I The Fiscal Year 2000 Tax Reform Proposal

As a “final push” to stimulate a slowly recovering economy, the fiscal year 2000 Budget Plan of ¥84.99 trillion (the largest ever, $809.4 billion at ¥105 to the dollar) and a Tax-Reduction Plan for ¥215 billion ($2.0 billion) was submitted by the government to the ordinary Diet session in January. In addition, the government had set the economic growth target for fiscal 2000 at 1 %, up from the 0.6% revised forecast for fiscal 1999 which runs through March 31, 2000.

Most economists believe that the economy has bottomed out but there is little momentum to stage a fully self-sustaining recovery. As a result, the budget is the largest ever and 38.4% of the budget will be financed by a record ¥32.61 trillion in bond issues. Japan is expected to have the highest gross debt-to-GDP (gross domestic product) ratio among all OECD countries by 2001. Last December, the OECD recommended that the Japanese government take measures such as broadening its tax base, and raise its consumption tax rate to reduce it’s debt.

As for the fiscal year 2000 tax reforms, all major acts such as the consolidated taxation system were put on hold for future discussion. Relatively small tax cuts are proposed because of the current fiscal situation and the upcoming Lower House general election (no later than October). One focus of the tax reforms is in providing assistance to venture businesses and small-to-midsize companies.

We have outlined the major acts of the tax revision proposal which will take effect from April 1, 2000.

(1) Assistance to venture businesses and small-to-midsize companies.

① Applying tax to only 25% of the profits from sale of stocks in venture businesses — if individual investors (or angels) purchase stocks in a five year period beginning next April and hold such stocks for a minimum of three years prior to the company going public (angel taxation).

② Exempting specific industries from a retained profits tax. Internal reserves of family-owned companies will not be subject to taxation for two years starting April if these entities have been inexistence for less than ten years.

③ Changing the method used to calculate the value of shares in privately held companies and reducing interest rates for delinquent inheritance tax payments.

(2) Preferential tax treatments for defined-contribution pension plans (Japanese version of the U.S. 401(k) plan) slated to be introduced this fall.

Ceiling on tax-deductions for annual contributions

	(C.T.) Employer’s contri-butions(per employee)	(I.T.) Worker’s contributions
Companies with corporate pensions	¥ 216,000	not allowed
Companies without corporate pensions	¥ 432,000	¥ 180,000
Self-employed	N/A	¥ 816,000

Under the defined-contribution pension scheme, there are two types of contribution schemes — ① the “corporate type” (C.T.) in which employers contribute premiums for their employees and ② the “individual type” (I.T.) in which workers contribute premiums for themselves — both the employer and employees cannot jointly subscribe to the pension plan at the same time. For self-employed individuals, up to ¥816,000 in yearly contributions, including those to the existing national pension, would be tax deductible.

The defined-contribution pensions would be portable when employees change companies. Because the decision to which financial product to invest is decided by themselves, the final benefits they receive will vary according to their investment decisions.

(3)One-year extension on the deduction for personal computers

The entire cost of computer related information equipment with acquisition costs less than ¥ 1 million, such as personal computers, would be deductible for an additional year (i.e., effective through March 31, 2001).

(4) Six-month extension on the expanded housing loan deduction

Those who moved into residences they purchased prior to June 30, 2001 would be eligible for income tax credits of up to ¥5,875,000 over 15 years.

(5) Reduction of the registration tax rate levied on company establishment and capital increases.

To support new and emerging businesses, the rate will be decreased from 0.35% to 0.15%.

(6) Gradual reduction over three years

The real property tax in some commercial districts will be reduced base from 80% to 70%.

(7) Dependency exclusion reduction

The deductible amount for families with children under the age of 16 will be reduced from ¥480,000 to ¥380,000 per child.

II Stock Options

Employee Stock Option Taxation from Foreign Companies and/or Head Offices

Recently, taxation on stock options received by McDonald's Japan employees was widely publicized. Although stock options have been popular in Europe and the US, the plans are becoming more widely practiced in Japan in recent years.

1. Stock Option Plan
Officers and employees of the company are granted stock options from their employer or its parent. The employees can later exercise their options and purchase shares at a set price during a certain time period and later sell those shares at a profit.

2.Taxation
a. Granting of stock options – non taxable.
b. Exercise of options– non-qualified plans: difference between the set price and market price are treated as employment income if the individual is employed with the same company; other income if the individual is not.
c. Sale of stock – treated as capital gains.

There is an issue is whether or not stock options granted by parent companies and/or head offices to employees hired by their local subsidiary/affiliate in Japan would be taxed at the higher employment income tax rate or able to use the capital gains rate, despite no direct employment contract.

III Future Topics

During this spring, the government's tax commission will submit to the Prime Minister a recommendation compiled every three years on the mid-term taxation system. Main points of the recommendation are expected to be ① a consumption tax rate hike from the current 5%, while applying a lower rate for "necessary" goods, ② reduction of a variety of tax deductions, ③ introduction of a local tax on unprofitable companies based on the number of employees etc, and the ④ introduction of the taxpayer numbering system.

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