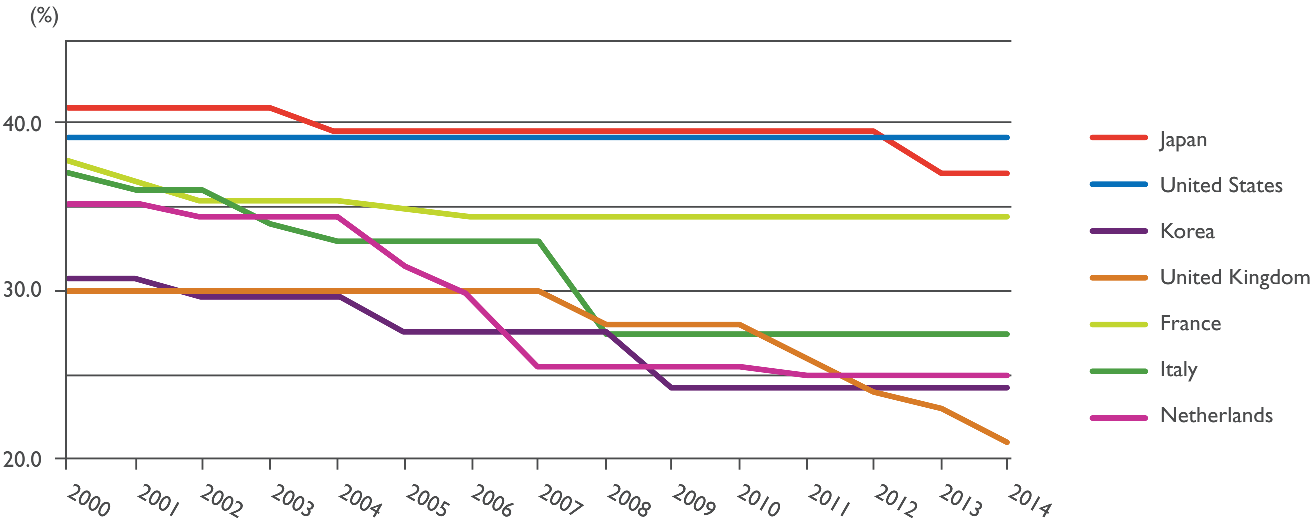
JAPAN TO REDUCE CORPORATE INCOME TAX RATE

INTRODUCTION

The corporate income tax rate in Japan is known to be one of the highest worldwide. To encourage foreign companies to do business in Japan and make Japan a more attractive location for investments, Prime Minister Shinzo Abe is considering reducing the corporate income tax rate to a "competitive rate in the global market" in the near future. Reduction in the corporate income tax rate is expected to revitalize the Japanese economy and encourage repatriation of Japanese multinationals that have moved their operations to low-tax jurisdictions due to the high tax rate in Japan. The current corporate income tax rate, a national tax levied on a company's profits, is 25.50 %, and the effective tax rate ("**ETR**") is 35.64 %.[1] The ETR takes into account, in addition to the corporate income tax, various small taxes such as the Enterprise Tax,[2] the Inhabitants Tax,[3] and the Special Local Corporation Tax.[4]

CHANGES IN ETR IN OECD COUNTRIES



reference: http://www.oecd.org/ctp/tax-policy/Table%20II.1-May-2014.xlsx

[1] This rate is applied to companies in Tokyo with capital of more than JPY 100 million (equivalent to approximately US$1 million). The reduced rate is applicable to small-and-medium-sized companies.

[2] A local tax which has several different tax rates depending on the nature of businesses. The Enterprise Tax is deductible for corporate tax purposes.

[3] A local tax which is applicable to companies/PEs in the location of their main offices, The Inhabitant Tax is a combination of income-based tax and per capita tax, which are respectively imposed based on amount of income and number of employees.

[4] This is a national tax created recently to subsidize the tax revenue of local governments.

RECENT DISCUSSION ON REDUCTION OF CORPORATE TAX RATE

The Prime Minister is positive toward reducing the corporate income tax rate and has advocated for a corporate income tax reduction at a seminar held to invite investments to Japan on 1 March in London. Since then, there have been active discussions among the key players in order to make the corporate income tax reduction happen. For example, the Government Tax Commission, which is an advisory panel to the Prime Minister, has established a specialized discussion group regarding corporate tax reform (the "**Discussion Group**"), and the Discussion Group is having active discussion recently. Akira Amari, the Minister of Economic Revitalization, commented that the ETR should be reduced to around 29%.

The biggest concern to reduce the corporate income tax rate is how to secure an alternative source of revenue. The current corporate tax revenue is about JPY 10 trillion (equivalent to approximately US$100 billion),[5] but it is reported that the annual corporate tax revenue will decrease by approximately JPY 490 billion (equivalent to approximately US$ 4.9 billion) if the rate is reduced by 1%. If the rate is reduced to below 30%, the decrease in annual corporate tax revenue will be approximately JPY 3 trillion (equivalent to approximately US$ 30 billion). There are some solutions suggested by the Discussion Group, and one of the prominent solutions is to change the depreciation rules. The Discussion Group is considering changing the current depreciation methods by abolishing one of the major methods, Fixed Rate Method, which is widely adopted in Japanese companies except for buildings.[6] According to media reports, if the depreciation system changes, the government will likely be able to secure JPY 500 billion (equivalent to approximately US$ 5 billion) at maximum in the first few years after the reduction of the corporate income tax rate has been implemented.

Some lawmakers are proposing expansion of size-based corporate tax rate because more than 70 % of Japanese companies are in deficit balance, which means most of the companies in Japan are not liable for corporate income tax according to a survey conducted by the National Tax Agency[7]. The size-based corporate income tax, if imposed, regardless of the revenue or profit of the company, will be based on the amount of paid-in capital and employee salary. The size-based methodology has been partially introduced in the Enterprise Tax since 2008, however its expansion will likely cause fierce controversy.

FUTURE PROSPECTS

The ruling Liberal Democratic Party has clarified in a the Basic Policies for Economic and Fiscal Management, which the Prime Minister announced on 13 June 2014, that the reduction of corporate income tax rate will happen for a few years starting from the fiscal year of 2015. The reduction of the corporate income tax rate is expected to be implemented soon because it is stated in the policies mentioned above, and these policies are usually reflected in budget drafting and key policies. Maintaining sufficient permanent national revenue after the reduction in corporate income tax rate will be of major concern to the ruling party, but it is still under discussion regarding which solutions should be adopted, and the perspective solutions are not clearly deliberated in these policies, which are scheduled to be approved on by the cabinet council in late June.

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[5] In the fiscal year of 2012, according to a survey by the National Tax Agency (http://www.mof.go.jp/tax_policy/publication/brochure/zeisei2507/04.htm (Japanese only))

[6] There are currently two major methods permitted to reduce tax burden after equipment investment: (1) Fixed Rate Method (a.k.a. Declining Balance Method): the depreciation base is reduced each year by the amount of the depreciation deduction and a uniform rate, which is calculated by taking into account the useful life, is applied to the resulting balance; and (2) Fixed Amount Method (a.k.a. Straight Line Method); the depreciation amount is determined by dividing the acquisition cost of the asset less its salvage value by its useful life. Under (1) Fixed Rate Method, companies can ease tax burden to a large degree for the first few years after the investment due to the higher deductible amount.

[7] http://www.nta.go.jp/kohyo/tokei/kokuzeicho/hojin2012/pdf/04_hojinsu.pdf

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