

# Japan Tax Bulletin

## Restricted Stock

August 2016

In recent times, companies in Japan have introduced several plans to incentivize their directors, including Restricted Stock (“RS”).

Prior to this year’s tax reform, the tax treatment related to RS was not clear, for example the amount and timing of deductions in a company’s income tax calculation were not clearly defined. Due to the uncertainty, the 2016 reform clarified the tax treatment of this increasingly popular form of remuneration.

### 1. General tax treatment of directors’ salary

Under income tax laws, directors’ salary is not treated as a deductible expense in a company’s income tax calculation unless the salary satisfies any of the following conditions:

- The salary is paid periodically (e.g. on a monthly basis or a shorter period) where the amount is the same for each period. (*Teiki dogaku kyuyo*).
- Pre-determined/pre-reported salaries which are fixed amounts paid in accordance with advanced notice given to the tax authority. The notice must be filed by the earlier of: one month after the ordinary shareholders’ meeting in which the salary payments are resolved is held; or 4 months after the beginning of a business year (*Jizen kakutei todokede kyuyo*).
- Profit related salaries which are salaries paid to directors of a non-family corporation that meet certain conditions (*Rieki rendo kyuyo*).

Additionally it that RS would be treated as “*Jizen kakutei todokede kyuyo*”.

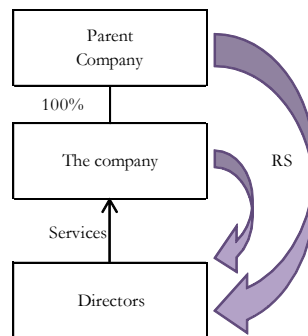
### 2. Definition of RS

Based on the revised income tax laws, the definition of RS is as follows:

- RS is issued by the company to which the recipients (i.e. directors/employees) provide services

to or a parent company that holds the 100% of the stock of the company.

- The transfer of RS is restricted for a certain period.
- The RS is transferred to the issuing company for no consideration if certain performance issues (e.g. retirement / bad work behavior of the recipient, decline in performance of the company in the restriction period) occur.
- The RS is granted to the recipients in compensation for services rendered by them.



### 3. Taxation of RS

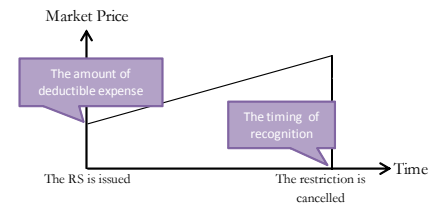
#### 3.1 Tax treatment for companies

The salary expense in granting RS is recognized as a deductible expense at the same time as the recipients recognize income, generally at the time the restrictions are lifted. Therefore, it is treated as a non-deductible expense (i.e. prepaid expense) until that time.

Example:

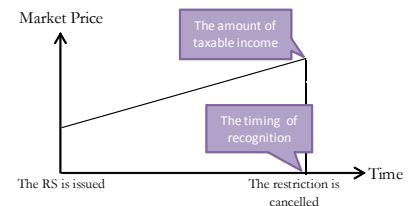
- When payment of salary is determined:  
Prepaid salary XXX / Debt XXX
- When the RS is issued:  
Debt XXX / Capital XXX
- When the restriction is cancelled:  
Salary XXX / Prepaid expense XXX  
Cash XXX / Withholding tax XXX

Also, the amount of deductible expense is calculated as the market price at the time when the payment is resolved.



#### 3.2 Tax treatment for recipients

The recipient will be treated as receiving taxable income from RS at the time the restrictions on transfer are lifted. The amount of taxable income is based on the market price of RS at that time.



As the value of RS is calculated based on the market price on different dates, there is a difference between the amount of taxable income for the recipients and the amount of the deductible expense for the company.

#### 3.3 Withholding tax

When the restriction on RS is lifted, the recipients are taxed since they have the right to sell the RS at that time and the company is obliged to withhold tax from them. However as the receipt is not cash in hand, the tax will be withheld from their regular salary or the recipient will be asked to pay the withholding tax to the company.

### 4. Compliance

Documents related to the market price per stock when RSs are granted, total number of granted RSs, the number of cancelled RSs in the year and other related information are required to be attached to the corporate tax return of the company.



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