

Client Alert

December 2010

2011 Tax Legislation Proposals

On December 16, 2010, proposals for Japan's 2011 tax reform program were officially announced. This Client Alert summarizes the key reform items.

Corporate Taxation

- A 5% reduction in the national corporation tax rate (as a result of the reduction, the standard effective tax rate will be reduced from 40.69% to 35.64%)
- Introduction of an 80% cap on utilization of NOLs
- Extension of the NOL carry forward period from 7 years to 9 years
- Abolition of tax qualified contributions in kind from a foreign corporation to a domestic corporation
- Scaling down of favorable tax treatment measures (i.e., dividend exclusion treatment and income tax credits, etc.)

The 5 percent reduction in the standard national corporation tax rate from 30 percent to 25.5 percent for fiscal years beginning on or after April 1, 2011 is perhaps the most significant of the proposed 2011 reforms. In addition, as a temporary measure (i.e., for tax years ending on or after April 1, 2011 and on or before March 31, 2014) a further reduced rate of 15% will be available for first ¥8 million of income of certain medium- and small-sized corporations.

As a result of the tax rate reduction, the standard effective tax rate (i.e., national tax plus local tax) will be reduced from 40.69% to 35.64%.

Most foreign multinationals with interests in Japan apply the calendar year-type fiscal year (i.e., starting January 1 and ending December 31). The benefit of the new tax rate reduction can be enjoyed only from fiscal years starting January 1, 2012. In order to accelerate the benefit, some entities may find it worthwhile to consider changing their fiscal year, subject to any business and accounting system impacts in this regard.

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Individual Income Taxation

- Introduction of a cap on salary income deductions for employees with a gross annual salary of more than 15 million yen
- Introduction of a special restriction on salary income deductions for directors
- Introduction of a restriction on the 50% deduction in computing taxable retirement income for certain directors
- Abolition of the 10% local tax rate discount for retirement income
- Extension of the 10% favorable tax rate for dividend and capital gains from shares of listed companies for two years (until 2013)

Inheritance Taxation

- A 5% increase in the marginal inheritance tax rate (from 50% to 55%)
- Scaling down of basic deductions

Inheritance Taxation

- Introduction of environmental tax (by introducing a surtax on the petroleum coal tax)

Further Updates

The proposals summarized in this Client Alert are expected to be approved by the Diet in February or March 2011 with few if any changes. A further Client Alert will be issued at that time detailing the full extent of the 2011 tax reform program.