

Client Alert

June 2012

New Requirement: Japanese Subsidiaries and Branches of Foreign Companies Must Report Employees' Stock Option and Equity-Based Income

First Reports Due in 2013

Japan's 2012 tax legislation included new provisions requiring companies to file annual reports to the tax authorities where employees receive offshore equity-based compensation (including stock options, RSUs, or any other benefit related to the stock price or other performance indicator of the parent company or an affiliate). This applies even where the stock options or other equity-based incentives granted by the foreign parent company or affiliate do not result in a withholding tax obligation on the part of the Japanese subsidiary or branch. These provisions were implemented in light of frequent incorrect reporting by resident recipients of stock option income.

To summarize the rules, where resident employees or directors of either (i) a Japanese company that is owned 50% or more directly or indirectly by an offshore company or (ii) the Japanese branch of an offshore company, receive income or benefits as a result of equity-based incentives offered by the offshore company or an affiliate, the Japanese company or branch must file a report with the Japanese tax office.

To emphasize, the filing requirement will be triggered if the incentives relate to the shares (or any other financial indicator) of the offshore parent itself, or to a company with a 50% or more direct or indirect relationship to the parent.

Japanese companies or branches must file the report with the Japanese tax authorities by March 31 of the year following the year that the employees realize the income arising from the option or other equity-based incentive. This new reporting requirement is applicable for reports which should be filed on or after January 1, 2013. Thus, option or other equity-based incentive income recognized by employees in 2012 is subject to reporting to the authorities by the March 31, 2013 deadline.

Details of Reporting Requirements Released

While provisions implementing the new rules were introduced through legislation passed in April 2012, Japan's National Tax Agency ("NTA") recently released enforcement regulations setting out additional details of items that must be reported through Form 9(3) by a Japanese company or branch employing persons that have received compensation derived from offshore options or other equity-based incentives.¹ The information that must be reported is as follows:

¹ See Income Tax Law Enforcement Regulation Art. 97-3-2.

For further information please contact

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- (1) Name and address of the person receiving the economic benefits associated with the offshore equity plan
- (2) Date that the economic benefits were received
- (3) Details of the economic benefits received
- (4) Number of shares (or amount of cash, or other economic benefit), identification of the currency in which denominated, and information regarding the following, as of the income recognition date:
 - (a) Number of shares or units associated with the economic benefits received
 - (b) Single share (or unit) value
- (5) Information regarding the agreement granting the right to receive the economic benefits, including:
 - (a) Date the agreement was concluded
 - (b) Details of rights granted under the agreement
 - (c) Maximum number of shares or units exercisable
 - (d) Name, address, and country of the foreign parent company that concluded the agreement governing the offshore equity plan.

Potential Ramifications to Current Employees, Persons Who Have Changed Employers in Japan, or Who Have Left Japan

The primary focus of the new provision appears to be the enforcement of tax filing obligations of individuals currently employed in Japan by Japanese companies or branches who earn option or other equity-based income while in Japan. The reporting requirement is of the nature of an annual "snapshot" of the option or similar equity-based compensation received by employees during the year.

As a result of the information companies will be required to report to the tax authorities, including the maximum number of shares or units exercisable by the employee (item (5), above), the tax authorities will have detailed information about persons entitled to such option or equity-based income. Because of this, it is possible that the authorities will seek to follow up with individuals earning option or equity-based income even if they have retired or have changed employers while in Japan. Further, the authorities may seek to follow up with individuals with option income attributable to service in Japan even if such individuals no longer reside in Japan.

If you have any questions or would like to discuss, please do not hesitate to contact us.

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