JAPAN

International Comparison of Insurance Taxation

March 2007

PricewaterhouseCoopers

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Japan – General Insurance

	Accounting	Taxation
1 Definition Definition of property and casualty insurance company	**Accounting** A company which is licensed by the Financial Services Agency (FSA) to carry on insurance business and to which insurance legislation applies.	**Taxation** A company licensed as a general and casual insurance company.
2 Commercial accounts/ Tax and Regulatory returns Basis for the company's commercial accounts	**Accounting** Accounting principles for insurance companies regulated by Insurance Business Law and the FSA.	**Taxation** N/A.
Regulatory return	A separate return as required by the FSA.	N/A.
Tax return	N/A.	A separate return as required by the tax authorities. A group consisting of a Japanese parent company and its 100%-owned domestic subsidiaries may elect to file a consolidated return. Because such an election is rare for insurance companies, this summary focuses solely on non-consolidated tax filers.

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Japan – General Insurance (continued)

3 Technical reserves/ Equalisation reserves	Accounting	Taxation
Unearned premium reserves (UPR)	Calculated by time apportionment, e.g. 1/12ths.	In general, the UPR reserves for accounting purposes are tax deductible, provided that the UPR reserve is reported by a method recognised to the government.
Unpaid claims reported	Calculated on case-by-case basis. Estimated claims are reserved, and no discount factors are considered.	In general, the accounting reserve is tax deductible.
Claims incurred but not reported (IBNR)	Calculated based on an FSA formula for certain lines, and no discount factors are considered.	This reserve is calculated per a different tax formula, which may give rise to book-tax differences.
Unexpired risks	No special treatment.	Generally not deductible.
General contingency/solvency reserves	No special treatment.	Generally not deductible.
Equalisation/catastrophe reserves	Calculated in accordance with a method approved by FSA.	Catastrophe reserves are allowed for certain types of policies. The tax limit is generally 3% or 4% (on or before 31 March 2007) of net annual written premiums aggregated by type of insurance. It is uncertain whether these deductions are allowed after 31 March 2007.

Japan – General Insurance (continued)

4 **Expenses/Refunds**	**Accounting**	**Taxation**
Acquisition expenses	Fully charged in the year incurred.	Tax deductible if classified as current expenses for accounting purposes.
Loss adjustment expenses on unsettled claims (claims handling expenses)	Charged when claims are paid.	Tax deductible.
Experience-rated refunds	Offset against premium when incurred. In Japan, experience-rated refunds apply to 'Loss of income insurance' and 'Marine cargo' only.	Taxed when recognised for accounting purposes.

5 **Investments**	**Accounting**	**Taxation**
Gains and losses on investments	Securities should be classified into one of three categories below: Securities that are actually traded for the purpose of gaining from short-term changes in market prices ("trading securities") should be measured at fair value on the balance sheet, recognizing unrealised gains or losses through the income statement. Debt securities that are designated as held-to-maturity (held-to-maturity debt securities) should be measured at amortised cost on the balance sheet. Securities other than trading securities and held-to-maturity debt securities (available-for-sale securities) should be measured at fair value, and the changes in fair value should be accounted for with unrealised gains/losses reported in shareholders' equity.	There are three types of securities: 1) trading securities valued at market price on the closing date; 2) held-to–maturity debt securities amortisable over the period until maturity; 3) securities other than 1) and 2) above recorded book value. Please note that classification of 1), 2) and 3) above is similar to accounting, but not necessarily the same as accounting.

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Japan – General Insurance (continued)

	Derivatives are valued at fair value and any unrealised gains/losses are recorded in the income statement. Special accounting treatment applies to hedging companies.	Generally for derivatives, unrealised gains are taxable and unrealised losses are deductible. Special accounting treatment applies to hedging companies.
Investment reserves	Reserves against price fluctuation of stocks and bonds are calculated pursuant to FSA regulations.	Movement in this reserve will create a tax deduction or taxable income.
Investment income	Included in P&L.	50% to 100% of domestic dividend income (after deducting related unallocated interest expenses) may be excluded from income (depending on the percentage of shares owned). Dividend exclusion is uncommon, however, due to restrictions. Interest income is fully taxable.

Japan – General Insurance (continued)

	Accounting	Taxation
6 **Reinsurance** Reinsurance premiums and claims	Reinsurance transactions are disclosed on a net basis in the financial statements. Deposit accounting for non-risk transfer reinsurance has not been established in Japan.	Reinsurance premiums are normally tax deductible. Reinsurance claims are normally taxable.
7 **Mutual companies** Mutual companies (all profits returned to members)	Policyholder dividends are deducted from retained earnings.	For a mutual insurance company, interest on the capital foundation fund (Kikin) is tax-deductible. The interest is not recognised in the income statement, but is treated as deduction from surplus. The dividends exclusion rule is not applicable to the interest on Kikin distributed to shareholders.

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Japan – Other Tax Features

8 Further corporate tax features	Taxation
Loss carry-overs	Seven year carry-forward and one year carry-back (carry-back is suspended since 1992).
Foreign branch income	Foreign income is combined with HO's income. Foreign income taxes may be creditable against Japanese corporate taxes, subject to limitations.
Domestic branch income	Calculated under ordinary rules. No special branch tax.
Corporate tax rate	36.21% national 30.0% + local 6.21% (Tokyo metropolitan government rate).

9 Other tax features	Taxation
Premium taxes	No premium tax is imposed on individual premium payments or contracts. Enterprise tax however, which is a prefectural tax, is imposed on aggregated annual net premiums (net of reinsurance) at the rates of 1.3% to 1.365%. The taxable base is the sum of 10% to 45% of the net premiums by type of insurance.
Capital taxes	N/A.
Captive insurance companies	Japanese CFC legislation applies if the conditions are met.

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Japan – Life Insurance

1 **Definition**	**Accounting**	**Taxation**
Definition of life assurance companies	A company which is licensed by the FSA to carry on insurance business and to which insurance legislation applies.	A company licensed as a life insurance company.

2 **Commercial Accounts/ Tax and Regulatory Returns**	**Accounting**	**Taxation**
Basis for the company's commercial accounts	Accounting principles for insurance companies regulated by Insurance Business Law and the FSA.	N/A.
Regulatory return	A separate return as required by the FSA.	N/A.
Tax return	N/A.	A separate return as required by the tax authorities. A group consisting of a Japanese parent company and its 100%-owned domestic subsidiaries may elect to file a consolidated return. Because such an election is rate for insurance companies, this summary focuses solely on non-consolidated tax filers.

3 **General approach to calculation of income**	**Accounting**	**Taxation**
Allocation of income between shareholders and policyholders	Payments to the policyholders are calculated by the actuary and approved by the FSA.	Payments to the policyholders are normally tax-deductible. After-tax profits may be distributed to shareholders.

Japan – Life Insurance (continued)

4 Calculation of investment return

Calculation of investment income and capital gains

Accounting

Securities should be classified into one of three categories below:

Securities that are actually traded for the purpose of gaining from short-term changes in market prices (“trading securities”) should be measured at fair value on the balance sheet, recognizing unrealised gains or losses through the income statement.

Debt securities that are designated as held-to-maturity (held-to-maturity debt securities) should be measured at amortised cost on the balance sheet.

Securities other than trading securities and held-to-maturity debt securities (available-for-sale securities) should be measured at fair value, and the changes in fair value should be accounted for with unrealised gains/losses reported in shareholders’ equity.

Taxation

There are three types of securities:

1) trading securities valued at market price on the closing date;
2) held-to–maturity debt securities amortisable over the period until maturity;
3) securities other than 1) and 2) above recorded book value.

Please note that classification of 1), 2) and 3) above is similar to accounting, but not necessarily the same as accounting.

Japan – Life Insurance (continued)

In addition to the above three categories, another category policy reserve matching bonds is permitted for insurance companies to manage asset/liability duration matching. Policy reserve matching bonds shall be stated at amortised cost. Gains or losses on sales of bonds sold for the purpose of achieving target duration shall be posted to P&L as realised gain/loss in the period in which the sale occurs. Gains on sales of bonds sold for purposes other than achieving target duration shall be deferred and amortised over the remaining life of the bonds under the straight-line method, and losses on those sales shall be recognised as a loss in the year in which the sale is made.

Derivatives are valued at fair value and any unrealised gains/losses are recorded in the income statement. Special accounting treatment applies to hedging companies.

Generally for derivatives, unrealised gains are taxable and unrealised losses are deductible. Special accounting treatment applies to hedging companies.

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Japan – Life Insurance (continued)

5 Calculation of underwriting profits or total income	Accounting	Taxation
Actuarial reserves	The net premium level method is most common, but the Zillmer method is allowed.	Tax-deductible pursuant to a formula driven by the net premium.
Acquisition expenses	Fully charged in year incurred.	Tax deductible.
Gains and losses on investments	See 'Calculation of investment return' above.	See 'Calculation of investment return' above.
Reserves against market losses on investments	Reserve for price fluctuations with respect to stocks and bonds must be calculated in accordance with FSA regulation.	Reserve for price fluctuation is entirely taxable.
Dividend income	Included in P&L on a cash basis.	Dividend income is fully taxable if the provision for policyholders dividend reserve is deducted from taxable income. Otherwise, 80% to 100% of domestic dividend income (net of allocated interest) is excluded from the income (depending on the percentage of shares owned). As a result of the Y2002 tax reform, the exclusion rate for dividends from portfolio investment will be reduced to 50% on or after 1 April 2002.

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Japan – Life Insurance (continued)

Policyholder dividend	Calculated by an actuary and approved by the FSA.	Policyholder dividend reserve is tax deductible up to the amount of the dividend payable in the next year. However, the balance of the prior year's reserve, which was not paid or assigned to the policyholders, become taxable.
Other special deductions	None.	None.

6 **Reinsurance**	**Accounting**	**Taxation**
Reinsurance	Reinsurance premiums and claims are stated as separate components of operating income/ expense.	Reinsurance premiums are normally tax-deductible. Reinsurance claims are normally taxable.

7 **Mutual companies/Stock companies**	**Accounting**	**Taxation**
Mutual companies	Policyholder dividends are deducted from retained earnings.	For a mutual insurance company, interest on the capital foundation fund (Kikin) is tax-deductible. The interest is not recognised in the income statement, but is treated as a deduction from surplus. The dividends exclusion rule is not applicable to the interest on Kikin distributed to shareholders.

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Japan – Other Tax Features

8 **Further corporate tax features**	**Taxation**
Loss carry-overs	Seven year carry-forward and one year carry-back (carry-back is suspended since 1992).
Foreign branch income	Foreign income is combined with HO's income. Foreign income taxes may be creditable against Japanese corporate taxes, subject to limitations.
Domestic branch income	Calculated under ordinary rules. No special branch tax.
Corporate tax rate	36.21% national 30.0% + local 6.21% (Tokyo metropolitan government rate).
Minimum tax	If the taxable income is less than 7% of net book 'income' (as defined) plus the provision of the policyholder dividend for the year, the difference must be added to the taxable income.

9 **Policyholder taxation**	**Taxation**
Deductibility of premiums	An individual policyholder of life insurance (except for private pensions) may deduct up to 50,000 yen.
Interest build-up	Not taxable.
Surrender money	Surrender money received on a contract where the beneficiary is the same as the policyholder is taxable to the extent proceeds exceed cost basis (except compensation for injury). A 500,000 yen deduction is allowed. 50% of income, net of this deduction, is taxed at marginal rates.

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Japan – Other Tax Features (continued)

Death benefit	A policyholder's death benefit is subject to inheritance tax. Each heir is qualified to deduct up to 5 million yen and the remaining amount is taxed at a rate ranging from 10% to 50%.
10 **Other tax features** Premium taxes	**Taxation** No premium tax is imposed on individual premium payments or contracts. Enterprise tax however, which is a prefectural tax, is imposed on aggregated annual premiums (net of reinsurance) at the rates of 1.3% to 1.365%. The taxable base is the sum of 5% to 24% of the premiums by type of insurance.
Capital taxes	N/A.
Captive insurance companies	Japanese CFC legislation applies if the conditions are met.

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Contact Information

Tetsuo Iimura
Partner
Zeirishi-Hojin PricewaterhouseCoopers
Kasumigaseki Building 15F
2-5 Kasumigaseki 3-Chome
Chiyoda-ku
Tokyo
tel: +81 (3) 5251 2834
e-mail: tetsuo.iimura@jp.pwc.com

Kimihito Takano
Senior Manager
Zeirishi-Hojin PricewaterhouseCoopers
Kasumigaseki Building 15F
2-5 Kasumigaseki 3-Chome
Chiyoda-ku
Tokyo
tel: +81 (3) 5251 2698
e-mail: kimihito.takano@jp.pwc.com

Miyuki Kajiwara
Manager
Zeirishi-Hojin PricewaterhouseCoopers
Kasumigaseki Building 15F
2-5 Kasumigaseki 3-Chome
Chiyoda-ku
Tokyo
tel: +81 (3) 5251 2520
e-mail: miyuki.kajiwara@jp.pwc.com

Nobuyuki Saiki
Manager
Zeirishi-Hojin PricewaterhouseCoopers
Kasumigaseki Building 15F
2-5 Kasumigaseki 3-Chome
Chiyoda-ku
Tokyo
tel: +81 (3) 5251 2570
e-mail: nobuyuki.saiki@jp.pwc.com

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