

Financial Services Tax News

June 2009

PwC Japan Tax Newsletter

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Release of Q&A on loss as arising from valuation of listed securities

On April 3, 2009, the National Tax Agency published on its website guidelines in the form of frequently asked Questions and Answers (the "Q&A") on loss as arising from valuation of listed securities.

Under the Japanese corporate tax law, a company may claim a tax deduction for loss as arising from the valuation of listed securities where the following conditions are met:

- (1) The fair market value of the listed securities at the fiscal year end decreases by approximately 50% or more from their book value; and
- (2) The fair market value of the listed securities is unlikely to recover within a short period of time.

However, there were no guidelines available to determine the condition of non-recovery of the securities' fair market value.

The Q&A provides an insight of the Japanese tax treatment with regard to loss as arising from the valuation of listed securities when the fair market value of the listed securities decreases by 50% or more compared to their book value and a loss from valuation was recognized for accounting purposes.

The standard for judging the possibility of recovery in the value of securities in the case of a 50% or more decrease in value

For a company to be able to claim a tax deduction arising from a loss from valuation of listed securities where the fair market value of the listed securities at the fiscal year end is 50% or less of their book value, the possibility of recovery in the value of the listed securities must be considered. The Q&A clarifies that if a reasonable judgement standard based on an overall analysis of the historical market price movement of the securities, the historical market environment movement and the business conditions of the issuing company, etc. is provided from the company's perspective as a standard for judging the possibility of recovery in value, the standard is also followed from a tax perspective.

Further, the Q&A provides that if it would be difficult for a company to make a reasonable judgement regarding the possibility of recovery in the value of the securities on its own, objective opinions by professional third party advisors on the future industry movement for the issuing company and the forecast of the market price of the securities may be used as a basis for the reasonable judgement. The Q&A cites an opinion on the analysis of the market price of the securities on a different brand basis and a different industry basis and forecast of the industry movement by security analysts and business information related to the issuing company as examples of objective opinions issued by professional third party advisors.

Formal judgement standard on the continuous usage checked by accounting auditors

The Q&A clarifies that if a company formulates a standard for judging the possibility of recovery in the value of the securities and continuously uses the formal standard whose reasonableness is checked and approved by its accounting auditor, the judgement on the tax deduction based on the formal standard is allowed as a reasonable judgement for tax purposes except where the formal standard is obviously unreasonable from a tax perspective.

Further, if the financial statements contain deferred tax assets audited by the accounting auditor, the formal standard for tax deduction for loss from valuation of listed securities is treated as being checked and approved by the accounting auditor. With regard to this treatment, the Q&A explains that if the financial statements contain deferred tax assets, the reasonableness of the standard for loss from valuation of listed securities should be checked by the accounting auditor during the audit of the financial statements since the standard for tax deduction for loss from valuation of listed securities has an impact on the recognition amount of the deferred tax assets.

Timing for judging the possibility of recovery in the value of securities

The Q&A explains that the judgement of the possibility of recovery in the value of the securities is made at each fiscal year end based on a reasonable standard. The Q&A clarifies that even if the value of the securities will increase due to a change in the circumstances in the following fiscal years after the tax deduction on loss from valuation is claimed, such tax deduction will not need to be retroactively amended to the extent that a judgement of the possibility of recovery was made based on a reasonable judgement standard at the end of the fiscal year when the tax deduction was claimed.

Treatment for non-deductible items when circumstances fall under the judgement standard for possibility of recovery in the value of securities

The Q&A explains that if a security, which was subject to a loss from valuation for accounting purposes but the loss was treated as a non-deductible loss for tax purposes in a prior fiscal year, meets the conditions in order to claim a tax deduction for loss from valuation in a current fiscal year, the tax deduction can be claimed in the fiscal year including the non-deductible amount of the loss in the prior fiscal year.

The tax treatment for such a case is outlined as follows:

- (1) The amount of loss deducted from the taxable income on the tax return in a fiscal year, which was treated as a non-deductible loss for tax purposes in a prior fiscal year, is treated as being accounted for as an expense in the current fiscal year.

- (2) The deductible amount as a loss from valuation is the difference between the fair market value and the book value at the fiscal year end. However, the deductible amount is limited to the amount which is accounted for as an expense for accounting purposes. Accordingly, a loss which is not recognized for accounting purposes is not deductible for tax purposes.

For more detailed information, please do not hesitate to contact your financial tax services representative or any of the following members:

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