

Japan Tax Bulletin

The pre-determined notification system for officer remuneration

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1. Deductible officer remuneration

The tax deductibility of officer¹ remuneration is limited under Japan tax law (Corporation Tax Law (“CTL”) 34①). Officer remuneration consists of amounts other than retirement payments and are only deductible for corporate income tax purposes if they fall under the following categories:

- (1) Salary paid in the same amount on a regular basis² (CTL 34①(1));
- (2) Salary for which the fixed payment amount has been notified in advance (CTL 34①(2)); or
- (3) Performance-linked salary³ (CTL 34①(3)).

2. Salary for which fixed payment amount has been notified in advance

Salary for which the fixed amount of payment has been notified in advance is salary that does not correspond to either (1) or (3) above, and refers to the salary listed below that is delivered at a pre-determined time (CTL 34①(2), Corporate Tax Law Enforcement Orders (“CTL-EO”) 69③④, Corporation Tax Law Basic Circulars 9-2-15-2)

- Fixed amount of money (excluding certain salaries from shares or stock acquisition rights related to the provision of future services);
- A fixed number of shares (including investment);
- Stock acquisition rights;
- Specified transfer-restricted shares related to fixed amounts of monetary claims; or
- Specified stock acquisition rights.

If the salary is paid by a corporation other than a family company, it is necessary to submit a "Notification Form for Pre-established Salary" to the head of the tax office in charge by a certain notification deadline (CTL-EO 69④). The following amounts are excluded from this requirement

- Salary paid in cash to officers who do not receive regular salary; and
- A certain amount of salary from shares or stock acquisition rights related to the provision of future services.

It is not necessary to report salary based on the specified transfer restricted shares as stipulated in Article 54, Paragraph 1 of the Corporation Tax Act or the specified stock acquisition rights stipulated in as Article 54-2, Paragraph 1 of the Corporation Tax Act (CTL 34①(2), CTL-EO 69③)

If a corporation that has submitted a fixed salary notification in advance, intends to change the amount to be paid due to the deterioration of business performance, etc., it must submit a change notification form to the head of the tax office in charge by a certain notification deadline.

3. Applicability of pre-established notification salary when bonuses for officers are paid multiple times

For example, there is a judicial precedent in which the handling of pre-reported salary when it is given twice as shown below is disputed.

- The first salary will be paid as notified in advance.
- If the second salary is reduced and paid without changing the notification

According to the Tokyo District Court's decision on October 9, 2012, when a corporation pays bonuses related to prior final notifications to officers multiple times within the same business year, all bonuses stated in the notification form are paid as notified. If not, all those officer bonuses will not be deductible.

In the above case, if a bonus payment to an officer is not paid according to the prior notification even once during one job execution period⁴, then the entire amount stated in the notification form also becomes non-deductible.

However in 2006 the NTA had released the interpretation of the tax treatments for multiple bonus payments that were notified in advance, but paid over consecutive fiscal years. If the conditions at (1) to (3) below are met then if a bonus paid in the second fiscal year differs from the amount that was notified in the first fiscal year, only that bonus becomes non-deductible for tax purposes. The deductibility of the bonuses paid in the first fiscal year (and notified in advance) is not affected.

¹ In addition to the directors, etc. stipulated in the provisions of the Companies Act, etc., those who are substantially engaged in the management of the corporation in a similar manner to other officers in terms of their position within the corporation and the content of their duties are included (CTL 2(15)).

² Salary paid in the same amount on a regular basis means that the salary is paid at regular intervals of one month or less, and the amount of salary paid at each salary period within the business year is the same.

³ Performance-linked salary refers to the amount calculated based on indicators of corporate performance, such as indicators of profit status and indicators of stock market prices.

⁴ The period from the next day to the day when an annual shareholder meeting for a fiscal year is held to the day when an annual shareholder meeting for the next fiscal year is held.

- (1) If the execution period of duties of officers extends over two consecutive fiscal years, a notification of the bonuses to be paid that straddle those two years has been filed to the head of the tax office having jurisdiction over that period;
- (2) Officer bonuses equal to the amount notified the tax office in charge in fiscal year X are paid in accordance with the notification; and
- (3) Officer bonuses paid in the second fiscal year are different from the amount notified in advance, but they do not affect the taxable income in the first fiscal year.

In other words, the treatment for pre-notified remuneration is different for remuneration that covers a single fiscal year and for remuneration that covers consecutive fiscal years. For the former, if one payment differs from the notice then all payments become non-deductible for tax purposes. For the latter, the payments are considered individually and the non-deductibility of a payment in the second fiscal year does not affect the deductibility of payments in the first year, if certain conditions are met.

The court has approved the taxation of the tax office, but there are criticisms of this, and the tax office's stance is not always clear.