

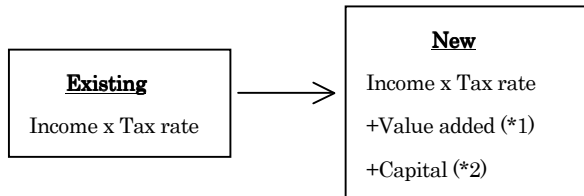


I 2004 Tax Reforms

The 2004 Tax Reform proposal was passed by the Parliament on March 20, 2004. According to a government spokesperson, "With a view to contributing to a continued invigoration of the economy and society, and considering the current economic and fiscal environment, the 2004 Tax Reform will affect land and housing taxation, SMEs (small-and-medium-sized enterprises), financial assets and stocks, and corporation and international transactions." This is a summary of the corporate and payroll tax reforms:

A. CORPORATE TAXES

- 1) NOLs – Extension of the period for Net Operating Losses carried-forward from the current five years to seven years.
- 2) Suspension of the net loss carryback provision - Suspension of the net loss carryback benefit has been extended for an additional two years. This will not apply for certain SMEs.
- 3) File retention - The storage period of bookkeeping records has been extended from five years to seven years.
- 4) Thin capitalization rule - New Japanese thin capitalization rules will allow the taxpayer to refer to a single fiscal year for comparables, rather than the past three years.
- 5) Per capita tax - 'Taxation of corporations by size' to be applied for companies with capital in excess of 100 million yen.



(*1) Value added = (Salaries + Interest + Rent + Profit) x 0.48%

(*2) Capital = (Capital + Additional paid in capital) x 0.2%

B. PAYROLL TAXES

- 1) Extension of the Housing Loan Tax Credit - The same tax credit will continue through 2004. The amount of credit will gradually be reduced from 2005 to 2008.
- 2) Extension of certain tax exemptions for interest paid by employees – If the employer continues to charge 1% or higher interest to the employee, this exemption can be extended until 2006.
- 3) Non-taxable amount for car commuter allowance
Prior to April 1, 2004:
35km and over 20,900 yen
From April 1, 2004:
35km to 45km 20,900 yen
45km and over 24,500 yen
- 4) Special deduction for spouses – This will no longer apply if the spouse's income is under 380,000 yen.

C. OTHERS

- 1) Capital Losses - For individual income taxpayers, capital losses from the sale of land and building cannot be offset with any other income.
- 2) Capital Gains - Income tax rates on capital gains arising from privately held stocks will be reduced from 26% (current level) to 20%.

II New Japan-US Tax Treaty

On March 30, 2004, Japan and the United States exchanged ratified copies of the "Convention between the government of Japan and the government of the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income." The New Treaty is consistent with the OECD Model Treaty and includes a zero rate on certain dividends and all royalties. It also aims at promoting trade and investment between the world's two largest economies. Some of the main points under the New Treaty are:

1) Royalties

In one of the most significant developments in the Japan-US treaty, royalties are exempted from withholding tax. However, a maximum withholding tax rate of 5% is imposed on royalties paid in excess of an arm's length amount.

	Existing	New
All royalties	10%	0%

The new zero percent withholding tax rate applies to transactions occurring on or after July 1, 2004. However, intentional delays on payments will be subject to tax avoidance assessments.

2) Dividends

	Existing	New
Dividends paid to corporate shareholders owning more than 50% of the voting stock	10%	0%
Dividends paid to corporate shareholders with 10%~50% ownership of the voting stock	10%	5%
Dividends paid to other corporate shareholders	15%	10%

3) Interest Income

Governments, the Central Bank and certain financial institutions will benefit from an exemption on interest withholding. However, interest withholding remains at 10% for other taxpayers.

4) Limitation On Benefits (LOB)

Only residents satisfying the conditions of the LOB provision will be entitled to benefit from the treaty.

5) Effective Date

With the exception of withholding taxes, which take effect on July 1, 2004, all other provisions of the Act are effective January 1, 2005.

III Social Security Agreements between Japan and the US

Japan and the United States have signed social security agreements on February 20, 2004 and the agreements are expected to go into effect next spring. The agreements will exempt expatriate employees from making payments to each country's social insurance plan (see below for details). Employees from both countries can now include the employment period in the other country in determining their qualification status. As long as such aggregated term satisfies the necessary length of contribution (Japan: 25 years; U.S.: 40 quarters = 10 years), they will become

eligible to receive benefits from their respective home country according to the number of years and amounts they contributed.

Pension Plan	Can be aggregated from both countries.
Health Insurance	Will be exempt from premium payments in visiting country. Premiums to be paid directly to home country.

1) Assignment period is five years or shorter

Employees need to participate only in their home country's pension and health insurance systems, and are exempt from the other country's system. Upon applying for an extension, they may continue to be exempt for an additional 3 or 4 years.

2) Assignment period is longer than five years

Employees are required to join the other country's pension and health insurance systems from the start of his/her new post. Aggregation of pension contributions can be made in their home country.

3) Retroactive application of the agreements

In general, the term of employment prior to the adoption of these agreements can also be included as part of the home country's pension contribution period. However, numerous issues must be considered as employees move between countries.

For details of the Agreements, please refer to: <http://www.mofa.go.jp/region/n-america/us/agree0402.pdf>

IV Revised Labor Standards Law effective January 1, 2004 (excerpt)

Companies are now required to include a paragraph in their work rules or employment contracts which would mandate employers to explain the nature of any terminations. If there are no reasonable grounds for termination, any dismissal shall be treated as an abuse of rights and deemed invalid.

If you have any specific questions, please send an e-mail to info@okamoto-co.co.jp.

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