Tax Reforms to Promote Participation in Corporate Pensions

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I. Measures in the FY2014 tax reform outline related to corporate pensions

The FY2014 tax reform outline proposed by the Liberal Democratic Party (LDP) and New Komeito Party on 12 December 2013 included proposals to raise the maximum contribution to corporate defined contribution (DC) pension plans and extend the suspension of the special corporate tax[1].

Specifically, it proposes raising the maximum monthly contribution from ¥51,000 to ¥55,000 for companies that only offer a DC pension plan and from ¥25,500 to ¥27,500 for companies that offer both a DC and a defined benefit (DB) pension plan (Figure 1).

The special corporate tax is a tax levied on the DC and DB plan assets. Because employee pension funds (EPFs), a type of defined benefit plan, are not subject to that tax until a considerable level of funds have accumulated, the tax is effectively only applied to DC plans and defined benefit corporate pension plans, the other type of DB plan. The special corporate tax was suspended temporarily in 1999, and that suspension has been repeatedly extended since then. The current suspension expires in March 2014, and the FY2014 tax reform outline proposes delaying that expiration date by another three years.

Figure 1: Raising maximum contribution to DC pensions

	Under the tax reform outline
Corporate DC plans Only corporate pension is DC Both DC and DB plans offered	Per plan participant Raise monthly contribution from ¥51,000 to ¥55,000 Raise monthly contribution from ¥25,500 to ¥27,500
Individual DC plans Self-employed Employees at firms without a corporate pension	Per plan participant Monthly contribution remains at ¥68,000 Monthly contribution remains at ¥23,000
＜Reference＞ Employees at firms with a DB plan but no DC plan Government employees Dependents of insureds	Cannot enroll

Source: Nomura Institute of Capital Markets Research, based on the FY2014 Tax Reform Outline

[1] The tax reform outline was passed as a Cabinet Office decision on 24 December 2013 and submitted to the Diet as tax reform legislation on 4 February 2014. The legislation was enacted on 20 March 2014.

Other measures proposed for consideration are described in the following excerpt from the reform outline.

"In the context of the aging of Japan's population and the increase in the number of people receiving pension benefits, take a comprehensive look at how contributions, investments, and benefit payments should be taxed, keeping in mind the need to maintain fairness between and within generations and provide security for the elderly, while striking a balance among the various types of pension programs, including corporate pensions meant to supplement the public pension as well as a balance between taxing savings products and taxing pension benefits, and between taxing wages and taxing pension benefits, at the same time taking into account the direction of pension reforms[2]."

II. Corporate pensions becoming increasingly important

Both the increase in the maximum DC plan contribution and the extension of the suspension of the special corporate tax are laudable components of the FY2014 tax reform outline, but many desirable tax reforms affecting corporate pensions were left for another day. Examples of these include expanding eligibility for DC plan enrollment and easing the requirements for making early withdrawals from those plans. The proposal also failed to include raising the maximum contribution into an individual DC plan by an employee not enrolled in a corporate pension plan, which would remain at the current ¥23,000 per month. There have been repeated calls to abolish the special corporate tax altogether, but the tax reform outline stopped short of recommending that.

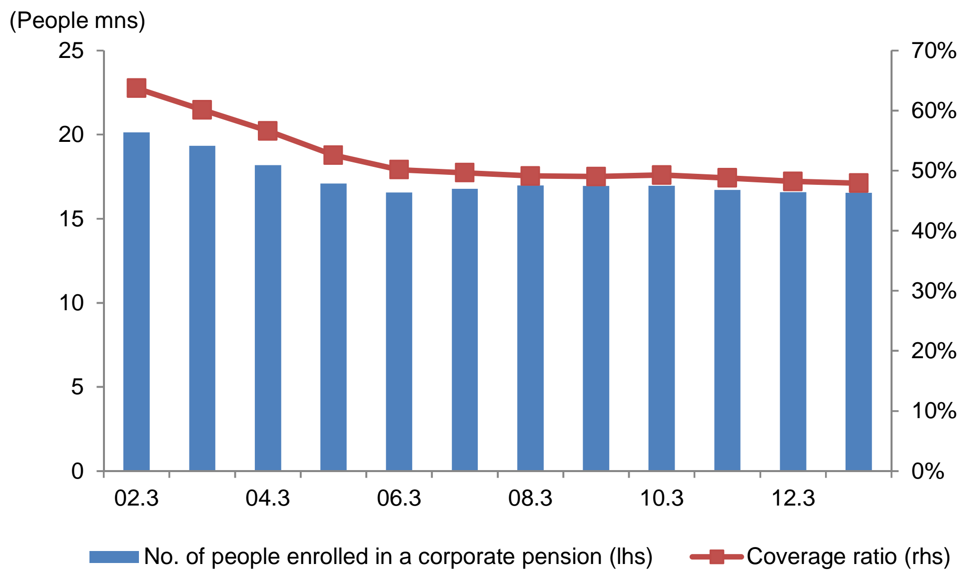
Japan's shrinking population makes it difficult to avoid public pensions playing a reduced role for most people, who instead will need to create larger retirement cushions on their own, including through corporate pensions and other private-sector pension plans. This is making corporate pensions increasingly important, although recent trends have not been encouraging. The coverage ratio for corporate pensions (the percentage of private-sector employees who are enrolled in a corporate pension) has either been declining or flat, with estimates putting it at about 50% on the high side (Figure 2).

Additionally, the June 2013 revision of the Employees' Pension Insurance Act[3] is likely to result in eventually dissolving most employee pension funds (EPFs). The dissolution via a special dissolution procedure or conversion to other pension plan will be encouraged for the first five years from the revised act's implementation (scheduled for April 2014) for underfunded EPFs, and during the next five-year period the remaining funds except for the most financially sound ones will be encouraged to do so, while the underfunded ones could be ordered to dissolve.

[2] See page 116 of the FY2014 tax reform outline.

[3] The revision is titled "Partial revisions to the Employees' Pension Insurance Act to ensure the soundness and reliability of the public pension system."

Figure 2: Enrollment in corporate pensions



Note: Participants in two or more plans are double counted.
Source: Nomura Institute of Capital Markets Research, based on data from the Pension Bureau under the Ministry of Health, Labor, and Welfare and from the Pension Fund Association.

Corporate pension reforms enacted in 2001 phased out the use of tax qualified pension plans, a type of DB plan, over a 10-year period ending in March 2012, with those plans encouraged to convert either to a DB plan or a DC plan. Because only about 30% of those plans wound up being transferred into corporate pensions, however, it appears the change actually led to a decline in the corporate pension coverage ratio. To keep the same thing from happening again, over the next 10 years measures will have to be implemented that make the DC plans that would receive these funds more attractive, including through favorable tax treatment, to ensure that as many EPFs as possible are converted into other corporate pension plans.

III. Taxing corporate pensions in a manner suitable for Japan

Given that the proposals in the FY2014 tax reform outline called for a comprehensive look at taxation, we expect to see further debate over the specifics of pension taxation. In fact, the Corporate Pension Committee was established under the Social Security Council in September 2013, based on "the need to discuss, from a specialist point of view, the nature of the corporate pension system overall, including both defined-benefit corporate pensions and defined contribution pension plans, while taking into account debate over what the public pension system should look like." The Committee has initially focused its debate on the above-noted revision to EPFs, but

plans to begin discussion of the overall framework for corporate pensions in April 2014[4].

Discussions of pension taxation can be fairly deep reaching, and are also related to the more fundamental taxation question of whether to build the tax base around income through a comprehensive income tax or around spending through a consumption tax[5]. Even if the debate does become this wide-ranging, it is important not to forget that in Japan, people must strive to accumulate assets for their later years on their own efforts, and the corporate pension, because it plays a very important role in that regard, merits considerable support. We hope that the quest for a corporate pension taxation regime that is suitable for Japan will be based on asking the right question: which taxation approach is needed to encourage greater participation in corporate pensions?

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[4] From "Document 3" submitted at the first meeting of the Corporate Pension Committee (29 October 2013).

[5] The special corporate tax appears to be based on a comprehensive income taxation approach.