

Japan Tax Update

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PwC Japan Tax Newsletter

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Tax Deductible Remuneration Paid to Directors

The deductibility of remuneration paid to company directors has been expanded as a part of the 2006 and the 2007 corporate tax reform. In addition, a new Corporation Tax Law Circular (the "New Circular") dealing with directors remuneration was issued by the National Tax Administrative Agency in March of 2008.

This Newsletter updates our earlier publication of Japan Tax Update released in June and July 2007 on the tax implications of director remunerations and payments.

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Under Corporation Tax Law as of March 2008, the following payments to directors are generally deductible, however, if the payments are unreasonably high, the deductibility is denied on excessive amounts exceeding the reasonable amount.

- fixed monthly payments;
- fixed payments with an advance notice to the tax office; and
- certain performance bonuses paid by public companies in Japan and determined in proportion to the company's earnings for directors who engage in the operation of the company's business.

Fixed monthly payments

General treatments

This type of payment is deductible if the monthly amount is fixed.

The treatments on revision of fixed monthly payments

If the monthly payment amount is increased or decreased due to a resolution made by a shareholders meeting or compensation committee, the monthly payments before and after the revision are deductible as fixed monthly payments when the following conditions are satisfied:

- The annual revision is made within 3 months from the beginning of the fiscal year. If such annual revision is made after 3 months from the beginning of the fiscal year in every year based on the rational reasons, the revision may be acceptable.

For example, rational reasons described above may include the following:

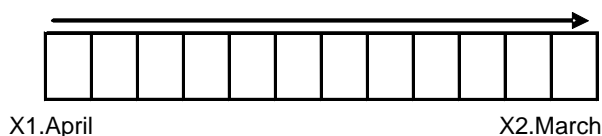
- i) The shareholders meeting is held 3 months after the beginning of the fiscal year due to the acceptance and approval of the financial statement by the relevant ministry and
- ii) Resolution for revision is made after annual shareholder meeting to consider the remuneration in the parent company.
- "A change in the position or responsibility of the director" includes
 - i) The replacement of the representative director during the servicing period (upon the approval of the special shareholders meeting) and
 - ii) The responsibility of the director is substantially changed due to the corporate reorganization (merger or spin off). "A change in the position of the director" is limited to the change in the statutory position as specified in the corporate bylaws or approved in the shareholders meeting or board meeting.
- A decrease in fixed monthly payments due to a worsening of the financial condition or a similar situation. "A worsening of the financial condition of the corporation or a similar situation" described above do not include the conditions of (a) the temporary shortage of cash or (b) less profit than the estimation of corporate earnings.

Monthly economic benefit

The economic benefit provided to director on fixed basis (or approximately equal payments) per month is deductible since it is considered as the fixed monthly payments.

The fixed payment is made on monthly basis

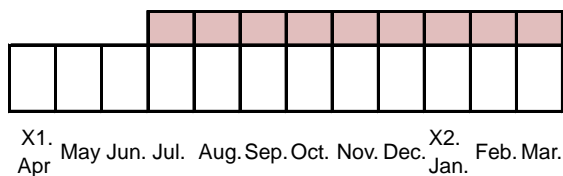
Example of general treatment:



Example of the revision:

The payments after July are increased pursuant to the resolution at annual shareholders meeting on June

(The fiscal year ending is March 31)



Fixed payments in accordance with an advance notice to the tax office

A pre-determined remuneration is deductible provided the company has filed an advance notice with the tax office by the earlier of

- 4 months (5 months for insurance company) from the beginning of the accounting fiscal year or
- 1 month after the earlier date of i) shareholders meeting or board of directors meeting and etc. in which directors remuneration is approved or ii) the day immediately before the relevant director commences the provision of his/her services if it is earlier than the date of shareholders meeting.

For the purpose of fixed payments under advance notice to tax office, “the day immediately before the relevant director commences the provision of his/her services” is the day of shareholders meeting if the director is assigned at the shareholders meeting.

If the payment amounts by an advance notice to the tax office are different from the actual amounts paid, in principle, all payments are not deductible. In addition, any non-monetary remuneration is not included for this type of payment since it is not considered as “fixed payment”. The deductibility of stock option fee by the issuing company, when stock options are granted as incentive non-monetary remuneration, is not subject to the above requirements but it is deductible if the requirement prescribed in Article 54 of the Corporation Tax Law is met.

Certain non-fixed payment(s) made to a director will be deductible without advance notice if the corporation making the payments is not a family corporation as defined the corporate tax law.

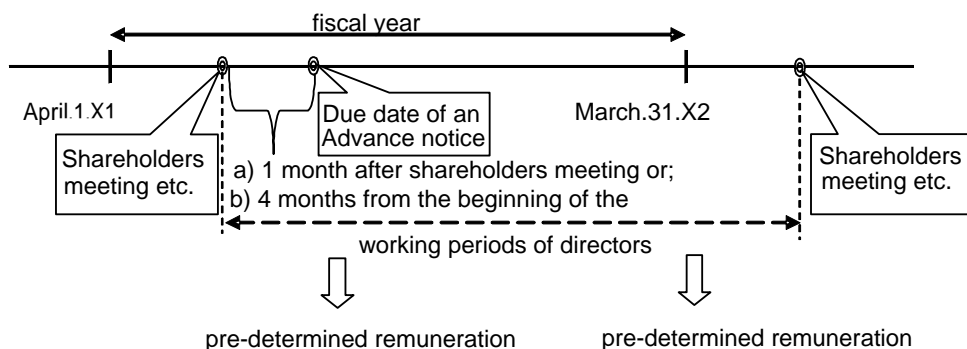
If the company is newly established, the due date of an advance notice is 2 months from the establishment. Further, if the company revises fixed the payments as the result of the unexpected event such as a change in the position of the director, a worsening of the financial condition and etc. the filing due date of the revised notice is 1 month after an occurrence of the event.

A company who already filed an advance notice is able to file the revised notice in accordance with the occurrence of the event (within 1 month after an occurrence of the event) such as a change in the position of the director, a worsening of the financial condition and etc.

Certain performance bonuses paid by public companies in Japan in proportion to the company's earnings for directors who engage in the operation of the company's business are deductible.

Deduction for this type of

Outline of fixed payment with an advance notice



Payment can only be claimed by a company who is subject to an external audit pursuant to the Japanese Securities Exchange Act (essentially companies listed in the Japanese capital markets). A bonus that is determined in proportion to the company's earnings is deductible provided the following conditions are satisfied:

- The remuneration is paid to directors who engage in the operation of the company's business (excluding family companies or group subsidiary companies).
- The remuneration formula is determined by shareholders' meeting, compensation committee, audit committee or any similar organization within 3 months from the beginning of the fiscal year.
- The remuneration formula and the definition of profit to which the formula is applied (by class of directors) is disclosed in the Japanese 10-K (a report that filed by listed companies similar in other countries disclosing information relating to financial position and corporate activities).
- The remuneration to be paid to each operating director (with prescribed ceiling) is calculated using the same formula. "Prescribed ceiling" described above should show a specific amount. Also, the applied formula is to be disclosed by the title and not necessary on individual name basis to comply.
- The remuneration is paid or expected to be paid within 1 month after the profit of the company is approved at the shareholders' meeting.
- The amount of the remuneration is recognized as an expense in the company's income statement.

The Seconded Directors' Remuneration

Under the New Circular, a subsidiary corporation (Payer Company) may claim a deduction for the recharged compensation from the parent company with respect to the seconded director if one of the above requirements and 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 for the 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.

A payer company can claim a deduction for the recharged cost only if the payment by the seconding company to the seconded director satisfies the deduction requirement of director's remuneration (fixed payment and advance notice).

When the recharged payment is larger than the actual payment made by the seconding company to the seconded director, the excess amount is not deductible.

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

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