

Japan Tax Bulletin

Taxation of Non-Cash Benefits for Expatriates

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For most expatriates stationed in Japan, it is important to ensure the tax treatment of various non-cash benefits provided by an employer. This memorandum discusses the tax treatments of various type of fringe benefits under Japan tax laws.

1. General rules

According to Income Tax Law (“ITL”) Section 36, cash compensation and non-cash benefits must be included in taxable income and such benefits are valued at market value. ITL Basic Circular (“ITLBC”) 36 – 15 gives examples of non-cash benefits as follows:

- 1.1 Purchase of goods or other property for free or below market price
The difference between the market value and the actual purchase price is taxable as a non-cash benefit.
- 1.2 Lease of Land or building for free or below market value
Basically, the difference between the rent that would be paid normally and the actual rent is taxable as a non-cash benefit. However, when an employer leases a residence to a director or an employee, there are special rules for computing the rent that would be paid normally and the taxable benefits. In this case, the rent that would be paid normally is called as “legal rent”.
- 1.3 Loan with no interest or below market interest rate
The difference between an interest that would be paid normally and the actual interest is taxable as a non-cash benefit.
- 1.4 Services other than 1.2 and 1.3 above for free or below market value
The difference between a consideration that would be paid normally and the actual consideration paid by an employee is taxable as a non-cash benefit.
- 1.5 Forgiveness of debt
The amount of a debt forgiven or borne by other persons is taxable as a non-cash benefit.

Fringe benefits, regardless of whether they are cash or non-cash benefits, provided by an employer who is a resident, a domestic corporation or a non-resident/a foreign corporation with an office in Japan, to a director or an employee in Japan are taxed as salary income and generally subject to withholding tax. Further, fringe benefits granted irregularly by a corporation to a director of the corporation are treated

as the director’s bonus and are not deductible for computing the corporation’s taxable income.

2. Residential Accommodation

When an employer leases a residence to a director or an employee, there is a special rule for computing the taxable fringe benefit.

When an employer collects legal rent from directors and 50% or more of legal rent from employees, the directors or employees are treated as not being provided with any taxable benefits by the employer.

Since legal rent is usually much lower than market rent, the rule is a tax break to employees or directors who are provided with a residence by their employer.

It should be noted, however, that a lessee must be the employer. Therefore, when an employee leases a residence from a landlord and an employer reimburses the rent to an employee, this rule is not applicable. The rule applies when the employer leases a residence from a landlord and sub-lets it to an employee.

2.1 Directors

(a) General rule

When an employer leases a residence to a director, the monthly legal rent of the residence is computed by the following formula (ITLBC 36-40);

$$\begin{aligned} & [12\% \text{ of the value of the "building" for Fixed Asset Tax purposes} \\ & \quad \text{(when the building is not wooden, 12\% is replaced by 10\%)} \\ & \quad + \\ & \quad 6\% \text{ of the value of the "land" for Fixed Asset Tax purposes on} \\ & \quad \quad \text{which the building is built}] \\ & \quad \times \\ & \quad \quad 1/12 \end{aligned}$$

Municipalities assess the value of land and buildings every three years.

However, when the employer sub-lets a residence which others lease to the employer, the legal rent is the higher of (1) 50% of the actual rent and (2) the amount computed by the above formula. Usually, the former is much higher than the latter.

(b) Special rule for small-sized residences

There is a special rule for a small-sized residences. When the floor space is not over 99 square meters (132 square meters in the case of a wooden residence), the monthly legal rent is, notwithstanding the above, computed by the following formula (ITLBC 36-41);



- (c) Residence partially used as an office
Further, when a residence is used for business as well, the legal rent may be at least 70% of the amount computed in (a) and (b)
- (d) Luxury Residence
When the floor space of a residence provided by an employer to a director is (1) 240 m² or more or (2) the residence is equipped with pool, or has interior design, which reflects personal preference etc. and leasing such a residence is considered beyond the generally acceptable range, the special rule is not applied. The taxable benefit is measured by the difference between the actual rent and the rent the director pays to the employer (Special Circular 8-1 Corporation Tax Department, 4-4 Income Tax Department dated July 4, 1995).

2.2 Employees

When an employer leases a residence to an employee, the legal rent is computed by using formula in 2.1(b) (ITLBC 36-45). Since the legal rent for a director is much higher than that for an employee, it is advisable to consider carefully whether an expatriate's position in a Japan subsidiary should be as a director or an employee.

3. Loan to employee or director

When an employer advances cash to an employee or a director interest-free or at below market interest rate, the difference between the interest that would be paid normally and the actual interest charged is taxable as salary income. When the employer borrows funds from others to advance them to an employee or a director, the interest that would be paid normally is computed by using the rate at which the employer borrows the funds. Otherwise, ITL Basic Circular states that the interest is 1.6% for the calendar year of 2018 (ITLBC 36-49).

If the interest rate is determined based on the actual average borrowing rate, or the amount of non-cash benefit from interest-free or below market interest rate loans is not over JPY5,000 per year, non-cash benefits do not need to be recognized. Further, when cash is advanced to an employee or director who needs the funds temporarily due to casualty or illness, a non-cash benefit from such a loan also does not need to be recognized, provided that the repayment is made within a reasonable period (ITLBC 36-28).

4. Home leave

Payments concerning home leave to a foreign national employee who plans to work continuously for more than two years may be excluded from the taxable income provided that the home leave is granted on an annual basis in accordance with the company's regulations and the amount of the

payments is reasonable. This exemption is allowed for one family trip per year to the home country of employee or his or her spouse (Special Circular 6-1 Direct Tax Department, 4-4 Income Tax Department dated January 16, 1975).

5. Corporate Scholarship Program

Under an agreement with Japanese National Tax Agency in 1978, donations to a designated international school made by the employer of the person whose children attend the school are considered as non-taxable benefits for the employee. However, the deduction of the donation in excess of the deductible limit is disallowed for the employer.

6. Language lessons

Language lesson fees borne by an employer may be excluded from taxable income provided that the language lesson is necessary for an employee or a director to work at the employer's business and such lesson is directly related to it and its amount is reasonable (ITLBC 9-15).

7. Stock Options

Expatriates assigned to Japan are sometimes granted stock options where the expatriates are authorized to purchase a foreign parent's or affiliates' stock at a favourable price and sell them after a certain period. A favourable price is a price lower than the market price by 10% or more (ITLBC 23-35 common 7).

There is no taxable event when an option is granted. When the option is exercised, the difference between the market price and the purchase price is included in employment income and taxed at the normal rate. As the benefit is provided by a foreign company without an office in Japan, the employment income is not subject to withholding tax. The expatriates are required to file a personal income tax return to declare the income. The Japanese subsidiary where the expatriates are assigned to is required to submit a report about economic benefits on this to the tax office.

When the expatriates sell the stock the capital gain, which is the difference between the sales price and the market price when exercised, is taxed separately from other income.

8. Restricted Stock

Under a stock compensation plan, expatriates are sometimes granted restricted stock rather than stock options. The expatriates are granted the right to receive stock with a restriction its future transfer, usually when conditions under the plan are satisfied. If the conditions are met, the employees are allowed to sell the stock during a certain future period. When granted, there is no taxable event. When the restricted stock is received (vested), the market value of the stock is included in employment income and taxed at normal rates. The tax filing requirement and the report requirement for the Japanese subsidiary are the same as for stock option.



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9. *Other benefits treated as salary income*

The following allowances are treated as salary income.

- Taxes
- Utility expenses
- Medical expenses
- Car expenses

Contact us for any enquiry on our services;

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