

Global Rewards Update: JAPAN

February 2010

CURRENT AND FORMER EMPLOYEES OF MAJOR FINANCIAL INSTITUTIONS AUDITED FOR NON-COMPLIANCE WITH EQUITY COMPENSATION REPORTING RULES

According to press reports released on February 19th, 2010, the Tokyo Regional Tax Bureau (TRTB) has identified at least 100 Japanese employees of a major global financial institution that have failed to meet their individual tax compliance obligations with respect to the equity compensation awarded by the non-Japanese parent company. In total, the amount of equity income not reported is said to be near ¥2 Billion (approximately US\$22 Million). At this time, the extent to which any penalties will be levied, or whether criminal charges of tax evasion will be brought, remains unclear.

The press reports allege that the foreign parent of the Japanese entity had granted stock options to the employees up until 2007 and, upon exercise of these options, the employees failed to properly report the income realized. Generally, where a foreign equity plan is administered abroad, current Japanese income tax law imposes no income tax withholding or reporting obligation on the employer with respect to equity income realized by an employee pursuant to the foreign equity plan, unless the award is settled in cash and the cash compensation is delivered in Japan.

Separately, according to a press report released on February 22, 2010, a former top executive at another major global financial institution has been accused of failing to declare near ¥140 Million (approximately US\$1.5 Million) in stock option income, and evading nearly ¥30 Million (approximately US\$330,000) in Japanese taxes.

These are the most recent in a series of successful audits conducted by the TRTB with respect to equity compensation reporting by resident individuals in Japan. The increased audit activity confirms that the Japanese tax auditors have made accurate and timely reporting of equity income by resident employees, and the corresponding tax payments, a priority.

Although it is unclear how the underreporting was discovered in either case, auditors may have obtained the information either through a targeted audit or from details related to a recharge agreement between the foreign parent and the Japanese entity that were disclosed in the course of a corporate tax audit. Since individual tax returns are due by March 15, the timing of the press reports seems to underline an effort by the tax authorities to encourage employee compliance with respect to reporting of income on 2009 tax returns.

The issue of increased non-compliance by employees may be one of the factors behind the Japanese authorities' decision to increase the maximum jail term for tax violations from 5 years to 10 years, as well as doubling the financial penalties for tax evasion.

ACTION

- Companies operating global stock plans should consider communicating this increased audit activity to their Japanese employees to ensure local compliance and address the reputational risks of non-compliance.
- Japanese employers should ensure that employees understand the tax treatment of their equity awards including the timing of taxation, and have sufficient information to ensure reporting compliance, including Japanese translation of plan documents where necessary.

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.

© 2010 Deloitte Touche Tohmatsu.

Deloitte refers to one or more Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms.

 **Deloitte RSS feeds**