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Understanding the deductibility of officer’s compensation as a business expense can often be difficult for foreign taxpayers as there are various restrictions on deducting such compensation for Japanese tax purposes. In order to avoid an unexpected disallowance or loss of opportunity for deduction, taxpayers should pay close attention to the rules surrounding deductibility.

1. Who is an officer
The definition of “officer” under Japanese tax law is broader than the general meaning and includes the following individuals:

a. Director of a corporation
b. Operation manager

c. Accounting counselor
d. Statutory auditor
e. Liquidator
f. Other persons engaged in managing a corporation

“Other persons” include the following individuals:

g. Persons who are not employees of a corporation that are engaged in managing the corporation, including:

(i) President, chairman, vice president etc. who are not directors of a corporation;

(ii) An individual manager of a Godo Kaisha (GK), Goshi Kaisha or Gomei Kaisha;

(iii) Officers stipulated in the articles of incorporation; and

(iv) A consultant or an advisor who is in fact engaged in managing a corporation in the same way as other officers.

h. Employees of a family corporation managing a corporation and meeting all of the following conditions:

(i) Being in a shareholder group owning more than 50% of a corporation or shareholder groups owning 50% or more in aggregation of two or three largest shareholder groups;

(ii) Being in a shareholder group owning more than 10% of a corporation; and

(iii) Owning more than 5% of a corporation

2. Disallowed officer’s compensation
A deduction for officer’s compensation is not allowed unless such compensation qualifies as:

- Fixed regular salary;
- Pre-determined/pre-reported salary; or
- Profits related salary.

2.1 Fixed regular salary
Fixed regular salary is salary paid periodically (e.g. monthly or shorter period) where the amount is the same for each period. Where the periodical amount is changed for the reasons below, the periodical amount must be the same for the period from the beginning of a business year through the day before the first period after the salary is changed and from the next day to the last period before the salary is changed to the end of the business year:

- Annual salary change made within 3 months from the beginning of the business year;
- Salary change based on significant changes in the status or duty of a director; or
- Salary decrease in response to a significant performance issue.

2.2 Pre-determined/pre-reported salaries
Pre-determined/pre-reported salaries are fixed amounts that are paid pursuant to pre-determined timing of which prior notice has been filed with the tax office. Such prior notice must be filed by the earlier of:

- one month after the ordinary shareholders’ meeting where the salary payments are resolved is held; or
- 4 months after the beginning of a business year.

As a practical note, when paying performance bonus to officers, it is sometimes difficult to pre-determine the amount and payment timing.

2.3 Profit related salaries
Profit related salaries are salaries paid to officers of a non-family corporation that meet all of the following conditions:

a. The calculation method is objective with reference to profit indicators in annual report (Securities report: Yuka Shoken Hokokusho) and must satisfy the following criteria:

- Limited under the fixed amount and equally applicable to other officers;
- Determined by a compensation committee within 3 months from the beginning of a business year; and
- Amounts are reported in the securities report or otherwise disclosed without delay.

b. Paid or expected to be paid within 1 month after profit indicators are fixed; and

c. Expensed in accounting ledgers.

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1 A person managing a company in a company with a committee governance structure (Article 402 of the Company Law)

2 A family corporation is a corporation of which more than 50% of outstanding shares or voting rights are owned by the three largest individual shareholders.

3 A securities report (Yuka Shoken Hokokusho) is required to prepare for a public company in accordance with the Securities Instruments Transaction Law.
3. **Excessive officers compensation**
Deductions for officer compensation can be disallowed where such compensation is excessive, even though they qualify as fixed regular salaries, pre-determined/pre-reported salaries or profit related salaries. Compensation will be considered excessive where (i) it exceeds the limit amount stipulated in the articles of incorporation or shareholders’ meeting minutes or (ii) it is excessive with reference to duties of officers, corporate performance, employee’s salaries or officer’s salaries in comparable corporations in terms of business lines and business size.

4. **Excessive officers retirement allowance**
Officer’s retirement allowance is tax deductible unless it is unreasonably excessive. Whether or not officer’s retirement allowance is excessive is determined by reference to an officer’s performance, reasons for retirement, number of years of service, corporate business performance, retirement allowance payments in comparable corporations in terms of business line and business size.

5. **Officers with employee status**

5.1 **Who is an officer with employee status**
Officers with employee status are officers who have employee status (such as managers) and are engaged regularly in the employer’s service. Officers titled representative director, chairman, executive director etc. cannot be an officers with employee status. Officers in 1.h.(i),(ii) and (iii) cannot be an officers with employee status.

5.2 **Tax treatment**
The employee portion of officer’s compensation are not subject to restrictions on deduction and entirely deductible.

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