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Japan enacts corporate tax rate reduction and tax-basis broadening provisions along with new surtax

On November 30, 2011, Japan enacted the 5% corporate tax rate reduction and related tax-basis broadening provisions including the limitation on net operating loss ("NOL") utilization. Japan also enacted a new temporary 2.5% surtax to raise revenue for the March earthquake's reconstruction effort. This will result in approximately a 2% net reduction in the corporate tax rate for three years starting in April, 2012 and a 5% reduction thereafter (see the summary chart below).

2011 Supplemental Corporate Tax Reform Provisions

Corporate Tax Rate Reduction

Japan's corporate tax consists of three parts; a national tax, an inhabitant tax, and a local enterprise tax. Under the new law, the national corporate tax rate will decrease from 30% to 25.5% for tax years beginning on or after April 1, 2012, thereby reducing the effective tax rate from 40.69% to 35.64% for large corporations.¹ This does not consider the temporary surtax which is discussed below. The United States now will have the highest effective tax rate among Organization for Economic Cooperation and Development ("OECD") countries.

Restoration Surtax

In addition to the corporate tax rate reduction, a temporary corporate tax rate increase, known as the "Restoration Surtax," is introduced to support the country's reconstruction effort for damages caused by the March earthquake. The temporary tax increases are effective for fiscal years beginning on or after April 1, 2012 and on or before April 1, 2014. In alignment with the corporate tax rate reduction, the

¹ All tax rates in this Newsalert are for corporations established in the Tokyo Metropolitan Area whose registered capital exceeds JPY 100 million.

restoration surtax amounts to approximately 2.55% in the computation of the overall Japanese effective corporate tax rate.

Corporate Tax Rate Summary

In aggregate, the effective corporate tax rate will be 38.01% for large corporations for the years beginning on or after April 1, 2012. Following tax years beginning on or after April 1, 2015 and the expiration of the restoration surtax, the corporate effective tax rate will be further reduced to 35.64%. The table below captures the approximate effects of the corporate rate reduction coupled with the restoration surtax on the overall Japanese corporate effective tax rate for large corporations.

Year Beginning On or After	4/1/2011	4/1/2012	4/1/2013	4/1/2014	4/1/2015 and after
	Current Law	New Law			
National Tax	30.00%	25.50%	25.50%	25.50%	25.50%
Surtax²	N/A	2.55%	2.55%	2.55%	N/A
Inhabitant Tax²	6.21%	5.28%	5.28%	5.28%	5.28%
Enterprise Tax²	4.48%	4.68%	4.68%	4.68%	4.86%
Total ETR	40.69%	38.01%	38.01%	38.01%	35.64%

Tax base-broadening provisions

To offset expected revenue loss from the corporate tax rate reduction, the new legislation includes tax base-broadening provisions. The most significant of all is the limitation on NOL utilization. Effective with fiscal years starting on or after April 1, 2012, a company's NOL utilization will be limited to 80% of current taxable income, versus 100% under the current rules. The new law will also extend the current NOL carryforward period from seven to nine years and applies to NOLs incurred during fiscal years ending on or after April 1, 2008.

Other tax base-broadening provisions include the slower recovery of depreciation, deferral of the bad debt allowance, abolishment of extraordinary repairs reserves, and reduction of donation expense deductibility.

Financial Statement Impact

For financial reporting purposes, companies are required to account for income taxes based on the tax laws as enacted (US Generally Accepted Accounting Principles, US "GAAP") or substantively enacted (International Financial Reporting Standards, "IFRS") at the balance sheet date. This legislation is considered enacted and substantively enacted on November 30, 2011, the date the legislation was passed by the Japanese Diet. Therefore, any impact of the changes in tax law should be recorded in the financial reporting period including November 30 2011.

As noted above, the corporate tax provisions are generally effective for tax years beginning on or after April 1, 2012. The overall corporate tax rate will reduce when the new rate and the surtax initially become effective, and then again three years later when the surtax expires. For financial reporting purposes, the annual effective rate should be revised to take into account the impact of the rate changes in the interim

² Tax effected rates

period that includes November 30, 2011. Companies must also consider the impact of the tax rate changes on existing deferred tax balances and record the impact as a discrete item in the interim period that includes November 30, 2011. The effect of the tax rate changes, particularly with the changes taking place in Japan over the ensuing years, may require a detailed scheduling analysis to determine when existing temporary differences are expected to reverse.

In addition to the tax rate changes, the new NOL limitation rule discussed above may prompt companies to reassess the realizability of deferred tax assets, particularly those representing the tax effects of NOL carryovers. This may affect the existence or the amount of valuation allowances for US GAAP purposes or the amount of net deferred tax assets reported under IFRS.

Under US GAAP, the effects, both current and deferred, should be reported as part of the tax provision attributable to continuing operations. Under IFRS, companies should backwards trace the effects of the law changes on existing deferred tax balances in order to determine the portion of the adjustment that should be recognized as part of the tax provision attributable to continuing operations or otherwise recognized as part of the tax provision allocable to other comprehensive income or equity.

Tax Planning Considerations

Deferral of Income/Acceleration of Deductions

Considerations for the scheduled corporate tax rate reduction may include deferring income, accelerating deductions and utilizing any expiring tax provisions. Examples include retaining investments or assets with built-in-gains until later or paying tax deductions in the current year.

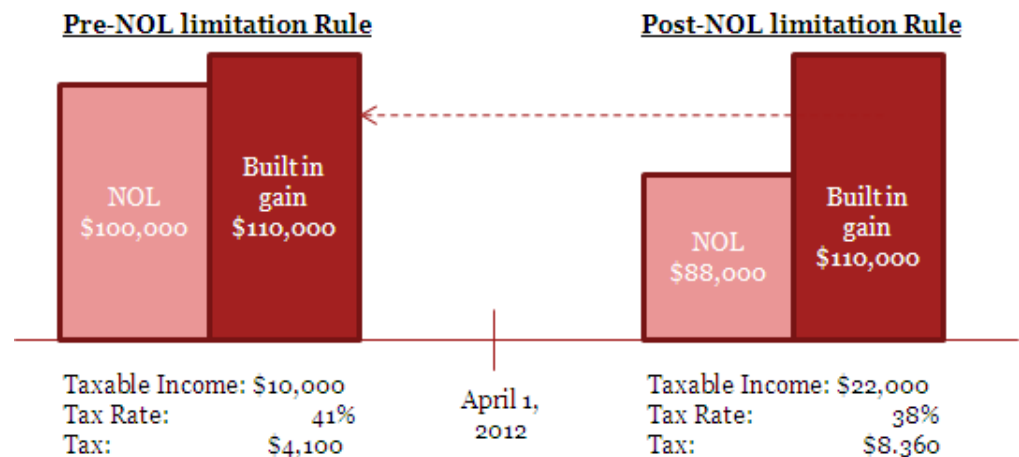
NOL Limitation Considerations

In general, taxpayers will benefit from deferring income and accelerating deductions when tax rates are projected to go down, as stated above. However, when considered collectively with the enacted NOL limitation rule, taxpayers with existing NOL carryovers may wish to accelerate income or defer deductions instead to utilize NOLs before the limitation takes effect.

Even where estimated taxable income exceeds the NOLs and thus the remaining income would be subject to the higher tax rate, taxpayers may still recognize a benefit from accelerating income or deferring deductions. The example below illustrates paying taxes on the excess at the higher rate (approximately 41%) by accelerating income as opposed to selling assets with built-in-gain when the rate is lower (approximately 38%).

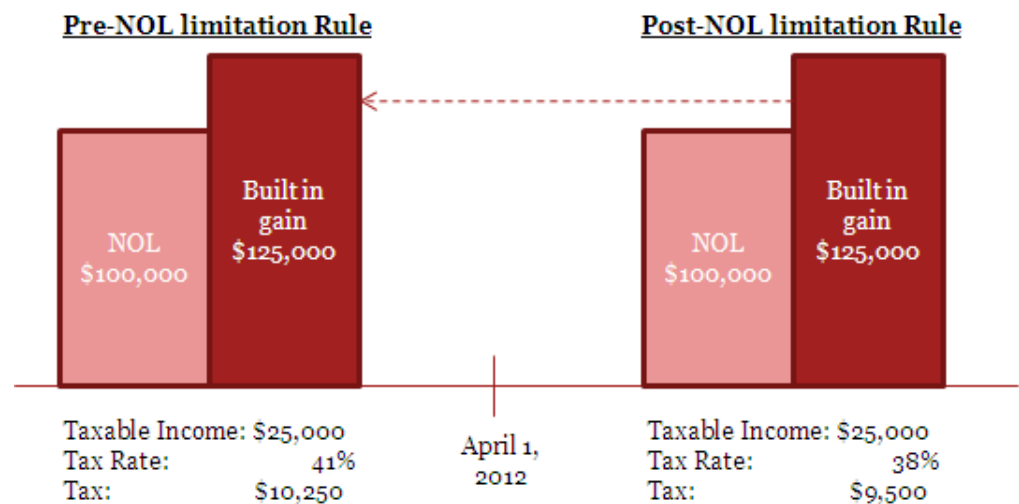
All Scenarios:
NOL carryover = \$100,000

Scenario 1:
Built in Gain = \$110,000



Scenario 1 illustrates that even though built-in-gain is recognized in excess of NOLs and thus subject to the higher tax, a company may still be better off accelerating the income rather than being subject to the NOL limitation and paying the lower tax rate for the excess gain.

Scenario 2:
Built in Gain = \$125,000



On the other hand, Scenario 2 illustrates the situation where NOLs are no longer limited by the NOL limitation rule because the amount of built-in-gain is so large that the 80% threshold no longer affects the NOL utilization. In this case, the taxpayer is better off recognizing the income in the year with the lower tax rate.

In general, therefore, where the amount of available NOL carryover represents 80% or less than the expected taxable income, it may be more beneficial to recognize income in the lower tax period. However, when the amount of NOL available represents greater than 80% of the expected taxable income, it may be more favorable, from a tax standpoint, to recognize the excess income in the period with the higher tax rate. Note that the additional tax due shown above in either period is temporary as the remaining NOLs that could not be utilized are carried forward to offset future taxable income. However, to the extent a company's NOLs may be

expiring and limited by the NOL limitation rule, companies should consider accelerating income or deferring deductions.

Tax Year Change Considerations

Given the scheduled corporate tax rate reduction, companies may wish to consider changing a tax year to accelerate the effective date of the rate reduction. For a company with a December 31 tax year end, the effective date of the lower rate is January 1, 2013. This company could change its tax year to March 31 before April 1, 2012 in order to immediately realize the benefit of a lower tax rate upon enactment of the lower rate on April 1, 2012.

However, given that the net rate reduction will be approximately 2%, the incentive to accelerate the effective date might not be strong. Instead, if a company has significant NOLs, it might want to defer the effective date and postpone the application of the NOL limitation rule. If a company with a March 31 tax year end expects to generate a considerable amount of income in late 2012 and cannot accelerate that income in order to get full utilization of its NOL before the NOL limitation rule takes effect on April 1, 2012, the company could change its tax year end to February 28, which would provide an additional 11 months to offset such income with available NOLs without limitation.

Given that the new rule will be effective as early as April 1, 2012, US companies with Japanese operations should consider the impacts of the corporate rate reduction and NOL limitation at once based on current Japanese NOL positions and future significant transactions.

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