

Japan Tax Update

Special Tax Measures for Tohoku Earthquake Restoration

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On October 28, and November 4, 2011, the Government submitted to the Diet three draft Bills: “Special Measures to Secure the Financial Resources to Implement the Restoration from the Tohoku Earthquake” (“Special Tax Bill”), “Amendment to the 2011 Tax Reform Draft Bill” (“Amendment Bill”), and “Amendment to the Special Measures to Restore the Tohoku Earthquake Affected Areas” (“Special Relief Bill”).

Those Bills cover introduction of surtax to fund restoration, implementation of the original 2011 proposed tax reform (lowering tax rate and increasing the tax base) and corporate tax investment incentives to restore the Tohoku Earthquake affected areas.

This Japan Tax Update discusses tax incentives as well as tax changes contained in the above Bills which apply to mainly corporate taxpayers.

1 Special Tax Bill

(1) Introduction of special tax measures to fund restoration

On October 7, 2011, the Cabinet approved the third Supplementary Budget for this fiscal year and the Basic Policy for Funding the Restoration from the Tohoku Earthquake (“Basic Policy”). According to the Basic Policy, the Japanese Government estimated that the restoration cost for the Tohoku Earthquake would be 11 trillion yen. In addition, the Government adopted as part of the Basic Policy the intention to fund 9 trillion of the restoration costs by adopting temporary tax measures.

The Special Tax Bill contains temporary tax measures which apply to income tax, corporation tax, and individual inhabitant tax. Current discussions have indicated that the temporary tax measures are intended to last for three to 10 years (likely to be extended to 25 years, according to the information available as of November 18).

With respect to corporation tax and income tax, a temporary surtax (“Restoration Surtax”) will be introduced with the following basic provisions (see the following table).

Those who file final tax returns will be obliged to file tax returns for Restoration Surtax (“Surtax tax returns”) by the filing due date of the final tax returns.

Tax payer will claim credit for the Surtax levied on the withholding income tax (“Withholding Surtax”)

from the Corporation Surtax or Income Surtax, or claim a refund of the Withholding Surtax, if any, by filing the Surtax tax returns.

Restoration Surtax will not be levied on local tax, consequently, only the national withholding tax on income such as dividend, interest etc., will be subject to the Withholding Surtax.

A non-resident or a foreign corporation who is not obliged to file final tax returns will be only subject to the Withholding Surtax. If the non-resident or foreign corporation is a resident of a tax treaty country with Japan, dividend, interest and royalties will not be subject to the Withholding Surtax to the extent that the applicable rate agreed in the tax treaty is lower than the aggregate domestic rate.

	Corporation Surtax	Income Surtax
Tax base	Corporation tax before (1) surtax on special family corporation, (2) income tax credit, (3) foreign tax credit (“FTC”), (4) tax deduction upon downward correction, etc. (“Base Corporation Tax”)	Income tax before FTC (“Base Income Tax”) by different category of taxpayers <ul style="list-style-type: none"> • Permanent resident: Base Income Tax on world-wide income • No-Permanent resident: Base Income Tax on domestic source income and remitted or domestically-paid foreign source income • Non-resident: Base Income Tax on domestic source income • Domestic corporation: Base Income Tax (i.e., withholding tax) on income including interest, dividend, etc. • Foreign corporation: Base Income Tax (i.e., withholding tax) on domestic source income including interest, dividend, etc.
Surtax rate	10%	4%(likely to be reduced to 2.1% in accordance with extension of the period according to the information available as of November 18)
Person who bears/withholds the tax	Taxpayer of corporation tax	Taxpayer of income tax and withholding tax
Periods effected	Three year period from the first fiscal year which begins during the period between April 1, 2012 and March 31, 2015	<ul style="list-style-type: none"> • Income tax levied on resident or non-resident for the income earned from 2013 through 2022 (likely to be extended to 2037, according to the information available as of November 18) • Withholding tax levied on the income earned by domestic corporation or foreign corporation for the period from January 1, 2013 through December 31, 2022 (likely to be extended to 2037, according to the information available as of November 18)
Tax return filing/ tax payment	<ul style="list-style-type: none"> • Taxpayer will be obliged to file the Surtax tax return as well as the final tax returns unless there is no tax liabilities • Taxpayer will pay the Corporate Surtax together with the corporate tax liabilities • Withholding Surtax will be credited from the Corporate Surtax or will be refunded by filing the Surtax tax return 	<ul style="list-style-type: none"> • Taxpayer will be obliged to file the Surtax tax return as well as the final tax return if obliged to file the final tax returns • Taxpayer who is not obliged to file the final tax returns will be only subject to the Withholding Surtax (and Interim Surtax if interim tax is to be paid) • Taxpayer will pay the Income Surtax together with the income tax liabilities • Withholding Surtax will be credited from the Income Surtax or will be refunded by filing the Surtax tax return

(2) Implementation of the original 2011 proposed tax reform

Prior to the Tohoku Earthquake, it was expected that there would be a number of proposals which would be adopted which would lower the corporate tax rate as well as broaden the tax base. These discussions in the Diet suspended after March 11, 2011, especially with regard to the lowering the corporate tax rate, under the circumstances where special tax measures should be taken to fund restoration. However, if the Special Tax Bill passes the Diet, it is expected that many of the measures contained in the original 2011 tax reform proposals will be adopted for fiscal years beginning on or after April 1, 2012.

These tax reform proposals would result in the lowering of the National corporation tax rate from 30% to 25.5%. After taking into account the affect on of Inhabitants and Enterprise tax purposes, the effective corporate tax rate would be reduced by approximately 5% from 40.69% to 35.64% for corporations operating in Tokyo (can be slightly less in other areas). However, the Restoration Surtax discussed above would increase the effective rate to approximately 38.01% for the fiscal years to which the Restoration Surtax applies (in principle, three year period from the first fiscal year which begins during the period between April 1, 2012 and March 31, 2015).

In the original 2011 tax reform proposals, a number of “base broadeners” were proposed including i) a change of allowable depreciation methods which generally deferred deductible depreciation, ii) limitations on the utilization of net operating losses to 80% of current year taxable income (although the carryforward period was extended from seven to nine years), iii) abolishment of the bad debt allowance, iv) abolishment of the reserve for extraordinary repairs, and v) reduction of the deductible donation amount (see prior Japan Tax Updates for details). If the overall rate reduction is enacted, it is likely that these base broadeners will be enacted as well.

2 Tax measures in Special Relief Bill

In response to Tohoku Earthquake, tax relief legislation including the allowance for a special tax loss carry-back was made effective on April 27, 2011 (see previous Japan Tax Update).

In addition, further special tax relief for restoration of the affected area have been proposed in the Special Relief Bill. Generally speaking, the following three incentives are under discussion. It is expected that a corporate taxpayer must choose one of (1), (2) or (3) below, and moreover (2) can be chosen only where Employment Promotion Tax Incentive is not applied.

(1) Tax incentive for a newly established company doing business in designated areas.

A newly established company satisfying certain criterion would not be subject to tax on income for the first five years of its existence. However, in effect the tax holiday is more akin to a deferral, since the income is offset by a special reserve which is reversed in later years.

The tax incentive applies to a company who acquires machinery, equipment and building structures in a specified industrial concentration area which is organized by an approved local government and designated by March 31, 2016 by the local government as a company which contributes to providing opportunities for employment (“Designated Company”) and newly established on or after the date when the designated restoration planning is approved.

i) If a Designated Company set up reserves for reinvestment in each of the fiscal years (including a day) within a designated period (five years from the date on which a company is designated), the amount of reserve (which may be set up to be 100% of taxable income) will be deductible and may essentially defer tax for 10 years.

ii) In a fiscal year where a Designated Company reinvests in machinery or building in specified industrial concentration area, a corporation will be allowed to claim deduction of the lesser of i) special depreciation up to the balance of the reserve and ii) special depreciation equal to the reversed reserve amount.

(2) Special corporation tax credit

It is proposed that the Designated Company will be allowed to enjoy a tax credit for 10% of salary paid (but limited to 20% of corporation tax due) to employees within a specified industrial concentration area.

(3) Special depreciation and special tax credit

It is proposed that the Designated Company will be allowed to enjoy special depreciation* or a special tax credit** for machinery & equipment and buildings & structures acquired in a specified industrial concentration area.

* Depreciation rates applicable for machinery & equipment would be 100% if acquired and used by March 31, 2014, and 50% if acquired and used on or after April 1, 2014. The depreciation rate applicable for buildings and structures would be 25%.

** The rates of tax credit applicable for machinery & equipment and for building & structures would be 15% and 8%, respectively, but limited to 20% of corporation tax due. Any tax credits in excess of this limitation could be carried forward for four years.

(4) Special treatment for research and development expenses

It is proposed that the Designated Company would be entitled to a 100% depreciation allowance when acquiring a depreciable asset used for research and development in a specified industrial concentration area. The depreciation expense would be treated as a special experiment and research expense when a company applies for research credit purposes.

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

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