



Financial Services Tax News

Financial Services Tax Group

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2007 Tax Reform on Directors' Remuneration

The 2007 tax reform amended the tax treatment of directors' remuneration under the Japanese Corporate Tax Law. The Japanese National Tax Authorities ("NTA") also released a Q&A in December 2006 and the basic Circular for Corporate Tax Law was revised in March 2007 in respect of directors' remuneration. A summary of these developments follow.

1. The 2007 tax reform

(1) Deductibility of directors' remuneration

In general, the following three types of directors' remuneration are deductible for Japanese corporate tax purposes.

- a) Directors' remuneration paid on a periodic basis (monthly or a shorter interval) in fixed amount ("**Periodic Fixed Remuneration**")
- b) Directors' remuneration where the amount and time of payment are predetermined and a tax report is filed with the relevant tax office ("**Predetermined Remuneration**")
- c) Performance bonuses linked to the company's earnings which satisfy certain prescribed conditions

Under the 2007 tax reform, the requirement has been made clear in part with respect to Periodic Fixed Remuneration and the due date of the tax report for Predetermined Remuneration has amended. These amendments are applicable to the fiscal years commencing on or after April 1, 2007.

i) Directors' remuneration revised by extraordinary reasons

As noted above, Periodic Fixed Remuneration must be paid in fixed amounts in principle to be deductible. The 2007 tax reform made it clear that if a directors' remuneration is revised due to a change of directors' position, the material change of directors' duty or other similar extraordinary reasons, the revised directors' remuneration is also regarded as Periodic Fixed Remuneration irrespective of its revision.

ii) The due date of the tax report

As noted above, Predetermined Remuneration is deductible provided the corporation files a tax report to the relevant tax office within the requisite notice period. The 2007 tax reform has changed the due date, which is now the earlier of

- a) 1 month from the date when the directors' remuneration is approved at the shareholders meeting; or
- b) 4 months from the beginning of the fiscal year for which the relevant director commences his/her duty.

In addition, where a corporation is not a family-owned corporation as defined under the Corporate Tax Law, the 2007 tax reform exempts that corporation from filing the tax report with respect to the Predetermined Remuneration paid to a director who does not receive any Periodic Fixed Remuneration from the corporation.

(2) Directors' remuneration paid by a certain family-owned corporation

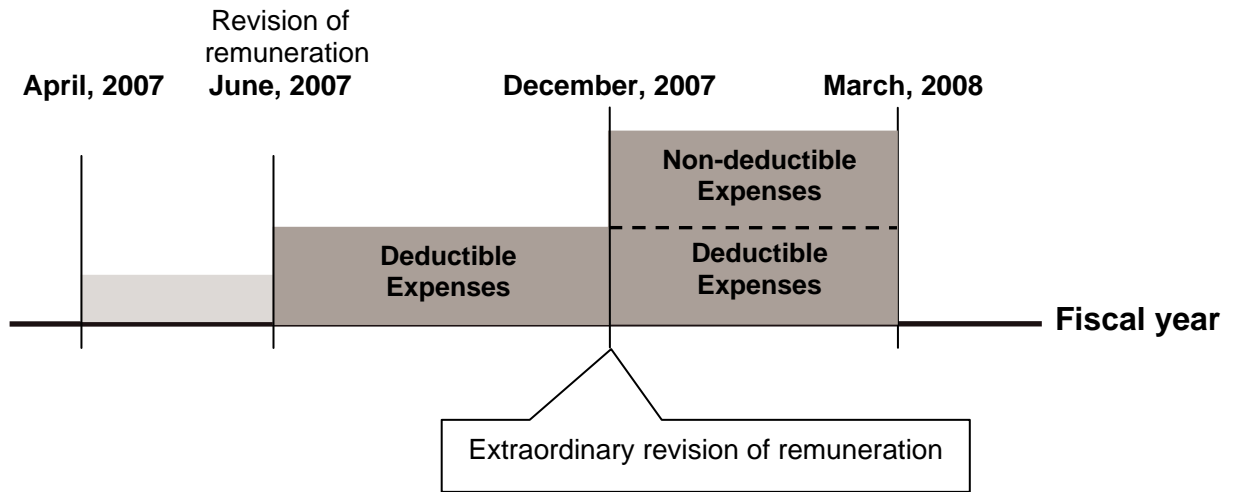
If a family-owned corporation satisfies certain requirements, the Corporate Tax Law limits the deductibility of directors' remuneration paid to a director who manages a family-owned corporation ("**Gyomu Shusai Yakuin**"). The amount subject to this rule is the portion equivalent to the salary income deduction claimed by the Gyomu Shusai Yakuin. This rule was not applicable to a corporation whose adjusted average income during the last three years does not exceed JPY 8M. However, the 2007 tax reform increased this amount from JPY8M to JPY16M.

2. The Q&A

In December 2006, the NTA released a Q&A on its website with respect to the tax treatment of directors' remuneration. The following summarize two cases which deal with the Periodic Fixed Remuneration problems.

(1) Tax treatment when the amount of Periodic Fixed Remuneration is revised

When the amount of Periodic Fixed Remuneration is revised during a fiscal year, for such remuneration to be deductible, the revision must be made within 3 months from the beginning of the fiscal year. For example, where an extraordinary shareholders meeting is held after 3 months from the beginning of the fiscal year and a corporation approves an increase in Periodic Fixed Remuneration at this meeting, it was possible that the total amount of Periodic Fixed Remuneration was not deductible for corporate tax purposes. However, the Q&A suggests that if the fixed amount is paid at each payment date after the revision, only the increased portion is disallowed deductibility but the original remuneration is deductible continuously. (Please refer below chart.)



(2) Tax treatment when directors' remuneration is cut during certain period

When a director is punished with a cut in remuneration for certain period and afterwards the previous full remuneration is paid again, it was possible that the remuneration was not a Periodic Fixed Remuneration because the amount is not fixed throughout the fiscal year. However, the Q&A suggests that if the remuneration is cut for the purpose of maintaining the company's operation or avoiding a bad influence on its reputation and the content of the punishment is appropriate compared with the behavior of the director, the remuneration should be treated as Periodic Fixed Remuneration and deductible in full throughout the fiscal year.

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