



GES NewsFlash

Japan – 2011 Tax Reform: Implications for Individual Taxpayers

December 20, 2010

In this issue:

Summary

Employment income deduction

Retirement income

Overview of other changes affecting individual income taxpayers

People to Contact

Summary

On December 16, 2010, the Japan Tax Commission set out its proposals for the Tax Reform 2011. Under pressure to find ways to cut the level of national debt and balance the budget, while at the same time wanting to cut corporate tax rates to make Japan more competitive in attracting international business, the news for individual taxpayers has been, in the main, bad, as deductions are cut and extra conditions added to obtain favorable tax treatments.

Employment income deduction

The employment income deduction is a statutory deduction available to provide an allowance for the costs incurred in relation to holding employment and is based on total taxable salary. To date, it has been uncapped and calculated as a percentage of salary phasing out from 40% to 5% for incomes in excess of 10,000,000 yen but with no cap on the deduction available.

The 2011 Japan Tax Reform includes measures which would cap employment income for high earners. Based on the current proposal, in the case of employees, the employment income deduction will be capped to 2,450,000 yen for employees earning more than 15,000,000 yen per annum. In addition, for directors, the employment deduction will be phased out for earnings over 20,000,000 yen to a cap of 1,250,000 yen where employment income is over 40,000,000 yen.

As an example, for an employee with taxable employment income of 25,000,000 yen, this would reduce the employment income deduction by 500,000 yen and therefore potentially results in an increase in taxes (national and local tax combined) of 250,000 yen.

Deloitte's View

Currently, after accounting for the employment income deduction, the highest effective marginal tax rate for employment income is 47.5% (national and local

inhabitants tax combined). With the imposition of an income cap, any employment income over 15,000,000 yen will now be, in many cases, taxed at 50%. For employers with tax equalized assignees, this would increase the gross up to 100% at the highest income levels, i.e. the gross pay required in order to provide US\$100 of additional net income to an assignee, could be US\$200 excluding any consideration for other available deductions or credits. Therefore employers with tax equalized employees in Japan may wish to review assignment costs and accruals for tax payments to be able to budget accordingly.

Retirement income

Payments made in respect of the end of an employment (such as severance pay), may be treated as retirement income and receive favorable tax treatment in Japan. This includes a deduction calculated based on years of service and after this deduction, only half the remaining amount is taxable. The taxable amount is subject to separate taxation at progressive national tax rates from 5-40%. Local inhabitant's tax may also be assessed on this income.

While not changing the availability of this favorable tax treatment for employees, the 2011 Tax Reform includes a measure whereby directors and public servants would need five years of service within the employment to qualify for the favourable tax treatment of retirement income.

Deloitte's View

The current tax treatment of retirement income significantly reduces the tax on such income when compared to employment income and therefore companies may need to review the level of severance payments offered to directors with less than five years service if wishing to ensure the director receives a certain level of net benefit.

Overview of other changes affecting individual income taxpayers

- The deduction available for adult dependents will be abolished for households with incomes in excess of 6.89million yen.
- Introduction of taxpayer identification number was first introduced in the 2010 Tax Reform but is planned to be implemented in 2011.
- Dividend income and capital gains derived from listed shares can, under certain conditions, benefit from a reduced withholding tax rate of 10% under separate taxation. This treatment was scheduled to expire in December 2011 but has been extended for a further two years through to December 2013.

Deloitte's View

Overall, the changes proposed for individual taxpayers, especially high earners and directors, are increasing the individual income tax burden as the Government bows to pressure from the business community and seeks to make its corporate tax rate more favorable compared to those of its Asia Pacific neighbors.

Even without the proposals outlined in the 2011 Tax Reform, registered directors in Japan already incur potentially higher tax costs than employees due to the difference in taxation of their housing allowances, treatment of remuneration as 100% Japan sourced and the corporate tax treatment of director's remuneration. Now, the changes to how the employment income deduction is calculated for directors, compared to employees, and an additional condition for obtaining favorable tax treatment of retirement income means that employers seconding employees to Japan and making them registered directors here, should consider carefully the additional tax costs compared to an employee and weigh these against the business' needs.

People to Contact

If you have any questions concerning the issues in this GES NewsFlash, please contact one of the tax professionals as follows:

Russell Bird

Tel: +81 (0)3 6213 3979

Frances Somerville

Tel: +81 (0)3 6213 3851

This NewsFlash information is also included in our bi-weekly GES newsletter, *Global InSight*, which you will receive directly if you are on the central distribution list.

If you are not on the central distribution list and received this communication by some other means, you can follow these few simple steps to be added to the central distribution list.

- Go to the [Deloitte Subscriptions Page](#) on Deloitte.com
- Make sure that under Step 1 you select "Tax" and "Global Employer Services"
- Under Step 2, select "Global Insight"
- Under Step 3, fill out your contact information and click "Save my profile"

Be sure to visit us at our Web site: www.deloitte.com/tax

[Back to Top](#)

1633 Broadway
New York, NY 10019 – 6754
United States

© 2010 Deloitte Touche Tohmatsu.

Deloitte refers to one or more Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms.

 [Deloitte RSS feeds](#)
