

Japan Tax Update

Monthly tax update



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As we all know, the only thing constant is change. And the only way to stay successful is to keep on top of changes — in the economy, the industry, and with regulation.

The "Japan Tax Update" seeks to update you on the latest developments in Japanese tax law that affect Japanese and foreign multinationals having operations in Japan. In addition to providing information on Japanese tax issues, the purpose of this newsletter is to make management aware of changes in the regulatory environment that may have an impact on their business.

Included in this issue are the following articles:

1. **Latest Tax Report on the Tax Denial Cases**
2. **Treaty Updates**
3. **IT Investment Incentives**
4. **Passage of the American Jobs Creation Act of 2004 and Treaty Updates**

1. Latest Tax Report on the Tax Denial Cases

In October and November 2004, the National Tax Agency ("NTA") announced statistics for corporate taxation in the business year 2003 (from July 1, 2003 to June 30, 2004).

According to the statistics, the number of corporations subject to the filed audit was 115,000 (4% of the total number of corporations). Of the corporations which were subject to the field audit, 70% were subject to a tax assessment or tax decision, and the average amount of additional tax due found was 4 million JPY per case.

For the corporations under the jurisdiction of the Examination Division (domestic corporations with capital amounts in excess of 100 million JPY and foreign corporations), only 12% were subject to the tax audit.

However, more than 80% were subject to tax assessments and tax decisions, and the average amount of additional tax due was found to be 37 million JPY. The number of corporations who adopted and filed consolidated taxation was reported as 239 in the business year 2003, and 30% of these were subject to filed audit, and tax assessments or tax decisions followed. Corporations filing consolidated tax returns (the average number of corporations in a consolidated group was calculated as 11) appear to have been easy targets for the filed audit compared to single corporations. The additional amount of income for the consolidated corporations subject to field audits was reported as 376 million JPY per case, almost double the amount of 167 million JPY for single corporations. However, the additional tax amount per case was 9 million JPY, less than one third of the 37 million JPY for single corporations. The reason for this is that the ratio of declaration of income (20.1%) in consolidated tax returns was far below the ratio of that for field tax audit conducted (33.1%), so even the amount of additional income would not be enough to cover the deficit of the corporations. There were many cases where the parent company reported significant losses at the time of the commencement of the consolidated tax return. Consequently, additional tax amounts commensurate with the additional income amount according to the increase of ratio of declared income.

It was also noted that the additional tax amount relating to overseas transactions was as much as several hundreds million JPY per case and this would be effected mostly by a denial of tax deductibility in the filed audit.

2. Treaty Updates

The Japanese government recently began talks on revising its tax treaty with the United Kingdom with the purpose of reinvigorating corporate investment and trade between the two countries. The current treaty with the United Kingdom became effective in 1970 and was amended by a Protocol that was signed in 1980.

There have been similar announcements to hold negotiations to revise treaties between Japan and other countries including India, Indonesia, and Switzerland.

Currently, Japan is negotiating with representatives of the Netherlands to revise the existing Japan-Netherlands Tax Treaty.

PwC Comment

The Japanese government's desire to begin negotiations to revise existing treaties with other Asian and European countries follows from the execution of a new Treaty with the United States earlier this year, a move that was unprecedented in the scale of the tax exemptions and reductions that were agreed to. Japan's aim in renegotiating other major treaties is to boost trade and investment by mutually agreeing to reduce or eliminate taxes on dividends, charges for the use of patent rights or trademarks, etc.

3. IT Investment Incentives

The 2003 tax reforms introduced tax incentives designed to stimulate investment by companies in Japan in Information and Communication Technology assets and software.

What types of assets qualify for relief?

The following potentially qualify, when acquired for business use:

- Large memory electronic calculators
- Digital copying equipment
- Facsimiles
- IC card-using equipment
- Digital telecommunication equipment
- Internet telephone equipment

- Router switches
- Digital circuit connection systems
- Software

By investing in qualifying assets, you may be eligible for:

- Accelerated tax depreciation of 50% of the acquisition cost,
OR
- A tax credit of 10% of the acquisition cost (limited to 20% of the company's corporation tax liability, although any excess tax credit may be carried forward for one year).

Eligibility

The assets' total acquisition cost must meet the minimum requirements set out below, in order for the investment incentives to apply:

Large companies	Software assets – 6 million yen Non-software assets – 6 million yen
Smaller companies (<i>capital equal to or less than 300 million yen</i>)	Software assets – 0.7 million yen Non-software assets – 1.4 million yen Leased software assets – 1 million yen Leased non-software assets – 2 million yen

Applicable period

The tax credit and accelerated depreciation incentives are available for the acquisition of assets between 1 January, 2003 and 31 March, 2006.

PwC Comment

Companies with approaching year-ends and which are considering making acquisitions of potentially qualifying assets in the near future may wish to accelerate asset purchases so that they take place prior to the year-end.

By doing so, tax relief, which would otherwise be obtained in the next period, could be brought forward to the current period.

4. Passage of the American Jobs Creation Act of 2004 and Treaty Updates

On October 11, 2004, the United States Congress passed the American Jobs Creation Act of 2004 ("Act"). Of particular relevance to U.S. multinational companies with respect to the Act is the incentive to repatriate foreign earnings (e.g. dividends from Japanese companies).

The Act creates a temporary incentive for U.S. multinationals to repatriate accumulated income earned abroad (including Japan) by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations.

The deduction is subject to a number of limitations. First, it applies only to repatriations in excess of the average repatriation level over the three or five most recent tax years ending on or before June 30, 2003.

Second, the amount of eligible dividends is limited to the greater of US\$500 million or the amount shown on the most recent financial statement as permanently reinvested outside the United States. Third, the dividends must be described in a domestic reinvestment plan approved by senior management and the Board of Directors. The Act provides an election to apply the deduction to dividends received either during

the first tax year beginning on or after the date of enactment, or during the last tax year beginning before the date of enactment.

PwC Comment

We have had many inquiries from U.S. companies regarding repatriating earnings from their Japanese subsidiaries to take advantage of the reduced effective rate of U.S. tax on such dividends. Since the provisions of this Act will extend into 2005, we anticipate additional questions being raised relating to making dividend payments from Japanese subsidiaries.

You have a vision. PricewaterhouseCoopers helps bring that vision to reality. We hope you enjoy the current issue of Japan Tax Update and appreciate your comments about our current issue or ideas for what you'd like to see covered in future issues

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