



## J-GAAP and IFRS

### **Topics under discussion**

On March 27 and 28, the Accounting Standards Board of Japan (ASBJ) and the International Accounting Standards Board (IASB) held their fifth joint meeting in increasing convergence between Japanese GAAP and IFRS in Tokyo. Developments were made in the following areas: intangible assets (including R&D expenses), retrospective restatement, scope of consolidation (disclosure related to special purpose entities), post-retirement benefits and business combinations. The next meeting is scheduled in London.

### **Evaluation of J-GAAP**

In the 2005 EU equivalence assessment, the CESR reported 26 items which required remedies to Japanese GAAP. Another assessment report is scheduled for early 2008. The FSA and EC are jointly developing a two-way monitoring framework on the convergence progress, to move towards mutual recognition.

### **J-GAAP in the U.S.**

The FSA is working with the SEC in exploring the possibility of mutual recognition of each other's accounting principles. However, to recognize any foreign standards, the SEC has placed conditions that the accounting standards must be widely used in the US market and that the standards must be comprehensive, high quality and consistently interpreted and applied.

## “J-SOX”

### **General**

On February 15, 2007, the Business Accounting Council finally released its report on the establishment of Standards and Implementation Standards for Evaluation and Auditing of Internal Control over Financial Reporting (the “Implementation Standards”).

### **Differences with U.S.SOX**

Similar to the U.S.-SOX, the suggested overall approach for the management evaluation of internal control is a top-down, risk-based approach. However, the scope of the audit differs. The current US-SOX requires an audit of both the effectiveness of management's assessment of Internal Control over Financial Reporting, and also a direct audit of the Internal Controls itself. Under J-SOX, the requirement is solely on the audit of the effectiveness of management's assessment of Internal Control over Financial Reporting. However, based on the proposed U.S. PCAOB standard, only the direct audit of the Internal Controls over Financial Reporting will be required.

### **Effective Date**

The new Japanese standards require all listed companies in Japan to submit consolidated internal control reports from the fiscal year ending March 31, 2009.

## 2007 Tax Reform Act 1~6

### (also includes update to 2006)

The main objective of the 2007 Tax Reform Act is to invigorate small and medium sized enterprises and enhance Japanese competitiveness in the international market. Compared with the 2006 tax reform which was primarily tax increases such as the abolition of Special tax reduction and non-deductible director's compensation for one-man family corporation, the 2007 Tax Reform focuses on the economy. On the other hand, compliance with the New Company Act and cost burdens from the implementation of Japanese SOX is an administrative burden on many corporations. The following summary does not cover all aspects of the Act, but only includes topics which we felt would be of the most interest to our clients.

### **1. Related to the Company Act**

#### **(Edited by Tokyo Roppongi Low Offices)**

The Company Act formalizes the procedures required by corporations. The following are the main points relating to yearend:

#### **1) Approval by annual shareholder's meeting on annual financial statements**

Within 2 or 3 months after yearend (depending on the article of incorporation), the annual shareholder's meeting will be held to approve on annual financial statements. One month extension filing on tax returns is applied if the annual shareholder's meeting is held within 3 months.

#### **2) Determination of Director's compensation for coming year**

Under the revised tax laws, when any change to the director's salary should be determined within three months of the new fiscal year. Changing a director's compensation retroactively through an approval of an extraordinary shareholder's meeting, to increase or decrease a director's salary without substantial reason and to pay commissions to directors will no longer be permitted for Japanese corporate income tax purposes (refer to “Director's Compensation” for details).

#### **3) Public Notice of Financial Statements**

Corporations including Japan branches of foreign corporations are required to disclose a summary of their financial statements such as 1) Official Government Gazette 2) Daily newspapers 3) Company website. Corporations should elect how to disclose a summary of their financial statements in the articles of incorporation. Otherwise, corporations are assumed to disclose in the Official Government Gazette.

#### **4) Quasi-foreign companies**

Although a company may be established in a foreign country, if the primary purpose of its establishment was to conduct business in Japan the company is considered a “quasi foreign company.” In

general, such companies are no longer permitted to conduct business under this structure (Company Law Section 821). If you have concerns about your entity, please contact your attorney for details.

## 2. Revise tax rate both National and Local tax

Inhabitation taxes, which previously had three tax brackets of 5%, 10% and 13% have all converted to a flat 10% (4% prefectural and 6% municipal) rate from this year. As a result, there will be individuals who will incur higher (and lower) inhabitation taxes. However, the income tax rate for individuals in the 10% tax bracket in the previous year will now be in the 5% tax bracket, and those in the highest 37% tax bracket will now be in the 40% tax bracket. The number of tax brackets will increase from four to six. In computing inhabitation taxes, they will also be considerations for dependents. These changes are considered in a shift of income taxes from the federal government to the local governments. With the exception of the abolition of the fixed-rate tax cuts, the total tax burden for individuals remain essentially unchanged.

## 3. Taxation on Financial, Securities & Housing

### 1) Taxation of stocks

The current preferential treatments to apply a 10% withholding tax rate instead of 20% for dividend and capital gains on listed stocks will be extended for one year.

### 2) Housing Loan Tax Credits

New tax regulations on the amount of annual tax credit available will be introduced. This is because the amount of available tax credit may shrink for low and middle income earners due to the transfer of the tax revenue sources from national to local governments. [Detailed information is available in the Japanese version.]

### 3) Gain and Loss Statements for each Partner

An unlimited liability partnership is required to submit statement of gains and losses to each limited partner to the tax office by January 31 of the following year. This reform applies to the statements being submitted on or after January 1, 2008.

### 4) Requirements of Information Return and Withholding Tax on "Tokumei Kumiai" Distributions

Formerly, this requirement applied only to the distributions to residents and domestic companies when the total number of TK partners exceeded 10. Now they apply to all distributions regardless of the number of partners. This reform applies to all distributions made on or after January 1, 2008.

## 4. Director's Compensation

### 1) Family Corporations surtax

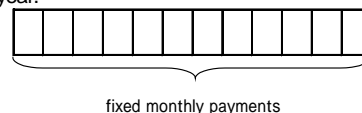
For accounting years beginning on or after April 1, 2007, undistributed profits of Family Corporations (i.e. companies with group ownership in excess of 50%), with paid-in capital of 100 million yen or less, will not be subject to Family Corporations surtax.

### 2) Directors' Compensation -Fixed monthly payment-

Additional clarification has been issued since our May 31, 2006, Tax alert. Under the new guideline, deductible directors' compensation can be clarified as one of the following types;

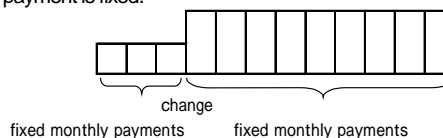
#### Type #1

A fixed monthly salary will be applied from the first month of the fiscal year.



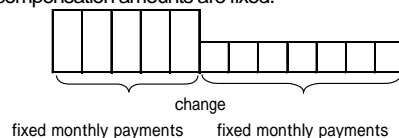
#### Type #2

New compensation will be applied from the fourth month of the fiscal year upon approval from the Board of Directors' meeting. With the exception of the one-time change in compensation, each monthly payment is fixed.



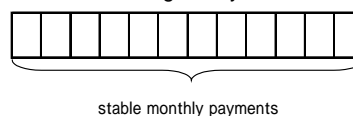
#### Type #3

When the monthly salary decreases due to a significant deterioration in the company's financial situation, otherwise the compensation amounts are fixed.



#### Type #4

Fringe benefits which are provided on a continuous basis and the amount of the benefits is generally stable month to month.



### 3) Late charges to directors' compensation

In the past, if the new compensation was undecided by the designated timeframe, retroactive adjustments (i.e. adjustments to past salary) were accepted and those amounts were treated as being deductible. From the latest tax revision, such differences are no longer tax deductible.

### 4) Change of directors

When a directors' compensation changes in accordance with a change in position of the director, that new compensation amount will be considered deductible as long as the amounts are fixed.

## 5. Depreciation

### 1) Abolishment of salvage value and limit on depreciable amount

(1) Tangibles which will be in service after April 1, 2007

Salvage value (10% of acquisition cost) and the limit on depreciable amount (95% of acquisition cost) were abolished, therefore, companies can depreciate assets until the net book value (NBV) of the assets is 1 yen.

(2) Tangibles which were in service prior to March 31, 2007

Tangibles which were in service prior to March 31, 2007 will continue to be depreciated under the old method (i.e. until NBV of assets reach 5% of acquisition cost). Thereafter, companies can evenly depreciate the remaining NBV over a period of 5 years until the NBV reaches 1 yen.

### 2) Revision of depreciation rates used for calculating declining balance method

- (1) Depreciation rates: 250% greater than the straight-line method  
 (2) Methodology:  
 (a) Depreciation expense for the year = Acquisition cost or Beginning NBV \* (1)  
 (b) If depreciation expense calculated by the above formula is less than the amount that calculated by the following formula, the following formula will apply until NBV of assets is reduced to 1 yen.  
 NBV / Residual number of years in its estimated useful life

### 3) Evaluation method of depreciable assets for property (depreciable assets) taxes

The evaluation method for depreciable assets for property tax return purposes remains unchanged.

## 6. Lease Transactions

### 1) Classification of lease transactions

Classification		Accounting	Taxation	
			Before revision	After revision
Financing lease (*1)	Transfer of title	Sale and purchase	Sale and purchase (Financing)	Sale and purchase (Financing)
	No transfer of title	Sale and purchase	Lease (Financing)	Constructive sale and Purchase (Financing)
Operating lease		Lease	Lease	Lease

(\*1) Lessee is unable to cancel the contract and substantially pays for the cost of the leased assets through lease payments.

### 2) Various tax treatments for finance lease without transfer of title

#### (1) Corporate income taxes

	Taxation
Useful lives	Lease term
Salvage value	Zero
Depreciation method	Straight-line
Allocation method of interest	Effective interest method or straight-line
Small value leases (*1)	Rent is depreciation expense
Short-term leases (*2)	

(\*1) Small value leases are lease agreement in which the total lease payments are less than 3 million yen in principle.

(\*2) Short-term leases are lease agreement in which the lease term is shorter than one year in principle.

#### (2) Consumption taxes

Finance lease without transfer of title is regarded as a purchase and sale under Consumption Tax Laws. Therefore, consumption tax paid (or consumption tax received) is recognized at the beginning date of the lease term.

#### (3) Property taxes

Finance lease without transfer of title was regarded as a purchase and sale with reservations under Local Tax Laws. Therefore, the seller (lessor) and purchaser (lessee) are joint owners of the lease asset, however the lessor will continue to pay property taxes as a sole owner for property tax return purposes.

## Payroll Update

From April 2007, we will start seeing numerous changes in the Japanese social insurance system.

### 1. Health Insurance

- There will be additional four grades at the low and high ends of the insurance premium table. This increases the number of grades from 39 to 47.
- Restate the upper limit of the annual leviable bonus amount to ¥5.4million per year (4/1 - 3/31 next year) for insurance calculation.
- Increases in the jury/sickness and maternity leave allowances from 60% to 66.67% of the employee's average daily wage.

- Abolition of injury/sickness and maternity leave allowance for members wishing to continue the health insurance system (however, individuals who received before April 1, 2007, may continue collection after April 1, 2007).
- Abolition of the extended maternity allowances for those who have delivery within six months after her last day of employment.
- It will become possible for insured persons under the age of 70 to claim benefits to the medical institutions for the high-cost medical care by constantly paying the maximum amount. However, one must be certified as an insured person through the issuance of a certificate beforehand.

### 2. Pension Insurance

- From April 1, 2007, divorced couples may split their welfare pension entitlements (remuneration related portion) vested during their period of marriage upon agreement of both parties or an approval by a family court.
- For those born after April 2, 1937, when the employee reaches age 70, a portion of Old-age Employee's Pension may not be payable in certain instances. Employers must submit reports regarding employment, retirement, or salary statements for such employees.

### 3. Worker's compensation insurance

For the purpose of aiding the victims of asbestos, the burden of employer's portion of workers' compensation insurance will slightly rise (0.005%).

### 4. Employment Insurance

Premium rates are as shown:

	Premium total	By Employer	By Insured person
Ordinary business	1.5%	0.9%	0.6%
Agriculture, Forestry, and Fisheries (Brewing industry)	1.7%	1%	0.7%
Construction business	1.8%	1.1%	0.7%

### 5. National Pension

A raise in the premium of ¥240 to ¥14,100 (month)

### 6. Equal Employment Opportunity Law

Originally, the law was established to eliminate discrimination against females. However, the new law now also applies to males. It explicitly forbids any discrimination between genders in the process of job advertising, recruiting, job assignments (including allocation of duties and grant of authority), promotion, training, fringe benefits, retirement, or any other employment situations. As an example, the law forbids actions such as demotion, change in type of job or employment status, encouragement of retirement, and updating employment contract. Further, it shall be a legal obligation for all employers to discourage sexual harassment at workplace. This includes the protection of males, not only females.

### 7. International Social Security Agreements

In October 2005, the Social Security Agreement between Japan and the US came into effect. The Agreement grants Japanese nationals (or Americans) working in the US (or in Japan) an exemption to join the US (or Japanese) social security system for up to five years upon providing an exemption certificate. Further, the agreement permits combining summing the periods contributed towards both the

Japanese and US pension systems ("totalization"). If such periods total 10 years or more, individuals will be eligible for US social security. If such periods exceed 25 years, individuals will also be eligible for Japanese pensions. Similar agreements will be executed between Japan and Belgium in January 2007, and one between Japan and France will go into force in June 2007. Currently, Japan works on such agreement with Canada and Australia. Details are still being discussed for the agreement with Holland.

Germany	Signed April 1998	Effective February 2000
United Kingdom	Signed February 2000	Effective February 2001
Korea	Signed February 2004	Effective April 2005
United States	Signed February 2004	Effective October 2005
Belgium	Signed February 2005	Effective January 2007
France	Signed February 2005	Effective June 2007
Canada	Signed February 2006	In final discussions
Australia	Signed February 2007	In final discussions
Holland	In discussions	

#### Status of International Social Security Agreements

Country	Scope of Insurance System covered by the Agreement	Totalization Agreement
Germany	Japan: Pension Germany: Pension	Yes
United Kingdom	Japan: Pension U.K.: Pension	No
South Korea	Japan: Pension South Korea: Pension	No
United States	Japan: Pension and Health U.S.: Pension and Health	Yes
Belgium	Japan: Pension and Health Belgium: Pension, Health, Worker's compensation insurance and Unemployment	Yes
France	Japan: Pension and Health France: Pension, Health and Worker's compensation Insurance	Yes
Canada	Japan: Pension Canada: Pension	Yes
Australia	Japan: Pension Australia: Pension	Yes

### **Establishment of Yamamoto Social Insurance and Consultant Office**

Effective April 1, 2007, Yoko Yamamoto, an experienced social insurance and labor consultant, has moved her office within Okamoto & Company.

#### **Primary Services Offered:**

- 1) Consulting on social and labor insurance procedures
- 2) Consulting of employee workrules, overtime, labor related administration
- 3) Consulting on pensions for the elderly and the disabled
- 4) Consulting on pension procedures and claims for the aged and the disabled, and as well as pension benefits for survivors (approximately 2,500 pension consultation cases to date)
- 5) Application for various governmental subsidies/benefits.

All companies in Japan must be registered with the social and labor

insurance agency. Yamamoto Social Insurance Consultant Office, our new affiliate, assists in such application filings, including benefit applications and required registrations. Yoko Yamamoto, an adviser on personnel and labor affairs, can also correspond with various agencies, stand in as a proxy in individual labor disputes.

### **Preparation of English Annual Reports**

In an environment where foreign investment into Japan continues to grow, the need for adequate financial reporting and disclosures for Japanese public companies is rising. The financial section of such English annual reports requires technical accounting expertise. Knowledge of the differences among Japanese GAAP, US GAAP and IFRS are necessary to properly address issues faced by foreign investors. Inadequate or erroneous disclosure may also be worse than no disclosure at all. Many companies require and seek professional help.

If you would like high quality service but do not have the budgets to seek assistance from the Big Four, Okamoto & Company may be a good fit for you. We employ numerous US CPAs and have experience preparing English annual reports for dozens of public companies in Japan in a wide range of industries.



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