

## PwC Japan Tax Newsletter

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Zeirishi-Hojin PricewaterhouseCoopers  
Financial Services  
Kasumigaseki Bldg., 15F  
2-5 Kasumigaseki 3-chome  
Chiyoda-ku, Tokyo 100-6015  
Telephone: 81-3-5251-2400  
<http://www.pwc.com/jp/tax>

\*connectedthinking

## Release of Q&A regarding director's remuneration

On December 17, 2008, the National Tax Agency published guidelines in the form of frequently asked Questions and Answers regarding director's remuneration ("Q&A") on its website. The Q&A covers five cases, including taxation treatment following a revision of a director's remuneration.

By the way of background, the 2006 tax reform amended the corporate tax treatment of director's remuneration with the introduction of Periodic Fixed Remuneration (as defined below) as one form of deductible director's remuneration.

Requirements for Periodic Fixed Remuneration are stipulated in the Corporation Tax Law, Enforcement Order and Circular; however, in practice, there were certain cases where there was no specific guideline in the laws and regulations regarding whether a director's remuneration was deductible. For instance, when a director's remuneration is reduced because of worsening financial conditions of the corporation, it was unclear what kind of specific facts would limit deducting the decreased director's remuneration.

In the Q&A, Question 1 "the treatment following a revision of a director's remuneration due to worsening financial condition" gives some examples specifying reasons to allow a deduction of the reduced director's remuneration. Due to the global economic downturn, many Japanese corporations are now experiencing difficulties in their financial performance and so may consequently decrease a director's remuneration. This Q&A will assist clarifying the tax treatment in such situations.

This newsletter provides a summary of "the treatment following a revision of a director's remuneration due to worsening financial condition".

## Periodic Fixed Remuneration

For Japanese corporate tax purposes, Periodic Fixed Remuneration is deductible as follows:

1. Director's remuneration paid on a periodic basis (monthly or a shorter interval) ("Periodic Remuneration") in a fixed amount.
2. If the Periodic Remuneration is increased or decreased and either of the following conditions is met, the fixed amount before and after the revision:
  - (1) The annual revision is made within three months from the beginning of the fiscal year (or the annual revision is made after three months from the beginning of the fiscal year every year based on special reasons);
  - (2) Director's remuneration is revised due to a change in the director's position, material change of director's duty or other similar extraordinary reason; or
  - (3) Director's remuneration is decreased due to worsening financial condition or a similar situation.
3. The economic benefit is provided to the director on a continuous basis at approximately an equal amount per month

## Worsening financial condition or a similar situation

The Corporation Tax Law Circular states that "due to worsening financial condition or a similar situation" in 2(3) above means "having a reason to be obliged to decrease director's remuneration because of worsening financial condition" (emphasis added). The Q&A reveals that the reason includes not only considerably worsening deficit on financial statements and being on the brink of bankruptcy but also cases where director's remuneration must be decreased in order to maintain relationships with third party stakeholders such as shareholders, lenders and business partners under worsening business conditions.

Examples for the reason taken up in the Q&A are as follows:

1. Director's remuneration must be decreased in order for a director to accept responsibility for mismanagement having caused worsening business and financial conditions.
2. Director's remuneration must be decreased as a result of discussions for rescheduling of loan repayment(s) with a bank(s).
3. Decrease of director's remuneration is included in a revival plan prepared in order to maintain confidence from third party stakeholders due to worsening business and financial conditions.

In addition to the above three examples, the Q&A states that, if there is a reason for decreasing director's remuneration in order to maintain relationships with third party stakeholders under worsening financial conditions, such director's remuneration is generally treated as Periodic Fixed Remuneration. In such a case, it is necessary to be able to explain the reason why director's remuneration must be decreased, if required upon a tax audit.

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

**Zeirishi-Hojin PricewaterhouseCoopers**

Financial Services  
Kasumigaseki Bldg. 15F  
2-5 Kasumigaseki 3-chome  
Chiyoda-ku, Tokyo 100-6015  
Telephone: 81-3-5251-2400  
<http://www.pwc.com/jp/tax>

<b>Partner</b>	Sachihiko Fujimoto	81-3-5251-2423	sachihiko.fujimoto@jp.pwc.com
	Katsuyo Oishi	81-3-5251-2565	katsuyo.oishi@jp.pwc.com
	Yuka Matsuda	81-3-5251-2556	yuka.matsuda@jp.pwc.com
	Tetsuo Iimura	81-3-5251-2834	tetsuo.iimura@jp.pwc.com
	Akemi Kitou	81-3-5251-2461	akemi.kitou@jp.pwc.com
	Hiroshi Takagi	81-3-5251-2788	hiroshi.takagi@jp.pwc.com
	Raymond Kahn	81-3-5251-2909	raymond.a.kahn@jp.pwc.com
	Stuart Porter	81-3-5251-2944	stuart.porter@jp.pwc.com
<b>Managing Director</b>	Marc Lim	81-3-5251-2867	lim.marc@jp.pwc.com
<b>Senior Manager</b>	Kenji Nakamura	81-3-5251-2589	kenji.nakamura@jp.pwc.com
	Yoko Kawasaki	81-3-5251-2450	yoko.kawasaki@jp.pwc.com
	Kimihito Takano	81-3-5251-2698	kimihito.k.takano@jp.pwc.com
	Nobuyuki Saiki	81-3-5251-2570	nobuyuki.saiki@jp.pwc.com
<b>Manager</b>	Akiko Hakoda	81-3-5251-2486	akiko.hakoda@jp.pwc.com
	Mami Sasaki	81-3-5251-2471	mami.sasaki@jp.pwc.com
	Kyoko Imamura	81-3-5251-2855	kyoko.imamura@jp.pwc.com
	Satoshi Matsunaga	81-3-5251-2586	satoshi.matsunaga@jp.pwc.com
	Soichi Toyama	81-3-5251-6212	soichi.toyama@jp.pwc.com
	Takashi Nonaka	81-3-5251-2417	takashi.nonaka@jp.pwc.com
	Hiroko Suzuki	81-3-5251-2156	hiroko.x.suzuki@jp.pwc.com
	Kotaro Fujino	81-3-5251-2036	kotaro.fujino@jp.pwc.com
	Koichiro Ito	81-3-5251-6525	koichiro.ito@jp.pwc.com
	Nobuyoshi Hiruma	81-3-5251-2871	nobuyoshi.hiruma@jp.pwc.com
	Miyuki Kajiwara	81-3-5251-2520	miyuki.m.kajiwara@jp.pwc.com
	Daniel Lutz	81-3-5251-6640	daniel.lutz@jp.pwc.com