

Japan tax alert

Ernst & Young Shinnihon Tax

2012 Japan tax reform proposals introduce earnings stripping rules

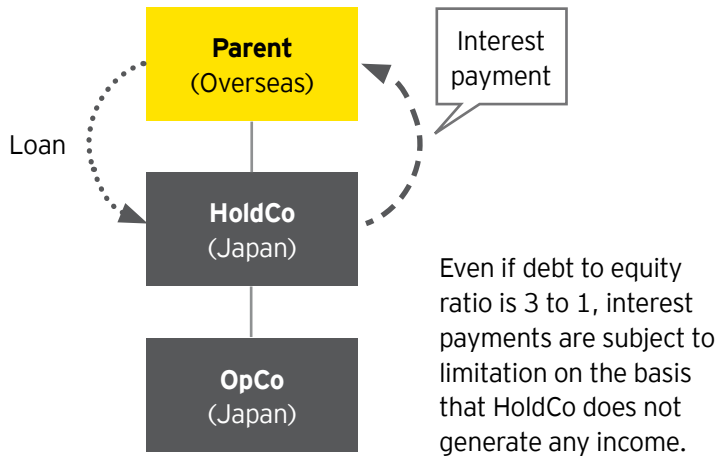
On 9 December 2011, the Japanese government released an outline of its tax reform proposals for 2012. These proposals will form the basis of a finance bill, expected to be introduced in the Diet in February 2012. In particular, the proposed introduction of earnings stripping rules may or may not significantly impact debt push-down structures into Japan. The current Japanese tax law contains thin capitalization provisions, which prescribe a 3:1 debt-to-equity ratio (determined on a stand-alone financial statements basis). Interest expenses in excess of this ratio are permanently disallowed as a tax deduction for corporate income tax purposes. As in the case of earnings stripping rules in some European countries, Japan's proposed reforms introduce restrictions in addition to the thin capitalization rules. The new rules will cap interest deduction derived from "net" interest payments to related parties at 50% of adjusted taxable income. For more details, please see below.

1. Interest costs subject to limitation would include guarantee fees, etc.
2. Excess interest will be carried forward for up to seven years.
3. Adjusted taxable income is calculated by adding back the following items to taxable income (for corporate tax purposes):
 - ▶ Interest payments made to related parties
 - ▶ Depreciation
 - ▶ Exempt dividends, etc.

4. The 50% threshold is determined on a stand-alone financial statements basis unless the entities are part of a tax consolidation group in Japan.

Note that, Japan HoldCo structures with intercompany debt should be reviewed to ascertain if corrective action is required in order to mitigate the impact of these provisions. If an adverse result is anticipated, tax planning ideas such as tax consolidation, merger, cash repatriation or refinancing of HoldCo debt may be considered.

Example



The anticipated tax reform will be applicable to fiscal years starting on or after 1 April 2013.

Comments or general inquiries regarding this tax alert may be directed to our Corporate Communications team at tax.marketing@jp.ey.com.

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