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Global Employer Services

GES NewsFlash
Japan – Individual Income Tax Update

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Tax compliance — an increasing burden in Japan?

In addition to dealing with the questions that many countries are faced with in this current economic climate such as how to maintain tax revenues while stimulating growth and how to deal with sovereign debt, Japan is also facing the consequences of the triple disasters of March 11, 2011, and the cost of reconstruction. Here we present an update of Japan tax changes most likely to impact individual taxpayers in Japan and their employers.

Equity compensation reporting

A new employer reporting requirement is expected to come into effect from January 1, 2013.

By way of background, currently there are no employer reporting or withholding tax requirements in Japan when resident employees are in receipt of equity awards (e.g., stock options, performance shares, restricted stock units) from the foreign parent entity if the plan is administered outside of Japan.

Instead, the employee is responsible for reporting the income from equity awards on his or her individual income tax return for the year in which the taxable event arises, and paying any taxes due thereon. However, recent tax audits have exposed some cases of significant levels of under-reporting of equity compensation by some employees in Japan and the new reporting requirement may be a response to this issue.

The new reporting requirement will apply to Japanese subsidiaries that are owned 50% of more by a foreign entity and to Japanese branches of foreign entities. Such entities will be required to submit a report to the national tax office detailing the exercise or award of equity compensation to resident employees by the foreign parent entity. The statement will need to be submitted by the Japanese entity to the National tax office by March 31 of the year following the year of exercise. Therefore, if the reporting requirement comes into effect from January 1, 2013, then statements would be due by March 31, 2013, for equity compensation exercised in 2012.

Deloitte's view

Without this reporting requirement, the national tax office currently has no way of compelling entities in Japan to report employee equity compensation and therefore no easy way to determine if an employee is correctly reporting such income on their individual tax return as information is often retained outside of Japan by the entity awarding the equity compensation.

We understand that in its current form the penalties for noncompliance with this reporting requirement may be relatively light although the tax office may decide to address this if the compliance level is low.

Employers in Japan who will fall under this new reporting requirement should start taking steps to ensure they have access to the equity compensation data that would need to be reported as more details about the report become available to ensure they will be in a position to be compliant by March 31, 2013.

The current provisions do not appear to extend to nonresidents of Japan even though nonresidents will often have a filing obligation for equity compensation that relates to the period when the employee was in Japan.

New individual reporting requirement — foreign assets

Taxpayers with income over JPY20 million are already required to submit a statement of their worldwide assets and liability to the national tax office. However, a new requirement is expected to apply to resident taxpayers who will be required to report foreign asset holdings which exceed JPY50 million as of December 31. The report would be due by March 15 following the year in which the condition is met.

So far, we are waiting for further details about the format of the report and the level of detail that will be required and if any lower thresholds will apply to the assets which will need reporting. However, if a taxpayer under-reports income relating to foreign assets which are not declared in the report, we understand that an additional 5% penalty of the tax due on the under-reported income would be imposed. It is expected that this reporting requirement will take effect for reports due on or after January 1, 2013 (e.g., if foreign asset holdings exceed JPY50 million on December 31, 2012).

2012 Tax reforms

For individual taxpayers, the 2012 tax reforms generally repeated proposals first seen at the end of 2010 but which did not pass into law due to the events of 2011. We expect the following reforms to take effect from January 1, 2013

- Introduction of a cap on the employment income deduction for employees earning JPY15 million or more
- Expansion of the qualifying expenses that can be claimed under the specific work-related expenses deduction
- Introduction of the requirement for directors and public servants to have completed five years of service to qualify for the favorable tax treatment of retirement income

Special tax measures for Tohoku Earthquake Restoration

On November 30, 2011, a number of measures were passed into law to broaden the tax base from both corporate and individual taxpayers on a temporary basis to pay for the restoration of the Tohoku region which was so severely affected by the triple disasters of March 11, 2011.

For individual taxpayers, a “restoration surtax” for national income tax will be calculated on “Base income tax” at the rate of 2.1%. The “Base income tax” being the national income tax of a taxpayer, including permanent, nonpermanent, and nonresidents, before foreign tax credits.

This surtax is expected to apply for taxes assessed on income earned from 2013 through to 2037 and for those taxpayers who have a national tax return filing requirement, an additional surtax return will also be required to be filed.

For local inhabitants tax, a surtax will be assessed in the form of an additional per capita levy of JPY1,000 per year from June 2014 through to May 2024.

Deloitte's view

In light of the disasters of 2011, the government's need to increase finances specifically aimed at dealing with the restoration of the Tohoku region is understandable.

However, this comes on top of other measures, such as the employment income deduction cap which will see a broadening of Japan's tax base mainly at the expense of higher rate taxpayers. Also in discussion is the addition of a new tax rate of 45% which may be introduced for incomes in excess of JPY35 million, perhaps signaling an ongoing trend in this respect.

Even without the potential additional tax rate, employers with tax equalized assignees in Japan, should review now the impact of the employment income deduction cap and additional surtax to understand assignment-related costs and for accrual purposes.

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People to contact

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