

# Japan Tax Update

Monthly tax update



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## Expected 2007 Tax Reform

In mid-December, a draft bill of the tax reform for the 2007 fiscal year will be released by the Japanese government party. The tax reform has been discussed and proposed by the “Research Working Group on the Taxation System” (“Working Group”), which reports to the Minister of Finance.

On December 1, 2006, the Working Group released a Summary Paper of the the proposed 2007 tax reform, as requested by Prime Minister Abe. The tax reform topics include (1) fixed asset depreciation, (2) amendment to the tax administration of the transfer pricing regime, (3) amendment to the criteria for size-based taxation (corporation enterprise tax), (4) tax legislation in respect of the corporate reorganization rules (which will become effective as of May 1, 2007), the proposed amendment to the trust law and the expected amendment to Japanese GAAP on leasing transactions, and (5) repeal of the preferential tax treatment of capital gains and dividend income from listed stocks.

### 1. Depreciation on fixed assets

Under the current tax rules, a corporation is allowed to claim depreciation on fixed assets of up to 95% of the acquisition cost. Since many developed countries allow a corporation to claim depreciation on the entire amount of the acquisition cost of fixed assets, the Japanese tax law is considered to have a negative affect on the competitiveness of Japanese corporations in the global market. To improve the competitiveness, it is proposed that the 95% ceiling be withdrawn and the depreciation system reviewed, including a review of applicable useful lives and accelerated depreciation methods.

### 2. Amendment to the tax administration of the transfer pricing regime

In recent years, the number of tax assessments and the assessed amounts in relation to transfer pricing has increased as a result of cross-border transactions by Japanese corporations. Such tax assessments cause double taxation issues and increase the tax burden for corporate taxpayers. In order to enhance the certainty of the tax administration for taxpayers, it is proposed that the application of the tax rules be clarified and there be improvements to the APA procedures.

### 3. Amendment to the criteria for size-based taxation

The size-based taxation for corporate enterprise tax was introduced by the 2003 tax reform and is applied to corporations with registered capital of 100 million yen for fiscal years beginning on or after April 1, 2004. Under the tax regime, enterprise tax is calculated based on three different factors: current taxable income, registered capital and value added. Accordingly, an applicable corporation will be liable to tax even if it incurs a loss during the period. To avoid the size-based taxation, some corporations have decreased their registered capital to less than 100 million yen. It is proposed that the criteria for this tax regime be reviewed in order to ensure that the tax imposed on corporations is fair.

### 4. Tax legislation in respect of the corporate reorganization rules (which will become effective as of May 1, 2007) introduced under the new corporation law, the proposed amendment to the trust law and the expected amendment to Japanese GAAP on leasing transactions

It is expected that the new corporate reorganization rules under the corporation law that will become effective as of May 1, 2007 will allow M&A of a Japanese target by a foreign acquirer via a triangular merger. Under the current tax statute, such a corporate reorganization is not classified as a tax qualified reorganization (i.e., the target company as well as its shareholders will be subject to income taxation as a result of the reorganization). It is proposed that the tax statute be amended to enable such triangular mergers to be tax free under specific circumstances to help promote M&A activities in Japan.

On March 13, 2006, the draft bill for the amended trust law was submitted to the Diet for approval. In the amended trust law, the trust scheme has been reviewed on a large scale and various types of trusts have been introduced. To cope with the amended trust law, it is proposed that the tax regime on trusts be reviewed including the taxation on the trust itself as if the trust were a taxable entity.

It is expected that Japanese GAAP on leasing transactions will be revised in 2007 or soon thereafter. In order to align the tax treatment with the new accounting treatment, it is proposed that the relevant tax statute be revised to minimize the tax adjustments required.

### 5. Repeal of the preferential tax treatment of capital gains and dividend income on listed stocks

A preferential tax treatment of capital gains and dividend income on listed stocks was introduced by the 2003 tax reform to activate the capital market and help resolve the bad debts of financial institutions. The tax treatment is effective until December 31, 2007. Since the capital market has become quite active and the bad debt issue of financial institutions has almost been resolved, it has been concluded that no extension of the preferential tax treatment would be necessary.

You have a vision. PricewaterhouseCoopers helps bring that vision to reality. We hope you enjoy the current issue of Japan Tax Update and appreciate your comments or ideas for what you'd like to see covered in future issues.

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