

Retirement Allowance in Japan

Retirement allowance is a lump-sum payment that is paid to an employee by an employer when the employment is terminated. In Japan, the life-time employment has been a traditional working style and the retirement allowance has been primarily regarded as a reward for many years of service and a financial support for living after retirement. Today, the labor environments in Japan are significantly changing and the life-time employment system may not be standard any longer, and now there is a variety of retirement benefit plans to meet the current needs such as a 401k-type Defined Contribution Plan. However, the traditional type of retirement allowance is still adopted by many companies.

■ Set Up Retirement Allowance Plan

Payment of retirement allowance is not a legal requirement. An employer can decide whether to pay or not. When a company establishes a retirement allowance plan, the employer is required by the Labor Standards Act to stipulate provisions in the company work rules for the matters including scope of eligible employees, calculation method, payment date, etc., and then submit the document to the Labor Standards Inspection Office with an opinion letter by the representative employee. The employer with fewer than 10 employees is not subject to filing of the work rules. If such a small company does not prepare the work rules and pays retirement allowance, the employer needs to include those matters in an individual employment contract.

As the payment is not a legal requirement, companies freely decide the payment level. In general, the amount of retirement allowance is determined by multiplying the base wage by the number of service years. Monthly base salary at the retirement is likely used as a base wage. Also, it is common to apply a reduced payment rate for termination by a voluntary reason.

■ Taxation

Under the Income Tax Law, retirement allowance is categorized as retirement income. The payment is taxed separately from salary and bonuses, which are categorized as employment income. In consideration of the nature of the retirement allowance, a more beneficial tax rule is applied to the retirement income. The tax is imposed to one half of the payment amount net of retirement income deduction. Tax rate ranges 5-45% depending on the level of the taxable amount.

$$\text{Taxable amount} = (\text{Gross payment} - \text{Retirement income deduction}) \times 1/2$$

*The retirement income deduction is JPY400,000 per year up to 20 years and JPY700,000 per year after 20 years. The minimum amount is JPY800,000.

To be eligible for this beneficial tax calculation, an employee needs to submit the Declaration Form for Receipt of Retirement Income to the employer. Otherwise, a flat rate of 20.42% is applied on the gross payment.

Tax revision effective from 2022:

A tax revision has been made to income tax for retirement income and becomes effective from January 2022. The change is applied to employees who retire on or after January 1, 2022 and fall under the following categories.

- Employee's service years is 5 years or less, and
- Retirement income exceeds JPY3,000,000

In calculating the taxable amount, the one-half calculation is applied only up to JPY3,000,000, which will increase the taxable amount. As a result, the tax amount will be increased though a tax rate that remains unchanged.

$$\text{Taxable amount} = \text{JPY1,500,000} + [(\text{Gross payment} - (\text{JPY3,000,000} + \text{Retirement income deduction})) \times 1/2]$$

The above calculation rule is applied to employee status. Director's retirement allowance is subject to a different rule.

■ Other

In addition to the income tax, the inhabitant tax (local tax) is imposed on the retirement income. Social insurance contribution is not required.