

Year-end Tax Adjustment

■ Withholding tax system

In Japan, the individual income tax is based on a self-assessment system. Under this system, each individual who earns income should file a tax return for the calendar year between February 16 and March 15 of the following year. However, a withholding tax system will apply to salaried workers.

Under the withholding tax system, if an individual earns only employment income with one employer throughout a calendar year, and his/her gross salary is JPY 20,000,000 or less, he/she is not required to file an individual tax return. Instead, the employer is required to withhold income tax from the monthly salary or bonus payments and pay the tax to the national tax office no later than 10th of the following month. The employer is also required to reconcile the final annual tax due and the tax withheld throughout the year at the time of the final payroll of the year. If the final tax is smaller than the withheld amount, the excess is refunded. In the opposite case, a surplus tax is payable. After completing the last payroll with the year-end tax adjustment, the employer delivers a withholding tax certificate (*Gensen-Choshu Hyo*) to the employee by the end of January 31 of the following year.

Because of the timing of this procedure, it is called the “Year-end tax adjustment” (*Nenmatsu-Chousei*). For most employment income earners, the year-end tax adjustment takes the place of the filing of a tax return, and accordingly, is an important procedure. Of course, the employee may file a final tax return if additional deductions such as medical expenses, casualty losses or contributions etc. are to be claimed, as those items cannot be included in the year-end tax adjustment process.

The year-end tax adjustment is not applied to those who earn employment income of more than JPY 20,000,000, though withholding tax is deducted every month from payroll. Those employees need to file a tax return to settle their taxation.

■ Why reconciliation is needed?

In general, the year-end adjustment is required due to the following reasons:

1. The monthly withholding amount is determined based on the number of dependents declared by the employee at the beginning of the year. The employer needs to confirm dependent information as of the end of the year and calculate the final tax amount based on the updated information.
2. The withholding tax for bonuses is computed using a specific tax table which assumes that five months’ bonus would be paid per year. The final tax should be recalculated based on the bonus amounts actually paid at the year end.
3. Several income deductions such as “additional exemption for spouse” or “life and earthquake insurance premiums” are to be taken into account only at the time of the year-end adjustment. Those deductions are not included in the monthly withholding.

■ Special Notes

As you will see now, the year-end adjustment is processed at the time of last salary payment of the year. However, in some cases, it may be processed at a different time such as when the employment relationship discontinues and it is apparent that the employee will have no employment income for the remaining of the calendar year, as in the below examples:

1. The employee ceases employment partway through the year due to death, or serious mental or physical disability.
2. The employee leaves Japan partway through the year, for example, due to an overseas assignment, and salary will not be paid in Japan after leaving.