investor cannot be said to be carrying on the trade or business of film exploitation in Japan, Japanese tax is chargeable solely in respect of the Japanese investor’s activities and any other trade that the foreign investor may carry on in Japan. The issue is complicated if the foreign investor produces the film in Japan under a production contract. In that case, the foreign investor is likely to be taxed on the basis that business profits arise through a permanent establishment that it operates in Japan. If the foreign investor produces the film in Japan, it is likely that it would have a production office and a permanent establishment in Japan. Its business profits relating to that permanent establishment would be taxed in Japan and it would have to rely on the applicable treaty to obtain relief from double taxation.

#### *Partnership (Kumiai)*

Current profits or losses allocable to partners under a partnership agreement are treated as income or losses of each partner, which either increase their taxable income or are deductible from their income. Note that there are rules to limit the utilization of losses derived from a partnership. A partnership is not treated as a taxable entity. In other words, the partnership itself is not taxed in Japan. It is impossible for any partnership itself to claim the benefit of a double tax treaty.

#### *Equity Tracking Shares*

Japanese Corporate Law has allowed the issuance of “tracking stocks” in Japan. The dividends paid on tracking stocks would not be treated any differently than dividends paid on ordinary shares. Generally, the foreign tax withheld on dividends on tracking stocks in foreign countries would be available as a foreign tax credit in Japan.

*Lease Transactions*

**Sale and Leaseback**

A sale-and-leaseback transaction (where a lease is noncancelable and the lessee enjoys the economic benefits arising from the leased property and bears expenses in connection with the property) of property that has been used previously by the lessee is treated as a loan of funds in view of its economic reality, as the intention of such a transaction can be seen as that of financing. The lease charges are divided, on a reasonable basis, into payment of the loan principal and interest.

**Lease as Sales Transactions (Sales-type Lease)**

A noncancelable lease, where a lessee enjoys the economic benefits arising from the lease property and bears expenses in connection with the property, is treated as a sales-type lease.

For a sales-type lease, lease charges are recognized as sales revenue upon delivery of the leased property. Under certain conditions, however, the deferral of recognition of profits from sales-type leases is permitted (e.g., there is a method under which the profits portion is recognized over the lease period based on an interest method). The lessee is required to treat a sales-type lease as a purchase of the asset and is able to claim depreciation allowable for tax purposes.

*Other Tax-Effective Structures*

When investors resident in Japan invest outside Japan by way of equity, the investors may take 95 percent income exclusion on certain dividends, while in the case of loan capital, they will only take a tax credit for the tax withheld on the interest received. No indirect foreign tax credit system is available for the foreign taxes to be payable in the fiscal years beginning on April 1, 2009 or later.

Please refer to the "Foreign Tax Relief" section below for a further explanation of the foreign dividend exclusion system and the foreign tax credit system.

*Tax and Financial Incentives*

There are no special tax incentives designed solely for film producers or film distributors. However, the following tax incentive might be applicable to the film industry.

*Special Depreciation*

In addition to ordinary depreciation based on the statutory useful life, which is normally the maximum deduction for a business year, extra depreciation is available as a tax incentive to corporations that meet the specified requirements. This extra depreciation is not an investment tax credit but a type of accelerated depreciation.

## Other Financing Considerations

*Exchange Controls and Regulatory Rules*

A fundamental liberalization of Japanese exchange controls occurred near the end of 1980, and the new Foreign Trade Control Law came into effect as of April 1, 1998. The new law reflects the principle that all international transactions are freely permitted unless specially prohibited. Under certain circumstances, the exchange control law requires a film distributor or a film producer to file a report to the Japanese government in respect of remittances to foreign countries. The applicability of this reporting obligation is based on the amount and the purpose of the payments.

# Corporate Taxation

## Recognition of Income

Foreign corporations are only liable for Japanese taxes on income derived from sources within Japan. The scope of taxable income and the manner in which taxes are payable differ depending on how the taxpayer is characterized for Japanese tax purposes. Under Japanese tax law, foreign corporations are classified as those operating in Japan through a permanent establishment (PE); those not having a permanent establishment in Japan but having income that is subject to corporation tax only and other foreign corporations whose income from Japanese sources, if any, are subject to withholding tax only.

The definition of a permanent establishment for Japanese tax purposes includes the following:

- Fixed Place PE – A branch, factory, or other fixed place of business in Japan
- Construction PE – A construction, installation, or assembly project, or similar activity in supervising or superintending such a project or activities in Japan, carried out by a foreign corporation for a period of over one year
- Agent PE – A person who habitually concludes certain contracts in Japan or on behalf of a foreign corporation or habitually plays the principal role leading to the conclusion of the following contracts in Japan on behalf of a foreign company that are routinely concluded without material modification by the foreign company.

### *Transactions with Foreign Related Persons – Transfer Pricing*

When a corporation enters into a transaction in relation to film rights with a foreign related person who has a special relationship with the corporation, and if the consideration received by the corporation is less than an arm's length price or if the consideration paid by the corporation is in excess of an arm's length price, the foreign related transaction is deemed to have been conducted at arm's length prices for the purpose of Japanese corporate income tax law, and an adjustment is included in the taxable income of the corporation.

The following are various ways of ascertaining arm's length prices:

- The comparable uncontrolled price method (adopting, with necessary modifications, the uncontrolled market price for the same or similar film right)
- The resale price method (i.e., taking the final selling price and subtracting the cost and an appropriate profit markup for the related party receiving the property)
- The cost plus method
- Any other method that is acceptable other than the above three basic methods
  - Methods similar to the three basic methods
  - Other methods prescribed by the Cabinet Order
- The profit split method
- The transactional net margin method.

Under the 2016 tax reform, Japan adopted a three-tiered approach (i.e., country-by-country reports [CbC reports], master files, and local files) to the transfer pricing documentation rules in accordance with the recommendations of "Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting" of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project.

### Amortization of Expenditure

The statutory useful life for movie films is two years and a taxpayer can choose the straight-line method or the declining balance method.

The annual depreciable amount of the films acquired until March 31, 2007 is as follows:

— Straight-line method: Acquisition cost x 90 percent x 0.500

— Declining balance method: Tax book value at the beginning of the fiscal year x 0.684.

Note that the annual depreciable amount is calculated based on the length of the use in the acquisition year. The above films that depreciated to the allowable limit (95 percent of acquisition costs) in a particular business year can be further depreciated down to ¥1 evenly over five years, starting from the following business year.

The annual depreciable amount of the films acquired on or after April 1, 2007 is as follows:

— Straight-line method: Acquisition cost x 0.500

— Declining balance method: Tax book value at the beginning of the fiscal year x 1.000.

Note that the annual depreciable amount is calculated based on the length of the use in the acquisition year.

Also, please note that where the film is screened at two or more theatres, a special depreciation method is allowed by the tax authorities. Under the special depreciation method, the films are depreciated based on the proportion of the accumulated revenue to the total predicted revenue, subject to the following limitation:

| Months from date of premiere | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| Special depreciation rate (%) up to that month | 60 | 80 | 87 | 91 | 94 | 96 | 97 | 98 | 99 | 100 |

As all sources of income are generally aggregated in Japan in determining taxable income, other unrelieved expenditures incurred on the film can be offset against other sources of income, even if the company has no other films.

### Other Expenditures of a Film Production or Distribution Company

Neither a film production company nor a film distribution company has any special tax status for Japanese corporation tax purposes. Therefore, they are liable to tax under the general rules.

In calculating taxable income, it is generally possible to deduct business-related expenditures, except for capital expenditures and certain outlays related to business entertainment. With capital expenditures, for example, the acquisition cost of plant and machinery is not deductible, but depreciation on those assets is available over the useful life of the asset.

### Losses

Tax losses can be carried forward by the company for use in sheltering taxable profits of a future tax year. Such losses can be utilized against profits for the 9 or 10 succeeding years depending on when the tax losses are suffered. Thereafter, any unutilized element of loss will expire.

Japanese tax law also provides for a tax loss carryback system at the option of the taxpayer's company. This tax loss carryback system, under which a company suffering a tax loss can get a refund of the previous year's corporation tax by offsetting the loss against the income for the previous year, has been suspended since April 1, 1992 except for certain limited circumstances, including the following:

— Companies having paid-in capital of not more than ¥100 million (excluding when 100 percent of the shares are directly or indirectly held by companies whose paid-in capital is ¥500 million or more)

— Fiscal years, including the date of dissolution

— Fiscal years ending during liquidation procedures.

### Foreign Dividend Exclusion (FDE) System

Under the FDE system, 95 percent of dividend received from certain related foreign companies on or after April 1, 2009 is excluded from corporate income. A certain related foreign company means a foreign company that is (1) owned 25 percent or more by a Japanese company directly and (2) for six months or more before the dividend receipt right is effective. Also, under the FDE system, dividend withholding tax, if imposed, is neither tax creditable nor deductible. By the introduction of the FDE, the indirect foreign tax credit system was abolished; although direct foreign tax credit system is still available, except for the foreign withholding tax imposed on the dividend, which is subject to the FDE system.

## Indirect Taxation

### Consumption Tax

Almost every domestic transaction in Japan and every transaction for the import of foreign goods to Japan, except for financial transactions, capital transactions, medical services, welfare services, and education services, will be subject to tax at the rate of 10 percent effective on October 1, 2019. A Japanese resident company that delivers a completed film to a company also resident in Japan has to charge consumption tax, and it has to submit a consumption tax return and remit the amount of output tax on sales, less input credits on its own business-related purchases.

However, a film producer or film distributor whose total sales amount to less than ¥10 million in the base period is exempt from consumption tax liability (including the obligation to file a return). The base period is the year that is two years prior to the current year. Consequently, an entity created for the specific purpose of purchasing and distributing a film should begin its activities as a consumption tax-exempt entity.

However, this tax-exempt status does not apply to a newly established company falling under either of the following tests. Such a corporation is required to file consumption tax returns from the year in which it is incorporated.

(i) The newly established company's paid-in capital at the beginning of the fiscal year is ¥10 million or more.

(ii) The newly established company meets both of the following:

— The newly established company is controlled (e.g., the majority of the outstanding shares of which are directly or indirectly held) by a person (including individuals and companies) as of the beginning of the fiscal year.

— The amount of the taxable sales for the person who is treated as controlling the newly established company or the amount of the taxable sales for a company related to that person exceeds ¥500 million in the period corresponding to the theoretical base period of the fiscal year of the newly established company.

The test described in (ii) above will apply to companies established on or after April 1, 2014.

An exempt entity may elect for taxable status. Such an election can be beneficial if the consumption tax paid on purchases is expected to be greater than the consumption tax collected because it is necessary to become a taxable entity in order to get the consumption tax refund. In this case, it is important to note that the consumption tax status cannot change for two business years.

Furthermore, an invoicing system will also be introduced on October 1, 2023 so that the creditable tax amount can be calculated properly under the multiple tax rate system. The four years between the introduction of the multiple tax rate system and the invoicing system will be set out as a preparation period for businesses.

### Customs Duties

If goods are imported into Japan, Customs duties are generally levied. The tax rates are listed in the "Customs Tariff Schedule of Japan" in accordance with size, usage, etc. However, in principle, Japan levies no duty on film importation. For example, the duty on film of a width exceeding 16 mm, but not exceeding 35 mm, and of a length not exceeding 30 meters is generally free from Customs duties. The duty on negatives of the same specifications as above is also exempt. Prints consisting only of soundtracks are also exempt. Note that the amount of Customs duty is included in the taxable base of the import for consumption tax purposes.

## Personal Taxation

### Nonresident Artists (self-employed)

For Japanese tax purposes, the definition of "artist" includes actors, musicians, entertainers, and professional athletes.

If a nonresident artist receives payment arising from a Japanese activity, the Japanese payer is obliged to deduct withholding tax, regardless of the existence of a permanent establishment of the recipient, and remit it to the Japanese tax authorities. The withholding tax rate is 20.42 percent. The artist's Japanese tax liability is fully satisfied by virtue of this withholding tax. However, many tax treaties with Japan prescribe special tax treatment for artists, and it is necessary to review the applicable treaty in advance.

### Consumption Tax Implications

If the artist's activity is in Japan, consumption tax is levied on it regardless of whether or not a permanent establishment exists in Japan. If the amount of turnover is less than ¥10 million in the base period, the artist is exempt from submitting a consumption tax return and paying consumption tax.

### Resident Artists (self-employed)

When a resident artist receives any payment arising from a Japanese activity, withholding tax is deducted from his or her income at the rate of 20.42 percent (10.21 percent up to ¥1 million per payment), and he or she is required to submit his or her tax return to settle his or her tax liability in Japan.

### Consumption Tax Implications

The tax treatment is the same as for a nonresident artist.

### Employees

A withholding tax system on wages and salaries is operated in Japan, and employers are required to make periodic payments to Japanese tax authorities in respect of employees' personal tax liabilities arising from salaries or bonuses paid to them. The withholding tax system is operated on the basis of a prescribed withholding tax table. If an employee only receives employment income and his or her annual salary is not greater than ¥20 million, a year-end adjustment of the income tax on salaries is made by the employers to help ensure that the tax withheld during the year equals the employee's total tax liability. If the tax already withheld is greater than the total liability, then the employee is entitled to a refund.

### Social Security Implications

The social insurance program in Japan consists of health insurance, pension insurance, labor insurance, and employment insurance. Every individual who meets certain conditions is expected to join in the system regardless of nationality. (At the moment, the position of pension insurance is altered by applicable international social security agreements with Germany, the United Kingdom, Korea, the United States of America, the Kingdom of Belgium, France, Canada, Australia, the Kingdom of the Netherlands, and the Czech Republic.) Premiums for health and pension insurance are determined by multiplying the "monthly standard remuneration" and bonuses of the employee by the prescribed premium rate. The premium is shared by the employer and employee in equal portions. Labor insurance premium rates depend on the industry category, and the premium is borne solely by the employer. Premiums for the employment insurance system are paid by both the employer and employee.

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