

International Assignment Services Alert

2011 & 2012 Tax Reforms and impact on individual taxpayers in Japan

January 2012



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On November 30, 2011, the Japan Diet approved the “Amendment to the 2011 Tax Reform Bill” and the “Special Measures to Secure the Financial Resources to Implement the Restoration from the Tohoku Earthquake Bill”. Furthermore, on December 10, 2011, the Japan Tax Commission released their 2012 proposed tax reforms.

The focus of this alert is on the aforementioned bills which have been signed into law, and on the 2012 proposed income tax reforms and their impact on individual taxpayers in Japan.
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1. Outline

Apart from the earthquake restoration surtax of 2.1% which will take effect from 2013, the 2011 tax reforms signed into law do not result in increases to the individual tax rates. Rather the government has decided to defer and include most of the original proposed 2011 tax increase reforms to the 2012 proposals that are expected to be introduced in the Diet in January 2012.

2. Special Measures to Secure the Financial Resources to Implement the Restoration from the Tohoku Earthquake Bill

The Special Measures Bill to help fund the restoration of the Tohoku area passed into law a temporary (albeit long-term) surtax that effectively increases the National tax rate for resident and non-resident taxpayers. The 2.1% temporary surtax on National income tax will be in effect from January 1, 2013 until December 31, 2037. It is a separate tax that is based on the National income tax liability (not calculated on the Local Inhabitants tax liability) and is applicable to residents and non-residents of Japan. This will apply not only to National income taxes calculated on an individual's tax return but also on income taxes withheld at source.

Please find a summary below of the effective increases starting January 1, 2013 in the National Tax Rates:

	Current Rate	New Tax Rate
National Resident Tax (maximum)	40%	40.84%*
National Non-Resident Tax	20%	20.42%
National Withholding Tax on Japan Interest Income	15%	15.315%**
National Withholding Tax on Dividend Income from Listed Securities	7%	7.147%***
National Withholding Tax on Fees and Other Consideration	10%-20%	10.21%-20.42%

*Combined with the flat 10% Local Inhabitants tax, the top Japan tax rate will increase from 50% to 50.84%. As indicated above, the surtax is not applicable to Local Inhabitants tax. Instead, there will be a temporary 10-year 1,000 yen increase in the Local Inhabitants per capita tax starting January 1, 2014 (the current per capita tax is 4,000 yen for residents of the 23 wards in Tokyo).

**Combined with the flat 5% Local Inhabitants tax, the withholding tax on Japan interest income for residents will increase from 20% to 20.315%.

*** Combined with the flat 3% Local Inhabitants tax, the withholding tax on dividend income from listed securities for residents will increase from 10% to 10.147%.

3. Amendment to the 2011 Tax Reform Bill

The highlights of the 2011 tax reforms that were signed into law affecting individual taxpayers include:

- **Extension of the statute of limitations to file Requests for Downward Assessments** - Requests for downward assessments (refunds) were, in general, previously restricted to one year after the filing due date of the original income tax return. The new law extends the statute of limitations to 5 years from the original filing due date. However, the statute of limitations for the tax authorities to make an upward assessment to a taxpayer's tax liability under normal circumstances will be extended from 3 years to 5 years. As such, this would allow for tax audits covering the previous 5 tax years instead of the previous 3 tax years. This change is applicable for tax returns with a filing due date after December 2, 2011.
- **Increase in Foreign Tax Credits to be Allowed in Amended Tax Returns and through Downward Assessment Requests** – The tax authorities are allowing more potential requests for downward assessments by changing the rules on when they may be applicable. For instance, under the previous law, the tax authorities were not obligated to allow amendments which resulted in an increase in a taxpayer's foreign tax credit limitation or for additional foreign tax credits that were not claimed on the original tax return (only a downward change to the foreign tax credit was permitted). This new law will essentially not restrict the foreign tax credit to the amount originally claimed and thereby offer relief from potential double-taxation.
- **Local Inhabitants Tax on Retirement Income** - The credit against the local inhabitants tax on taxable retirement income paid from a company in Japan, thereby lowering the effective local inhabitants tax rate from 10% to 9%, is eliminated starting with taxable retirement payments on or after January 1, 2013.

4. 2012 Proposed Tax Reforms

(1) Employment Income

Current Law: An employment income deduction is allowed to all taxpayers with employment income. The deduction is calculated according to a prescribed table based on the amount of gross employment income and is deducted from employment income before applying any other deductions. This employment income deduction effectively reduces the top tax rate on employment income from 50% to 47.5% for taxpayers with taxable income in excess of 18 million yen.

Proposed Changes: The tax reform limits the employment income deduction to a maximum of 2.45 million yen. This limit is achieved when gross employment income reaches 15 million yen. Therefore, for high income earners, their tax rate on employment income above 18 million yen will increase from an effective 47.542% to the top bracket rate of 50.84% (including the new surtax).

Please find below, a side-by-side comparison of how this change will affect a single expatriate employee paid from outside of Japan with 25 million yen of gross employment income (using the tax brackets currently in effect):

	Current Law	Proposed Tax Reform	Change (in %)
Gross Employment Income	25,000,000	25,000,000	0
Employment Income Deduction	(2,950,000)	(2,450,000)	-16.95%
Income after Earned Income Deduction	22,050,000	22,550,000	+2.27%
Standard Deduction	(380,000)	(380,000)	0
Taxable Income	21,670,000	22,170,000	+2.31%
Combined National and Local Tax Liability	8,045,500	8,424,000*	+4.70%

*This also includes the 2.1% surtax on the National Income tax.

This proposed tax reform is scheduled to take effect starting January 1, 2013 if passed into law.

(2) Retirement Income

Registered directors who have served for 5 years or less will not receive the one-half exclusion of their retirement income payments, as is allowed under existing tax laws. Without this one-half exclusion, the taxation of retirement income for registered directors with 5 years or less service with a company will be similar to the taxation of employment income, which means the taxation could reach close to the top tax rate of 50.84%.

This proposed tax reform is scheduled to take effect starting January 1, 2013 if passed into law.

(3) Reporting of Offshore Equity and Equity-Based Income

It has been proposed that starting with the 2012 tax year, equity and other compensation income related to a company's stock price paid in 2012 to employees and directors resident in Japan from an offshore company would need to be reported to the tax authorities by March 31, 2013 by the offshore company's subsidiary or branch office in Japan.

The reform proposal indicates that the requirement would apply to Japanese subsidiaries that are owned 50% or more by a foreign entity or Japan branch offices of a foreign entity that provide or pay the equity compensation or equity related benefits.

(4) Reporting of Overseas Assets

In an effort to improve compliance and enforcement of the reporting of income from overseas assets, it has been proposed that a new report, due March 15th of the following year, be required for residents of Japan to complete and file to disclose their assets outside of Japan if these offshore assets exceed 50 million yen.

In connection with this potential new requirement, it has also been proposed that the penalty taxes in connection with the overseas assets be either increased or decreased by 5% depending on the proper disclosure of the overseas assets. If the penalty tax is due to an understatement of income from the overseas assets but these overseas assets have been properly disclosed on the report, then the penalty tax rate will be reduced by 5% (also applicable to inheritance tax where there has been an understatement of reportable assets). Conversely, if the penalty tax is due to an understatement of income from the overseas assets and these overseas assets were not properly disclosed on the report, then the penalty tax rate will be increased by 5% (only applicable to income tax and not inheritance tax).

If these proposed reforms are signed into law then the form would be required for assets covering the 2013 calendar year and due on March 15, 2014.

(5) Specific Work Related Expenses Deduction

The specific work related expenses qualifying for a deduction in excess of the employment income deduction have been expanded to include expenses incurred to qualify or maintain one's professional certifications (e.g., CPA license) and expenses directly related to the performance of one's job functions (e.g., books and training). However, caps and limitations on this deduction have also been introduced, especially for individuals with employment income in excess of 15 million yen.

This proposed tax reform is scheduled to take effect starting January 1, 2013 if passed into law.

5. Summary

PwC recommends that employees and their companies start thinking about the potential implications of the new tax laws and the 2012 proposed tax reforms and how these changes may impact their business.

Please contact one of our PwC Tokyo representatives listed below and he can discuss the potential ramifications with you in more detail.

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

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