



I The Fiscal Year 2002 Tax Reform Proposal

With the Japanese economy on the brink of a deflationary spiral, the government submitted ① the fiscal 2002 Budget Plan of ¥81.23 trillion (down 1.7% from the initial budget for fiscal 2001) and a fiscal 2002 Tax Reform Plan resulting in a tax-cut of ¥30 billion, to the ordinary Diet session which convened on January 21.

Based on this Plan, the government has projected no growth in real gross domestic product for fiscal 2002, following a 1% contraction in fiscal 2001; tax revenue due to the economic slump is projected to drop by 7.7% from the initial fiscal 2001 budget to ¥46.82 trillion.

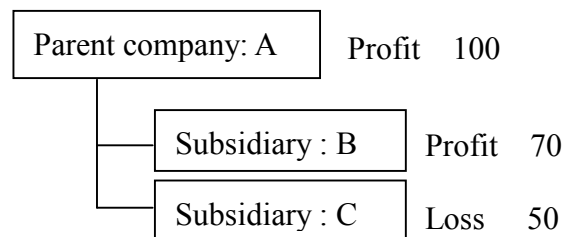
Although most thinktanks are forecasting the economy will improve slightly in fiscal 2002, it is still expected to stay in contraction due to further dips in corporate capital spending and consumer prices. Some economists say the draft budget, which is bound by Prime Minister Junichiro Koizumi's pledge to impose a ¥30 trillion cap on new government bond issues, lacks sufficient fiscal provisions to help prevent the economy from falling into a deflationary spiral.

In addition, a package of tax reform proposals for fiscal 2002 includes few effective measures to stimulate the economy. This is primarily because the government has no money with which to fund a major tax break. Under these circumstances, Mr. Koizumi indicated he will start reviewing the tax system in earnest early this year with a view of making sweeping changes and reflect them in the fiscal 2003 budget.

Now, let's take a look at key points of the fiscal 2002 Tax Reform Plan which is to become effective from April 1, 2002.

(1) Introduction of consolidated corporate taxation system

Consolidated corporate taxes will be levied on the corporate group (a parent company and its wholly owned subsidiaries) as a whole rather than individual group companies.



Taxable

	A	B	C
Current system	100	70	0
Consolidated system	100 + 70 - 50 = 120		

To compensate for the ¥800 billion revenue shortfall stemming from the introduction of this system, the following measures will be taken: ① imposing a 2% surtax for two years (¥100 billion); ② limiting the amount of subsidiary losses, etc. which can be included before consolidating (¥250 billion); ③ abolishment of retirement allowance reserves, limiting tax deductions for dividends received, etc. (¥400 billion).

(2) Expansion of preferential tax measures on stock-option programs

• The ceiling for taxation on exercised options to be carried forward has increased from ¥10 million to ¥12 million.

• Directors and employees of subsidiaries (over 50% ownership) will also be eligible

for preferential measures.

(3) **Increase of allowable deductions for entertainment expenses from ¥3 million to ¥4 million for companies with capital above ¥10 million and ¥50 million and under.**

(4) **Creation of a system under which brokerage firms will make withholding tax payments on behalf of individual investors.** This will be in effect from January 2003 when the current withholding tax system on stock sales is scrapped.

(5) **Phase-out of the “Maruyu” program for the elderly. Starting in January 2003,** the 20% tax on interest and yields from bank deposits and government bonds etc. will be phased out over three years, with a ceiling of 3.5 million.

Single-parent families and the disabled will remain eligible.

(6) **10% Inheritance tax income reduction of inherited shares (up to ¥300 million) from a family-owned company.**

(7) **Creation of a special financial zone in Okinawa Prefecture**

Financial institutions starting business in this special financial zone will be allowed to deduct 35% of their taxable income for 10 years.

(8) **Introduction of a local tax called “a pro forma standard tax” in fiscal 2003 at the earliest.**

This tax would be based on the number of employees, total wages, the size of capital, etc. and would also be levied on loss-generating companies.

II

Future Topics

As mentioned above, Prime Minister

Koizumi has requested both the government's Tax Commission and the LDP's Tax Commission to start a thorough review on the current tax system early this year. Among main issues to be discussed in the large-scale tax reform for fiscal 2003 will likely be ① lowering of the minimum taxable income for individuals, ② review of special road construction taxes, ③ introduction of a carbon tax, ④ overhaul of local allocation of taxes and ⑤ review of the consumption tax.

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