

Japan Tax Update

Tohoku Earthquake and special tax legislation

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Tohoku Earthquake and special tax legislation

On April 27, 2011, special national tax laws to help deal with the Tohoku Earthquake including associated amendments to the local tax laws were promulgated and immediately became effective (“Tohoku Legislation”). These tax laws are intended to provide special tax relief for affected individuals or corporations. For this purpose, the Tohoku Earthquake includes the associated tsunami and Fukushima nuclear crisis.

Additional legislation which is intended to help restore and to promote investment in the affected areas is expected to be released this summer.

This newsletter covers the following matters related to the Tohoku Legislation:

1. Summary of tax relief
2. Individual income tax relief
3. Corporate tax relief
4. Other tax relief

1. Summary of the tax relief provided under the Tohoku Legislation

For individual income tax purposes, qualifying individuals are allowed (a) disaster loss deductions, (b) tax exemptions under the Disaster Relief Law, (c) tax deductions for qualifying donations and (d) tax credits for qualifying housing loans.

For corporate tax purposes, qualifying corporations are entitled to (a) tax loss carry-backs, (b) withholding tax refunds upon the filing of an interim tax return, and (c) special depreciation for new assets which replace destroyed assets.

Tax reductions or exemptions are also provided for stamp duty, real property acquisition tax and fixed asset tax.

2. Special tax relief provided for individual income tax

(1) Special tax relief for disaster losses

Individuals who suffered disaster losses on their residence or other property may claim, by election, disaster loss deductions under the Income Tax Law or tax exemptions under the Disaster Relief Law.

Disaster losses are deductible from 2010 taxable income (for this purpose the Tohoku Earthquake is deemed to have occurred in 2010) and any excess losses may be carried forward for 5 years. If a tax exemption is elected, such relief is also effective in 2010. Since local tax in 2011 is based upon 2010 income, the 2011 local tax liability is also affected accordingly.

	Elective tax relief relating to disaster losses									
	Disaster loss deductions provided under the Income Tax Law	Tax exemptions provided under the Disaster Relief Law								
Basic rules prior to the Tohoku Legislation	<ul style="list-style-type: none"> Disaster losses* on a residence or other property may be claimed in the year of loss for the greater of (i) disaster losses in excess of 10% of total income or (ii) disaster related expenditures in excess of 50,000 yen. Excess losses not deductible may be carried forward for three years. <p>*Disaster losses + disaster related expenditures – insurance proceeds</p>	<ul style="list-style-type: none"> Tax liability is reduced or eliminated based upon an individual's income bracket if the disaster loss is in excess of 50% of the fair market value of the residence or other property. <table border="1"> <thead> <tr> <th>Income bracket</th> <th>Tax reduction/exemption</th> </tr> </thead> <tbody> <tr> <td>5 million yen or less</td> <td>100% exempt</td> </tr> <tr> <td>5 – 7.5 million yen</td> <td>50% exempt</td> </tr> <tr> <td>7.5- 10 million yen</td> <td>25% exempt</td> </tr> </tbody> </table>	Income bracket	Tax reduction/exemption	5 million yen or less	100% exempt	5 – 7.5 million yen	50% exempt	7.5- 10 million yen	25% exempt
Income bracket	Tax reduction/exemption									
5 million yen or less	100% exempt									
5 – 7.5 million yen	50% exempt									
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Special tax relief under the Tohoku Legislation	<ul style="list-style-type: none"> The disaster loss is deemed to have occurred in 2010. Excess disaster losses not deductible in 2010 may be carried forward for 5 years. 	The disaster loss is deemed to have occurred in 2010.								
Requirements for the application of the Tohoku Legislation relief	Elect the above special tax relief in the original 2010 tax return, 2010 amended tax return or a request for a downward correction of the 2010 tax return.	(i) Elect the application of the above special tax relief, (ii) provide an explanation of the disaster loss and (iii) estimate the loss amount in the 2010 tax return, 2010 amended tax return or a request for the downward correction of 2010 tax return.								

(2) Special tax treatment for monetary donations relating to Tohoku Earthquake

For donations by individuals which relate to the Tohoku Earthquake disbursed from March 11, 2011 through December 31, 2013, to certified NPOs or the Central Community Chest of Japan, (a) the maximum deductible amount is increased and (b) a tax credit may be claimed instead of an income deduction.

Applicable for individual income tax returns for 2011, 2012 and 2013		Donations relating to the Tohoku Earthquake	
		Donations to the national government or the local governments in the affected area	Designated donations to certified NPOs or the Central Community Chest of Japan
Income deduction	Income deduction is claimed for up to 80% of the total income	Applicable	Applicable by election
Tax credit	Tax credit is claimed for up to 40% of the total income	Not applicable	

(3) Tax credits for housing loans and tax exemptions for interest income from the cancellation of *zaikei* deposits

Individuals who previously were eligible for housing loan tax credits will be allowed tax credit in the residual years for both national and local tax purposes regardless of whether the residence is usable as a residence due to the Tohoku Earthquake.

Those who contracted *zaikei* contribution deposit (a type of deferred retirement bank deposit) and cancelled such deposits during the period between March 11, 2011 and March 10, 2012 due to the the Tohoku Earthquake, the interest income will not be subject to the withholding tax for national and local tax purposes (and thus essentially becomes exempt from tax).

3. Special tax relief provided for corporate tax

(1) Corporate tax refunds for loss carry-backs

Under current law, one year tax loss carry-backs are allowed for small and medium corporations (SMCs). Other corporations are allowed a one year tax loss carry-back in the year of liquidation. In the Tohoku Legislation, corporations which incurred a specified disaster loss from the Tohoku Earthquake (the “Tohoku Earthquake Disaster Loss”) may carry back such loss for two years for national tax purposes. Such carry-back may be elected either with the annual corporate tax return or an interim tax return based upon a full interim closing of the corporate books. For local tax purposes, the tax loss carry-back is not applicable although carry-forward of all losses (including the Tohoku Earthquake Disaster Loss) is allowed over the normal seven year carry-forward period.

Applicable tax year and tax return	Carry-back years	Refundable tax amount
Final tax return for tax year ending between March 11, 2011 and March 10, 2012	Tax years beginning within two years from the first date of the tax year when the Tohoku Earthquake Disaster Loss is incurred	$\text{Tax liability of carry-back year} \times \frac{\text{Tohoku Earthquake Disaster Loss}}{\text{Taxable income of carry-back year}}$
Closing basis interim tax return for interim period ending between March 11, 2011 and September 10, 2011	Tax years beginning within two years from the first date of the interim period when the Tohoku Earthquake Disaster Loss is incurred	

(2) Refund of withholding tax paid by interim tax return

A corporation which incurred a Tohoku Earthquake Disaster Loss for the interim period ending between March 11, 2011 and September 10, 2011 may claim a refund of withholding tax paid by filing a closing basis interim tax return. The refundable amount is withholding tax paid in excess of the corporate tax payable per the interim tax return subject to limitations based upon the Tohoku Earthquake Disaster Loss amount.

(3) Special depreciation for newly acquired assets relating to the Tohoku Earthquake

A corporation may claim a special depreciation of certain assets in the year of acquisition in addition to normal depreciation. The qualified assets should be acquired and placed in service between March 11, 2011 and March 31, 2016 and satisfy either (i) or (ii) below:

- (i) Newly acquired assets to replace Tohoku Earthquake destroyed assets including
 - a. Buildings, structures, machinery or equipment
 - b. Registered vessels, aircraft or vehicles, or
- (ii) Newly acquired assets placed in service in a business carried out at the affected area* including
 - a. Buildings, structures, machinery or equipment

* Areas where destroyed buildings or structures were located and surrounding areas where machinery or equipment were installed.

	Special depreciation rate applicable to the assets acquired and put into service between March 11, 2011 and March 31, 2014		Special depreciation rate applicable to the assets acquired and put into service between April 1, 2014 and March 31, 2016	
	SMCs	Other than SMCs	SMCs	Other than SMCs
Buildings, structures	18%	15%	12%	10%
Machinery, equipment	36%	30%	24%	20%
Registered vessels, aircraft, vehicles				

(4) Rollover relief given to the newly acquired assets to replace old assets

Under the current statutes, up to 80% of the capital gain realized when a corporation acquires an asset to replace an old one may be deferred. Under the Tohoku Legislation, for certain assets acquired between March 11, 2011 and March 31, 2016, the entire amount of capital gain may be deferred. Qualified replacement assets include the following:

- (i) Real estate or depreciable assets located in Japan purchased to replace real estate (including buildings or structures fixed to the land) in the affected area that had been acquired prior to March 11, 2011.
- (ii) Real estate or depreciable assets purchased in the affected area to replace real estate, buildings or structures located other than in the affected area.

When applying the rollover relief rules, the due date for acquiring replacement assets is extended for a further two years if it is difficult to acquire the replacement asset by the normal due date as a result of the Tohoku Earthquake.

Applicable transaction	(i) Acquiring replacement assets due to expropriation (ii) Acquiring certain other replacement assets
Cases where the extension will be approved	Difficulty in acquiring replacement assets by the normal due date which falls within a tax year which ends between March 11, 2011 and March 31, 2012
Requirements for applying the extension	(i) A corporation expects to acquire the replacing asset within the designated period (up to 2 years). (ii) A corporation expects to place the replacing asset in service within 1 year from acquisition date (excluding replacement assets due to expropriation). (iii) Extension is approved by the chief of the appropriate tax office.
Filing of the application form	The application form should be filed within two months from the beginning of the tax year following the transferring year

The tax relief for (3) and (4) above are also applicable for the purpose of enterprise tax and inhabitants tax.

4. Special tax relief provided for other taxes

(1) Consumption tax

The deadline for filing certain consumption tax application forms (e.g., taxpayer elections) has been extended.

(2) Stamp duty

Those contracts prepared for the period between March 11, 2011 and March 31, 2021 for the purpose of the following will be exempt from stamp duty.

- Loan contracts for affected persons made by a local government or government-affiliated financial institution
- Real estate transfer contracts or real estate construction contracts for affected persons

(3) Local taxes

In addition to the measures discussed above, other specific enterprise and inhabitants tax measures were passed to allow for specific reduced rates or tax exemptions in specific areas. Terms are likely to vary by prefecture and locality.

In addition, fixed assets taxes for 2011 is eliminated for real estate located in the affected area.

Also, real estate acquisition tax on real estate acquired to replace affected real estate up to March 31, 2021 is eliminated.

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