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KPMG Japan tax newsletter

Special Reconstruction Zone Act and Amendments to the Special Tax Law for the March 11 Earthquake



On 7 December 2011, the Diet approved the bill for the Special Reconstruction Zone Act aimed at facilitating reconstruction after the March 11 earthquake.

In addition, the bill to revise the Special Tax Law for the March 11 Earthquake originally enacted on 27 April 2011 was also passed by the Diet on the same day to provide for tax measures in line with the Special Reconstruction Zone Act.

This newsletter outlines the major tax measures for corporate taxpayers introduced by these laws.

I. TERMINOLOGY

The following list indicates keywords used in this newsletter:

Keywords	Definitions
Specified Disaster Zone	Certain municipal areas or any equivalent areas to which the Disaster Relief Act applied following the March 11 earthquake
Reconstruction Plan	A plan prepared by each local government of a Specified Disaster Zone to implement activities in order to facilitate the smooth and speedy reconstruction of the Specified Disaster Zone
Qualified Reconstruction Plan	A Reconstruction Plan that is endorsed by the Prime Minister
Qualified Local Government	The local government of a Specified Disaster Zone with a Qualified Reconstruction Plan
Industrial Concentration Zone	A zone in the Reconstruction Plan designated for promotion of industrial concentration and activity in order to achieve goals specified in the relevant Reconstruction Plan
Specified Industrial Concentration Zone	An Industrial Concentration Zone, all or a part of which includes municipal areas where many disaster-affected people have lost their jobs or where industrial production bases have been significantly damaged
Industrial Concentration Businesses	Businesses which contribute to job creation by promoting industrial concentration and activity in areas where many disaster-affected people have lost their jobs, or where industrial production bases have been significantly damaged (excluding Construction Business as discussed below)
Construction Businesses	Building construction/leasing businesses which promote industrial concentration and activity in areas where many disaster-affected people have lost their jobs, or where industrial production bases have been significantly damaged
Designated Company	A company designated by a Qualified Local Government as having met certain conditions, including having an appropriate and reliable plan to carry out Industrial Concentration Businesses ^(*) ^(*) In the case of a company applying for 'II. 3. Special depreciation/tax credits for business assets' discussed below, this refers to Industrial Concentration Businesses or Construction Businesses

II. SPECIAL CORPORATION TAX MEASURES

The following tax measures have been introduced to promote job creation in disaster-affected areas:

1. Reinvestment reserves
2. Tax credits for job creation for disaster-affected people
3. Special depreciation/tax credits for business assets
4. Special depreciation for R&D assets

Note that measures 1, 2 and 3 may not be applied concurrently.

1. Reinvestment reserves

(1) Accumulation of reinvestment reserves

Where a company is given the status of a Designated Company during the period from the effective date of the Special Reconstruction Zone Act to 31 March 2016 and satisfies the following requirements, reserves accumulated for reinvestment in an applicable fiscal year^(*) will be tax deductible to the extent of the Designated Company's taxable income for that fiscal year:

- (i) The company is established on or after the day the Qualified Reconstruction Plan is endorsed.
- (ii) The company hires at least 5 disaster-affected people and total remuneration paid to them is JPY10 million or more.
- (iii) The company does not carry on any businesses other than Industrial Concentration Businesses provided in the Qualified Reconstruction Plan in the fiscal year that the company accumulates the reserve.
- (iv) The company's head office is located in a Specified Industrial Concentration Zone.
- (v) The company does not have any offices outside of the Specified Industrial Concentration Zone in the fiscal year the company accumulates the reserve.
- (vi) The company acquires depreciable assets (machinery, equipment, buildings or structures) to be used in its Industrial Concentration Businesses in the fiscal year where it is recognized as a Designated Company. The minimum requirement for the total acquisition costs is JPY300 million (JPY 30 million for small and medium-sized companies).

^(*) Refers to any fiscal year occurring in the 5-year period from the day the company becomes a Designated Company (excludes the fiscal year in which (i) a company goes into dissolution or (ii) a company is in the process of liquidation, etc.)

(2) Reversal of reserves

The amount of the reinvestment reserve carried forward from the previous fiscal year should be reversed in each fiscal year starting from the 'base fiscal year'. The 'base fiscal year' is the fiscal year in which falls the day 10 years from the day the company is recognized as a Designated Company.

Reversal of reserve	Balance of reserve as at end of base fiscal year x number of months in each fiscal year / 120
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(3) Special depreciation

When a company with reinvestment reserves acquires new depreciable assets (machinery, equipment, buildings or structures) and puts them to use for its Industrial Concentration Businesses in a Specified Industrial Concentration Zone, special depreciation will be available in addition to normal depreciation in the fiscal year that the assets are used. The depreciable limit under the special depreciation is the net amount of the acquisition costs less the ordinary depreciable limit, subject to a ceiling of the reversed amount of reserve in such fiscal year.

2. Tax credits for job creation for disaster-affected people

In order to promote job creation in disaster-affected areas, a new tax credit system has been introduced as follows:

Applicable company	A Designated Company (provided the company is recognized as a Designated Company between the effective date of the Special Reconstruction Zone Act and 31 March 2016)
Applicable period	5-year period from the day the company is recognized as a Designated Company ^{(*)1}
Condition	The Designated Company remunerates the disaster-affected people ^{(*)2} working in its offices. The offices must be conducting Industrial Concentration Businesses in an Industrial Concentration Zone.
Creditable amount	[Total amount of remuneration paid to disaster-affected people] x 10% (capped at 20% of corporation tax liability for the fiscal year)

^{(*)1} This rule will not be available in the fiscal year where (i) a company goes into dissolution or (ii) a company is in the process of liquidation, etc.

^{(*)2} Disaster-affected people for the purpose of this rule are defined as follows:

- individuals who were employed by disaster-affected employers, or
- individuals who lived in disaster-affected areas

3. Special depreciation/tax credits for business assets

If a Designated Company acquires new depreciable assets as indicated below and puts them in use for its Industrial Concentration Business or Construction Business in an Industrial Concentration Zone between the effective day of the Special Reconstruction Zone Act and 31 March 2016, the company will be able to apply either (1) special depreciation or (2) tax credits in the fiscal year^{(*)1} that the assets are put to use.

	(1) Special depreciation (Depreciable limit)		(2) Tax credits (Creditable limit) ^{(*)3}
(a) Machinery/ equipment	from the effective day of the Special Reconstruction Zone Act to 31 March 2014	[Acquisition cost] – [Ordinary depreciable limit] (i.e. total acquisition costs can be expensed upfront.)	Acquisition cost x 15%
	from 1 April 2014 to 31 March 2016	Acquisition cost x 50%	
(b) Buildings ^{(*)2} / structures	Acquisition cost x 25%		Acquisition cost x 8%

^{(*)1} Excludes fiscal years in which (i) a company goes into dissolution or (ii) a company is in the process of liquidation.

^{(*)2} If assets are used for Construction Businesses, this regime will be applied only to buildings meeting certain requirements.

^{(*)3} The tax credit is capped at 20 percent of corporation tax liability for the fiscal year. If the creditable amount exceeds the ceiling, such excess amount can be carried forward for 4 years.

4. Special depreciation for R&D assets

If a Designated Company acquires new R&D assets as part of its plan to promote industrial concentration and puts them to use for its R&D activities in an Industrial Concentration Zone from the effective day of the Special Reconstruction Zone Act to 31 March 2016, the company will be able to apply (1) special depreciation and (2) tax credits for R&D costs as follows in the year that the company uses them for its R&D activities.

(1) Special depreciation (Depreciable limit)	[Acquisition cost] – [Ordinary depreciable limit] (i.e. total acquisition costs can be expensed upfront.)
(2) Tax credits for R&D costs	When special depreciation is applied, the amount of depreciation expense for the R&D assets is treated as specified R&D costs ^(*) .

^(*) Under the rules for tax credits on total R&D costs, the creditable amount is calculated by multiplying total R&D costs by a certain ratio. If R&D costs are treated as specified R&D costs, 12 percent is applicable. Otherwise, 10 percent or less is generally applied.

III. TIMING OF APPLICATION

Note that the Special Reconstruction Zone Act will come into effect within 2 months from promulgation and the effective day will be designated by a cabinet order.

The measures discussed in II. above will become effective on the day the revised Special Tax Law for the March 11 Earthquake is promulgated or the effective day of the Special Reconstruction Zone Act, whichever comes later.

Moreover, the measure discussed in II.2 will apply to fiscal years ending on or after the day the revised Special Tax Law for the March 11 Earthquake is promulgated or the effective day of the Special Reconstruction Zone Act, whichever comes later.

KPMG Tax Corporation

Izumi Garden Tower, 1-6-1 Roppongi, Minato-ku,
Tokyo 106-6012
TEL : +81 (3) 6229 8000
FAX : +81 (3) 5575 0766

Epson Osaka Building 14F, 3-5-1 Bakuro-machi, Chuo-ku,
Osaka 541-0059
TEL : +81 (6) 4704 3188
FAX : +81 (6) 4704 3962

Dainagoya Bldg. 5F, 3-28-12 Meieki, Nakamura-ku,
Nagoya 450-0002
TEL : +81 (52) 569 5420
FAX : +81 (52) 551 0580

www.kpmg.or.jp/tax
info-tax@jp.kpmg.com

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