Global Rewards Update: Japan — Equity Reporting Requirement
August 2012

Note: This communication is an update to the Global Rewards Update for Japan that was released in March 2012

Background

Our March 2012 Global Rewards Update introduced the new employer equity reporting requirement due to come into effect from January 1, 2013.

To recap: to date, there has been no employer reporting or withholding tax requirement in Japan when resident employees receive equity awards (e.g., stock options, performance shares, restricted stock units (RSUs)) from the foreign parent entity, provided the plan is administered outside Japan and the foreign entity does not recharge the cost of the equity awards to the Japanese subsidiary. Instead, the employee has been responsible for reporting the income from equity rewards on their individual income tax return due March 15 following the tax year-end.

Recent tax audits, however, have exposed cases of significant levels of underreporting of equity income by some employees, and it is in response to this issue that the new reporting requirement was implemented as part of the 2012 tax reforms.

From 2013, Japanese subsidiaries that are owned (directly or indirectly) 50% or more by a foreign entity and Japanese branches of foreign entities will be required to submit an annual statement to the national tax office detailing any income realized from equity income (including cash awards where the underlying value of the award is based on share value) for their tax-resident employees and directors. This statement would be due by March 31 of the year following the year of realization, with the first statement being due March 31, 2013, for transactions arising in 2012.

Format of the statement

Since our last communication, and the promulgation of the 2012 tax reforms on March 31, 2012, the Japanese National Tax Agency has released regulations addressing the data to be reported, as well as a template of the reporting form itself.

Rather than a summary report covering all employees, the tax authorities are requesting that a separate form be prepared for each relevant employee. The appearance of the proposed form is similar to that of the existing statement of income (withholding tax) or Gensen Choushuu-hyou that summarizes an employee’s annual earnings.

Details that need to be included on the equity reporting form are:

• The name and address of the individual receiving the income.

• Details of the compensation received (including date of receipt, details of the payment (i.e., whether paid in shares or cash), the total value of the compensation received, the exercise price paid, the number of units and the value of those units at receipt (e.g., the share price), and the currency of the transaction).

• The date the right to receive the income was granted (i.e., the grant date), the type of right (i.e., the type of scheme — stock options, RSUs, etc.), the total entitlement (i.e., total cash, number of shares, etc.) the individual has under the grant.

• Name of the issuing parent company and the country where it is based.
The name, address, and telephone number of the issuer of the statement.

The form, in its current format, only has space to report a maximum of three transactions per individual. We are in the process of discussing with Japanese tax authorities how individuals with a larger number of transactions should report the additional information and whether alternative formats will be acceptable.

### Action

It is important that branches, subsidiaries, and joint ventures of foreign companies based in Japan identify whether they will have a reporting requirement and begin collating the information required for the 2013 disclosure. We would propose the following three-step approach:

- **Step One**: Identify whether the Japanese entity would be a qualifying company under the 50% holding condition. Where the direct relationship between the parent company and the entity in Japan is complex or unclear, we would recommend a formal review of the corporate structure be carried out by a tax professional.

- **Step Two**: Perform a review of all equity and equity-based plans to identify what transactions are reportable under the new rules and the specific values that should be reported on the form. This can be complex, as there is little guidance contained in the Japanese tax law and regulations that specifically address the taxation of foreign equity. For any plans beyond a “vanilla” stock option or RSU plan, we would recommend professional advice be sought.

- **Step Three**: Perform a review of the Japanese tax residence position (at the time of receipt) of all affected employees to identify those individuals for whom a report will need to be filed. This will be most difficult for individuals not currently on the Japanese payroll where the Japanese company may not be aware of their tax residence status. Care must also be taken for globally mobile employees whose tax residence may change throughout the year.

Where the local entity has a reporting requirement, the correct data should then be collated on an ongoing basis for the individuals identified under Step Three. This data, if collated on a timely basis, may also serve to assist the company’s employees in preparation of their tax returns due by the March 15 deadline.

It is recommend that companies use the new legislation as an opportunity to remind their employees of their personal obligation to report any foreign equity income on their tax returns. Another change implemented in the 2012 tax reforms was an extension to the number of years, from three to five, that the tax authorities are able to go back in the event of underreporting being discovered. These two changes — the new reporting requirement and this extension — mean that there is a greater likelihood that underreporting will be identified and the amount of tax, interest, and penalties due to the tax office will be more than was previously possible.

Companies should consider the extent to which they are communicating the new rules and the increased audit risk to their employees, both to fulfill their obligation as an employer and to avoid any potential conflict or reputational risk at a later date.

### People to contact

For assistance in this matter, or any other issue related to the operation of your global rewards plans, please contact your local Deloitte global rewards consulting services advisor or email us at globalequity@deloitte.com, and a Global Rewards consultant will contact you.

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