

# Japan Tax Update

Monthly tax update

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## New Tax Treatment of the Seconded Directors' Remuneration

### 1. New Corporate Tax Law Circular 9-2-46

It is a practice for a parent company to second (i.e. transfer) its employee to its Japanese subsidiary company to serve as a director of the subsidiary.

In March 2007, a new Corporation Tax Law Circular dealing with seconded directors remuneration (the "New Circular") was issued by the National Tax Administrative Agency. The New Circular clarifies the applicability of Article 34 of the Corporation Tax Law ("Article 34") to individuals who are seconded to Japan to act as a director of the subsidiary. As discussed in our May 2006 issue, Article 34 generally disallows a deduction for directors remuneration for Japanese corporate income tax purposes unless the payments to the director are (i) fixed monthly payments, (ii) fixed payments in accordance with an advance notice to the tax office, or (iii) are performance bonuses paid in proportion to the company's earnings to directors who engage in the operation of the company's business.

Under the New Circular, a subsidiary corporation (payer company) is able to claim a deduction under Article 34 for the recharged compensation from the parent company with respect to the seconded director if, in addition to satisfying one of the above requirements, both of the following requirements are met:

- (1) The payer company (who bears the recharged costs for the seconded director) had a resolution from its governing body (such as shareholders meeting) approving the payment of the directors remuneration, including those of seconded directors, and
- (2) A Secondment Agreement which specifies the seconding period and amount of the remuneration payment to be charged by the seconding company is executed between the seconding company and the payer company.

Under the former Corporation Tax Law Circular 9-2-34 ("Former Circular"), a payer company was able to claim a deduction for the recharged cost only if the payment by the seconding company to the seconded director satisfied the requirement of being deductible director's remuneration.

Under the New Circular, if the above two requirements are met, the payment of the recharged cost to the seconding company is deemed a payment of directors remuneration, the deductibility thereof which is determined by the application of Article 34.

Accordingly, under the Former Circular, a portion of the recharged cost, if it was characterized as non-deductible director's remuneration based on the payment schedule to the seconded director would also be non-deductible, even if the payment was made in equal monthly installments.

Under the New Circular, it is interpreted that regardless of the actual payment by the seconding company to the seconded director, a payer company is able to claim a deduction for the recharged payment if the payment is made in equal monthly installments.

Note that if the recharged payment is not made in monthly equal installments to the seconding company, the payer company is required to file an advance notice to the tax office based on a payment schedule.

When the recharged payment is larger than the actual payment made by the seconding company to the seconded director, such excess amount will be deductible under Article 22 of the Corporation Tax Law ("Article 22") which prescribes the general rules for deductible expenses/taxable income of a corporation. Therefore, such excess could be non-deductible for Japanese corporate income tax purposes, based on the application of Article 22.

## 2. Application of the New Circular – Transition Rule

Under a transition rule, a payer corporation will still be allowed to claim a deduction for the recharged payment, even if no resolution of the governing body was made. The transition period is applicable to the following fiscal years or periods:

- (1) Fiscal years beginning between April 1, 2006 and March 31, 2007; and
- (2) For the first three months from the beginning of the fiscal year or the period until the date of the annual shareholders meeting, which comes earlier, for fiscal years beginning between April 1, 2007 and March 31, 2008.

Alternatively, if the payer company makes the recharged payment in accordance with the Former Circular (which does not prescribe two requirements under the New Circular) for the above period (1) or (2), such payment shall be treated as tax deductible.

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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