



Financial Services Tax News

Financial Services Tax Group

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Tax Treatment of the Remuneration for the Assigned Directors

Following the amendment of the rules regarding the tax treatment of director's remuneration under the 2006 and 2007 tax reforms, a Basic Circular for Corporate Tax Law was issued in March 2007 clarifying the tax treatment of "recharged allowance" for directors assigned to a company who are employees of another company and whose compensations and/or expenses are wholly or partially charged to the company ("Assigned Directors").

This Newsletter provides a summary of the tax treatment of Assigned Director's remuneration under the Basic Circular for Corporate Tax Law issued in March 2007.

1. The former Basic Circular for Corporate Tax Law

Under Article 9-2-34 of the previously issued Basic Circular for Corporate Tax Law ("**Former Circular**"), where an Assigned Director's remunerations and/or expenses were recharged ("Recharged Allowance") to the company ("Assignee Company") of which the Assigned Director was a director, the Recharged Allowance was treated either as a director's periodic remuneration that was tax deductible or an additional bonus that was tax non-deductible, with such determination being controlled by the payment terms agreed between the Assigned Director and the company employing the Assigned Director ("Assignor Company").

2. The new Basic Circular for Corporate Tax Law

The Recharged Allowance is deemed to be a director's remuneration paid by the Assignee Company to the Assigned Director. Under Article 9-2-46 of the new Basic Circular for Corporate Tax Law ("**New Circular**"), if both of the following requirements are met, Article 34 of the Corporate Tax Law, which allows director's remuneration to be deductible for Japanese corporate tax purposes in certain circumstances¹ would be applicable to the Recharged Allowance.

The amount of the Recharged Allowance was approved at the annual shareholder's meeting (including other meetings pursuant to it) of the Assignee Company ; and

An assignment agreement which specifies the assignment period and the amount of the Recharged Allowance has been executed in advance between the Assignee Company and the Assignor Company.

If the Assignee Company applies Article 34 of the Corporate Tax Law to recognize the Recharged Allowance as Predetermined Remuneration, the Assignee Company is required to file a tax report to the relevant tax office within the requisite notice period.

Notwithstanding the March 2007 tax reform proposed in the New Circular, if the amount of the Recharged Allowance paid by the Assignee Company to the Assignor Company exceeds the amount of the remuneration actually paid by the Assignor Company to the Assigned Director, such excess amount is not treated as Recharged Allowance for the Assigned Director and could accordingly not be considered deductible under Article 34 of the Corporate Tax Law.

3. The transitional rule for applying the New Circular

Based on the New Circular, the following transitional rules are applicable to the Recharged Allowance paid in fiscal years beginning between April 1, 2006 and March 31, 2007 and the subsequent period from the next day of the fiscal year end to the revision date of the director's compensation package (the revision must be made within 3 months (4 months for insurance companies) from the day after the fiscal year end).

Even if the amount of the Recharged Allowance is not approved at the annual shareholder's meeting of the Assignee Company, if an assignment agreement specifies the assignment period and the amount of the Recharged Allowance and has been executed in advance, such Recharged Allowance will meet the conditions and the New Circular may be applicable.

Even if the Recharged Allowance is not approved at the annual shareholder's meeting of the Assignee Company and no assignment agreement specifies the assignment period as well as the amount of the Recharged Allowance and has been executed in advance, the amount which is classified as a director's periodic remuneration that would be tax deductible under the Former

¹ In general, the following three types of directors' remuneration if reasonable are deductible for Japanese corporate tax purposes under Article 34 of the Corporate Tax Law.

- 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 ("**Performance Bonuses**")

Circular would be treated as Periodic Fixed Remuneration under Article 34, Paragraph 1 (1) of the Corporate Tax Law.

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