

Japan Tax Update

Proposed 2011 Tax Reform

Issue 59, February 2011



On January 25, 2011, the draft bill of the 2011 tax reform was submitted to the Diet for an approval. If the proposed 2011 tax reform, which, notably, would reduce the corporate tax rates by approximately 5% and limit the use of net operating loss carryforwards to 80% of current taxable income, is promulgated on March 31, 2011, the amended tax law is expected to take effect generally for fiscal years beginning on or after April 1, 2011

The proposal will be debated by the Diet in March. As the Prime Minister's party, the Democratic Party of Japan, has lost its majority in the House of Councillors and does not hold a two-thirds majority in the House of Representatives, prospects for the proposal's enactment appear more uncertain in comparison to prior years.

Corporate Tax

Japan's corporate taxes consist of three parts; a national tax, an inhabitants tax, and a local enterprise tax. Under the proposal, the national tax rate would be reduced from 30% to 25.5%. Consequently, the inhabitant tax, which is based upon a percentage of the national tax, would also be reduced. In aggregate, large corporations located in the Tokyo Metropolitan Area could see their effective tax rates reduced from 40.69% to 35.64%.

In order to offset an expected revenue loss from the corporate tax rate reduction, the legislation proposes to broaden the taxable base by:

- 1) limiting the net operating loss (NOL) deduction in any year to 80% of taxable income; however, the NOL carryforward period would increase from seven to nine years for losses incurred in the tax years ending on or after April 1, 2008.
- 2) deferring tax deductions by limiting the use of accelerated depreciation. The current depreciation rate of 250% (i.e., the 250% declining balance method) would be reduced to 200%;
- 3) eliminating gradually bad debt deductions by 25% annually with eventual abolishment of the allowance by 2014;
- 4) lowering the deductible donation expense to 50% of its current level;

- 5) lowering the current cap on the R&D tax credit (R&D expenditure based credit) from 30% to 20% of a corporation's tax liability; and
- 6) abolishing the special depreciation for certain qualified facilities (e.g., certain energy infrastructure facilities) and reserve.
- 7) revise the FTC (foreign tax credit) rules.

It should be noted that the amended tax law are expected to be generally applicable for tax years beginning on or after April 1, 2011. However, the depreciation changes are expected to be applicable for fixed assets acquired on or after April 1, 2011.

As a result, a corporation with a March 31 year end will be subject to the new tax rules (e.g., reduced tax rate and NOL limitation rules) from the tax year beginning April 1, 2011. On the other hand, a corporation with the December 31 tax year end will be subject to the new tax rules from the tax year beginning January 1, 2012 as long as the existing fiscal year is maintained.

This newsletter is prepared based on the outline of the draft bill of the 2011 tax reform released on January 25, 2011. The annual tax reform is usually approved by the Diet by the end of March. The full details of the amended tax laws will not be clarified until Diet approval has been received, and Cabinet Orders or Enforcement Orders enacting the changes issued.

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	Yoko Kawasaki	81-3-5251-2450	yoko.kawasaki@jp.pwc.com
	Akemi Kito	81-3-5251-2461	akemi.kitou@jp.pwc.com
	Jun Takashima	81-3-5251-2574	jun.takashima@jp.pwc.com
	Jack Bird	81-3-5251-2577	jack.bird@jp.pwc.com
Managing Director	Ken Leong	81-3-5251-2945	ken.leong@jp.pwc.com
	Yumiko Arai	81-3-5251-2475	yumiko.arai@jp.pwc.com

The Tax Practice of PricewaterhouseCoopers Japan (Zeirishi-Hojin PricewaterhouseCoopers) is one of the largest professional tax corporations in Japan with about 540 people. In addition to tax compliance services our tax professionals are experienced in providing tax consulting advice in all aspects of domestic/international taxation including financial and real estate, transfer pricing, M&A, group reorganization, global tax planning, and the consolidated tax system to clients in various industries.

PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 161,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice. See pwc.com for more information.

This document has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this document without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this document, and, to the extent permitted by law, Zeirishi-Hojin PricewaterhouseCoopers, its employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this document or for any decision based on it.

© 2011 Zeirishi-Hojin PricewaterhouseCoopers. All rights reserved.

In this document, "PwC" refers to Zeirishi-Hojin PricewaterhouseCoopers, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.