

Japan Tax Update

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

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Introduction of Local Corporate Special Tax

The 2008 Tax Reform introduced the Local Corporate Special Tax ("LCST") as an interim measure to rectify the uneven distribution of local tax revenue and help balance the local government finance. This tax is a new national tax introduced as temporary measure until the substantial revision are made to the current Japanese Tax System along with consumption tax and corporate income tax.

The existing income based enterprise tax rate is reduced and the LCST is established to collect approximately JPY 2.6 trillion of the enterprise tax reduction as a new national tax and to redistributes the tax revenue to the prefectural government.

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1. Background for the introduction of the LCST

The 2008 tax reform introduced the LCST as a temporary measure to balance local government finance until there is fundamental change to the current Japanese tax regime as a whole including changes to consumption tax and corporate tax. The LCST is applicable for corporation from fiscal years beginning on or after October 1, 2008. The LCST tax payment and return filing should be made along with the Enterprise tax.

2. Amendment of the current Enterprise Tax regime and overview of the LCST

(1) Effective date

The LCST is levied on the Enterprise tax liabilities of the going concern enterprise's fiscal year beginning on or after October 1, 2008 or of the liquidating enterprise's (excluding a disappearing entity upon the merger) fiscal period (including provisional liquidation returns) on or after October 1, 2008.

(2) Corporations subject to the LCST

Corporations subject to the Enterprise tax are required to file and pay the LCST.

(3) Computation of tax payable

Taxable base of the LCST

Taxable base of the LCST is computed as income or revenue multiply by the applicable enterprise tax rate. If the enterprise tax rate applied by a prefecture where the business is located is higher than the statutory standard rate, the standard rate would be used.

LCST

The amount of LCST is computed by the taxable base multiply by the applicable tax rate as below.

< Applicable rate of LCST >

| Taxable base | Type of corporation | Tax rate |
|--------------|---|----------|
| Income | Corporations subject to size based enterprise tax | 148% |
| | Other than above | 81% |
| Revenue | - | 81% |

Tax Payment

Both the Enterprise tax and LCST should be paid to the local government. The local government is collecting the LCST on behalf of the national government.

(4) Old and new tax rate comparison

Corporations subject to the size based enterprise tax (e.g., in Tokyo Metropolitan area)

| Corporate enterprise tax | | Business year beginning on or after October 1, 2008 | | Business year beginning before October 1, 2008 | |
|--------------------------|---|---|----------------|--|----------------|
| | | Standard rate | Surcharge rate | Standard rate | Surcharge rate |
| Income base | Annual income 4 million yen or less | (1.5%*) | 1.69% | - | 3.99% |
| | Annual income over 4 million yen up to 8 million yen | (2.2%*) | 2.475% | - | 5.775% |
| | 1) Annual income over 8 million yen 2) A corporation to which the reduced rate above is not applicable** 3) Liquidation income*** | (2.9%*) | 3.26% | - | 7.56% |
| Value added base | | - | 0.504% | - | 0.504% |
| Capital base | | - | 0.21% | - | 0.21% |

*The rate is not applicable for the computation of the Enterprise tax payable, however it is applicable for the computation of a taxable base of the LCST.

**A corporation (i) which has business offices in at least three prefectures, and (ii) the amount of registered capital is 10 million yen or over.

***Applicable to the liquidation income of a corporation who is dissolved on or after October 1, 2008 (excluding a disappearing entity upon the merger).

Corporations not subject to the size based enterprise tax (e.g. in Tokyo Metropolitan area)

| Corporate enterprise tax | | Business year beginning on or after October 1, 2008 | | Business year beginning before October 1, 2008 | |
|---|---|---|----------------|--|----------------|
| Type of corporation | Taxable base | Standard rate | Surcharge rate | Standard rate | Surcharge rate |
| -Corporation -Public interest corporation -Nonjuridical organizations | Annual income 4 million yen or less | 2.7% | 2.95% | 5.0% | 5.25% |
| | Annual income over 4 million yen up to 8 million yen | 4.0% | 4.365% | 7.3% | 7.665% |
| | 1) Annual income over 8 million yen 2) A corporation to which the reduced rate above is not applicable** | 5.3% | 5.78% | 9.6% | 10.08% |
| | Liquidation income | (5.3%*) | 5.78% | - | 10.08% |
| Special corporation (Cooperatives, Medical care corporations) | Annual income 4 million yen or less | 2.7% | 2.95% | 5.0% | 5.25% |
| | 1) Annual income over 4 million yen 2) A corporation to which the reduced rate above is not applicable** | 3.6% | 3.93% | 6.6% | 6.93% |
| | Liquidation income | (3.6%*) | 3.93% | - | 6.93% |
| Electric power suppliers, gas suppliers or insurers | Revenue base | 0.7% | 0.765% | 1.3% | 1.365% |

*The rate is not applicable for the computation of the Enterprise tax payable, however it is applicable for the computation of a taxable base of the LCST.

**A corporation (i) which has business offices in at least three prefectures, and (ii) the amount of registered capital is 10 million yen or over.

***Applicable to the liquidation income of a corporation who is dissolved on or after October 1, 2008 (excluding a disappearing entity upon the merger).

(5) Effective tax rate

The effective tax rate for corporations is not affected by the introduction of the LCST because the tax rate for the LCST was determined in line with the enterprise tax reduction and to keep with effective tax rate the same.

(6) Deductibility of the LCST for Corporation Income Tax

The LCST is deductible for corporation income tax purposes in the year when the tax return is filed because it is not listed as a non-deductible tax payment in Article 38 of the Corporation Tax Law.

(7) Interim tax return filing

Generally, if a corporation's business period exceeds 6 months, an interim tax return should be filed with the relevant tax office and the interim tax payable is computed based on the prior year's tax liability, unless the corporation opts to compute the interim tax liability based on the actual results for the first half

year. However, for the first business year beginning on or after October 1, 2008, there is special measure provided for the interim tax payment.

First business year commenced on or after October 1, 2008

Enterprise Tax: Prior year's Enterprise tax* X 3.3/12

LCST: Prior year's Enterprise tax* X 2.7 /12

*If the sized based tax is applicable, the sum of income based, value added, and capital based enterprise tax.

From the second year

Enterprise Tax: Prior year's Enterprise tax X 6/12

LCST: Prior year's LCST X 6/12

Note: Corporations listed below do not have to file interim return for enterprise tax and LCST

- 1) Corporations (other than corporations with consolidated tax return) with no obligation to file interim tax return for corporate income tax purposes.
- 2) Corporations elected to file consolidated return and the interim tax payment allocable to the corporation is 100,000 yen or less.
- 3) Special Corporation

4. Allocation and Distribution of the LCST by the National Government in the form of Local Corporate Special Transferring Tax

The special local corporate tax is collected as a national tax and it is allocated to each prefectural government based on population of the local residents and the number of employees beginning in the fiscal year of 2009.

For more information, please consult your international tax representative or contact any of the following members listed below:

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

| | | | |
|-------------------|--------------|---------------|--|
| Partner | Mie Onodera | 813-5251-2791 | mie.onodera@jp.pwc.com |
| Managing Director | Yumiko Arai | 813-5251-2475 | yumiko.arai@jp.pwc.com |
| Manager | Jeff Cheng | 813-5251-6532 | jeff.cheng@jp.pwc.com |
| | Yoko Shimada | 813-5251-2024 | yoko.shimada@jp.pwc.com |