

Japan tax bulletin

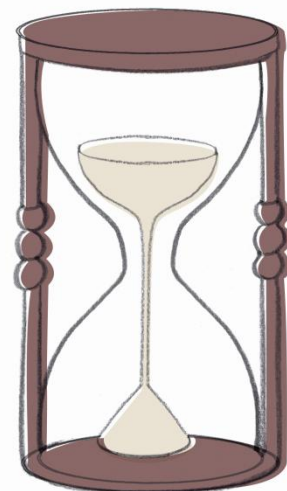
Newsletter on important tax and business developments in Japan

August 2011

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Tax measures adopted in response to the March 11 disaster

The tax measures discussed below were adopted as part of the bill titled *Special Tax Law for the Great East Japan Earthquake*. The bill was passed by the Diet on April 27 in response to the March 11 earthquake and tsunami disaster in eastern Japan.



Measures affecting corporate taxpayers

1. 2-year tax loss carry back

Losses of inventory or fixed assets related to the March 11 disaster arising in fiscal years ending between March 11 2011 and March 10 2012 may be carried back two fiscal years. The carry back may be claimed on the tax return for the fiscal year in which the loss occurs. Or, if the loss occurs in the first half of a fiscal year ending between March 11 2011 and September 10 2011, a claim may be made on the interim tax return. The carry back is available to companies of any size. Under current corporate tax rules, tax losses may only be carried back 1 fiscal year, and are only available to companies that qualify as small or medium-sized.

2. Early refund of withholding tax

If, as a result of the March 11 disaster, a company has a loss of inventory or fixed assets in the first half of a company's fiscal year, and the first half of that fiscal year ends between 11 March 2011 and 10 September 2011, the company may claim a refund of any withholding tax paid in excess of the interim corporation tax amount. The refund is capped at the amount of the inventory and asset loss. Refunds of withholding tax are normally available only after fiscal year end.

3. Accelerated depreciation on newly purchased assets

Buildings, structures, machinery, ships, aircraft, and vehicles purchased and used in the business between March 11, 2011 and March 31, 2016 may be eligible for accelerated depreciation. To be eligible, the assets must be either (a) purchased as substitute assets for assets damaged in the March 11 earthquake; or, for buildings, structures, machinery only, (b) used in business in earthquake affected areas.

The applicable depreciation rate depends on whether the asset is purchased before, on or after, April 1, 2014:

Additional depreciation rates

Asset type	Purchased btw March 11, 2011 and March 31, 2014	Purchased btw April 1, 2014 and March 31, 2016
Buildings, Structures	15% (18%)	10% (12%)
Machinery, Equipment	30% (36%)	20% (24%)
Ships, vehicles, aircraft	30% (36%)	20% (24%)

(Rates shown in parentheses are for companies that qualify as small or medium-sized.)

4. Capital gains rollovers for asset replacements

The special measures allow for deferral of capital gains on assets being replaced, provided certain restrictions related to acquisition timing and usage location and other conditions are met.

To qualify, existing land, buildings, and other structures in the disaster zone must have been acquired before March 11, 2011, and replacement assets must be land in Japan or depreciable assets to be used in business in Japan. If the existing land, buildings and structures are outside the disaster zone, there is no restriction with respect to their acquisition date, but replacement assets must be either land in the disaster zone or depreciable assets to be employed for the business in the disaster zone. If these restrictions are satisfied, a full or partial capital gain rollover is available if the following additional conditions are met:

- Sale of existing assets is between March 11, 2011 and March 31, 2016;
- Replacement assets are acquired in the fiscal year the assets being replaced are sold; and
- Replacement assets are expected to be put to use for the business within one year from the acquisition date.

If the acquisition cost of the replacement assets exceeds the sale proceeds from the existing assets,

the acquisition cost may be reduced by the full amount of the capital gain. If the acquisition cost of the replacement assets is less than the sale proceeds from existing assets, only a partial rollover is available. The acquisition costs may be reduced by the acquisition cost of the replacement assets multiplied by (capital gain/sale proceeds).

5. Relaxed deadlines for election to be taxable enterprise (Consumption Tax)

Under Japan's consumption tax law, businesses not meeting a certain threshold of consumption taxable sales in the period 2 years prior are generally exempt from filing consumption tax returns. An exempt enterprise that expects to be in a consumption tax refund position, however, may file an election to be a taxable enterprise. Normally, this application (or the application to cancel such an election) must be filed before the start of the tax period to which it will apply and the selection must remain unchanged for at least 2 fiscal years. Under the special disaster rules, the filing deadline for these applications and the 2 year non-revocation period has been relaxed for affected areas. As of August 1, 2011, the relaxed deadlines for enterprises in Iwate, Miyagi, and Fukushima Prefectures, have not been announced by Japan's tax authority.

In addition to the above mentioned special measures, the FAQ issued by the NTA after the disaster state that a flexible approach will be taken with respect to the application of the following items under existing tax law.

6. Deduction of casualty losses

The cost of waste removal or repair to assets damaged in the disaster can be fully expensed in the period incurred. Valuation losses on inventory or assets are also deductible.¹

7. Contributions to disaster relief

A corporation may fully deduct the cost of donating its own products or services to provide assistance to an unspecified large number of individuals harmed in the disaster. Additionally, contributions of business assets or services to assist customers or suppliers that have been damaged or harmed by the disaster are fully deductible for corporate tax purposes. Loans without interest provided to such customers or suppliers will not

result in taxation of the economic benefit received to the customer or supplier.²



¹ Corporation Tax Law Article 223-3; Corporation Tax Regulation 7-8-6

² Corporation Tax Regulation 9-4-6 3 & 4; Special Taxation Measures Regulation 61-4(1) 10-3

Measures affecting individual taxpayers

1. Relief for loss or damage to property

Casualty losses under Japan's income tax law include loss or damage to household property (excluding antiques, jewellery, paintings, and similar luxury goods) caused by earthquakes³. The deduction amount for casualty loss is limited to the amount of the loss (FMV + incidental expense), less any insurance proceeds, less either (a) 10% of the taxpayers taxable income; or, for losses caused by disasters, (b) less JPY 50,000.

Relief offered under the special disaster law (Article 4) supplements the casualty loss deduction with a special income tax reduction for taxpayers with taxable income of JPY 10M or less who due to the March 11 disaster suffered severe loss or damage (over 50% of fair market value of all property) to their home or other property.

Taxpayers may claim one of the above types of relief as applicable when filing their tax return. Receipts of expenditures (for casualty losses) or a schedule of losses (for relief claimed under the disaster rules) must be attached to the tax return.

Additionally, Article 4 of the special measures allows an individual taxpayer suffering a casualty loss related to the March 11 disaster to claim the loss a deduction on their 2010 tax return. For taxpayers who filed by the usual March deadline who had such a loss but did not claim it, the NTA has indicated that the loss may be claimed through the filing of an amended return.

2. Charitable donations

Special charitable deductions will be allowed for earthquake related donations given between March 11, 2011 and December 31, 2013 to the national government or affected local governments, or to organizations deemed appropriate by the Minister of Finance. Under income tax law, the amount of the available deduction for charitable contributions for the year is capped at 40% of the taxpayer's total

assessable income (before deductions). Under the special measures, this cap has been raised to 80% for earthquake related donations.

Taxpayers also have the option of choosing a tax credit in place of an income deduction for earthquake related donations to the national government and to designated non-profits. The credit is capped at approximately 40% of the creditable donation amount, subject to a ceiling of 25% of income tax liability. For taxpayers not in the top income tax bracket giving typical donation amounts, it will generally be more beneficial to select the credit, while taxpayers in the top bracket will typically achieve greater tax savings by selecting the income deduction.

³ Income Tax Law (or "ITL") Article 72; ITL Enforcement Order Article 206

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