

# Japan tax bulletin

**Newsletter on important tax and business developments in Japan**

**October 2010**

---

## In this issue

### Japan's new taxation agreements and a recent tax assessment

This edition of our newsletter contains updates on Japan's international tax agreements and discusses a tax assessment levied on IBM Japan.

2010 has seen Japan sign numerous Tax Information Exchange Agreements, revise existing treaties and enter into new ones. A broad overview is included below.

In addition the Tokyo Regional Taxation Bureau raised a 400 billion Yen assessment on IBM Japan in relation to a share repurchase arrangement which although conformed with the tax rules prior to the 2010 tax reform, was deemed to be an abuse of the laws and to have no commercial rationale.



# New taxation agreements

## Tax treaties

So far this year, Japan has been active in reaching agreements with the following countries:

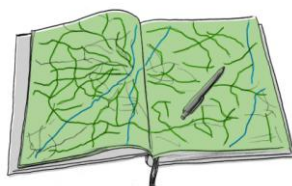
### Kuwait

The treaty is the first that Japan has signed with the Persian Gulf nation. Although it has not yet come into force, the headline rates are as follows:

Income type		Tax rate
Dividends	At least 10% shareholding	5%
	Other	10%
Interest		10% <sup>1</sup>
Royalties		10%

The treaty also contains provisions allowing Japan to impose tax at source on income and gains derived from a silent partnership (Tokumei Kumiai).

As with the agreement signed with Brunei Darussalam, the treaty contains a clause exempting interest paid to the Kuwait Investment Agency, a sovereign wealth fund, from taxation in Japan. It also exempts from taxation in Japan interest paid to the Kuwait Petroleum Corporation which is the state-owned umbrella organization for the country's oil interests. This will help encourage direct investment into Japan from the Kuwait government.



<sup>1</sup> 0% for interest from government bodies and financial institutions

### The Netherlands

Japan has recently signed a new treaty with the Netherlands. Although it has not yet come into force, the headline rates are as follows:

Income type		Tax rate
Dividends	At least 50% shareholding	0%
	At least 10% shareholding	5%
	Other	10%
Interest		10% <sup>1</sup>
Royalties		0%

As with the Kuwait treaty, the treaty contains provisions allowing Japan to impose tax at source on income and gains derived from a silent partnership.

The treaty also introduces limitation of benefits rules to restrict the tax treaty benefits to residents that satisfy special conditions.

In addition there are new Anti-Conduit Clauses to deny a resident beneficial ownership of an item of income where conduit arrangements are in place.

### Hong Kong

Japan and Hong Kong have reached consensus on a new Double Taxation Agreement. Although the DTA has not yet been signed, the headline rates are as follows:

Income type		Tax rate
Dividends	At least 10% shareholding	5%
	Other	10%
Interest		10% <sup>1</sup>
Royalties		5%

## Switzerland

Further to the article in our October 2009 tax bulletin, the Protocol revising the tax treaty between Japan and Switzerland has been signed, with the key revisions and rates being the same as described in that bulletin. The treaty also contains silent partnership provisions.

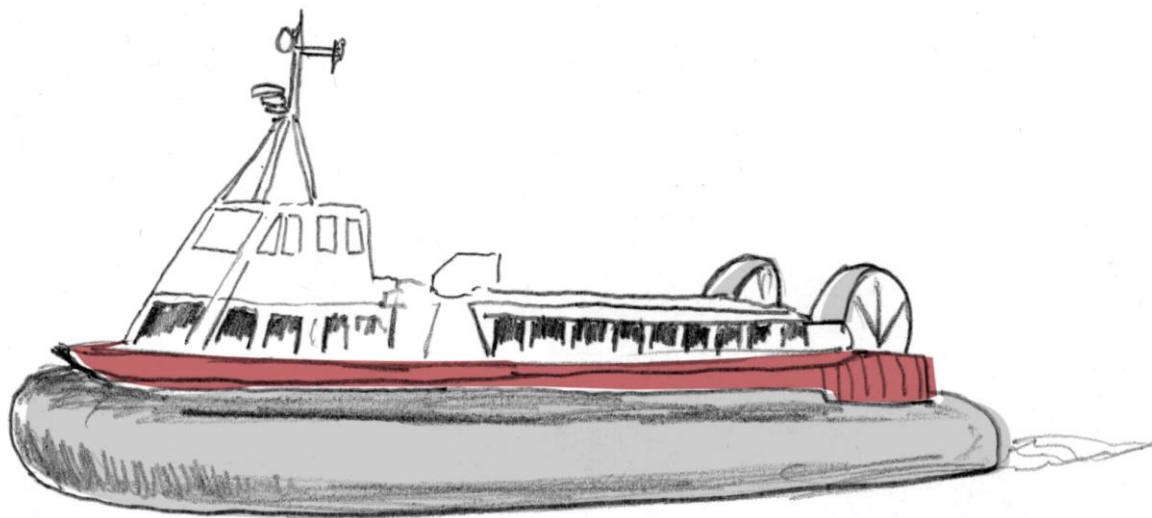
## Tax Information Exchange Agreements

So far this year Japan has signed a Tax Information Exchange Agreement with Bermuda which came into force on 1 August 2010. In addition a Protocol to amend the treaty with Singapore to increase tax information sharing powers came into force on 14 July.

Protocols have also been signed to revise the tax treaties with Malaysia, Belgium and Luxembourg to increase the tax information sharing powers in line with international standards.

## Summary

Japan's actions in agreeing new and updating old tax treaties will help multinational companies operating abroad by reducing the risk of incurring double taxation and reducing withholding tax rates. In addition, the efforts to include Tax Information Exchange Agreements are a sign that more countries are adopting the OECD standards on the sharing of taxpayer information.



# IBM Japan tax assessment

## Background

The exact fact pattern of this case has not been disclosed but our understanding of the transactions is as follows.

In 2002 IBM AP Holdings (“APH”), a shell company, borrowed money from its US parent to purchase 100% of the unlisted shares in IBM Japan from the US parent for approximately 2 trillion Yen. APH then sold part of the shares back to IBM Japan in three instalments, each time at a price lower than it had paid for them.

As a result of the above transactions, from a tax perspective APH was able to recognize deemed dividends as well as capital losses of 400 billion Yen over the five years ending 31 December 2008.

In 2008 the group adopted the consolidated tax regime. Under this system a Japanese parent corporation can opt to file a consolidated tax return and pay tax on behalf of the consolidated group. By using this system the losses of APH were offset against IBM Japan's profits resulting in no corporate tax liability for the group.

The Tokyo Regional Taxation Bureau deemed that the series of transactions was an abuse of the applicable laws and had no economic rationale other than to reduce IBM Japan's tax liability. It said that the 400 billion Yen of income should have been declared as taxable income and raised an assessment accordingly.

## Previous legislation

Before the 2010 tax reforms, when a company repurchased its own shares the price paid was split into a deemed dividend and sales proceeds.

Broadly speaking the deemed dividend is equal to the amount received minus the amount of share capital and capital surplus repurchased by the paying company.<sup>1</sup>

The sales proceeds are equal to the difference between the amount received and the deemed dividend. The deemed dividend is excluded from gross revenue under Japanese tax rules<sup>2</sup>.

However if the sales proceeds as calculated above are lower than the original purchase price of the shares, this gives rise to a capital loss which was allowed as a deduction from taxable profits.

## Current legislation

The 2010 tax reforms, as covered in our May 2010 bulletin, introduced a measure to prevent a parent company from recognising a capital loss in situations like this.

The measure, which comes into effect for repurchases that take place after 1 October 2010, states that if the repurchase price includes a deemed dividend, a parent company within a wholly owned group will not be able to recognise a gain or loss on the repurchase by a subsidiary of its own shares.

## Summary

IBM Japan has stated that it intends to appeal this assessment, which arose out of an audit into the company, as it believes it has not violated any laws.

Although the law has since changed to prevent a capital loss from being recognised in cases like this, at the time of the transactions it permitted the share repurchase and the use of the consolidated tax regime.

The actions of the tax authorities in this and other cases highlight an increasingly aggressive stance towards taxpayers trying to reduce their tax liabilities and the need for a strong commercial rationale for any business decisions with large taxation implications.

<sup>1</sup> Corporation Tax Law Article 24

<sup>2</sup> Corporation Tax Law Article 23(2)

Contact us for any enquiry on our services;

---

**Yoichi Ishizuka**

Managing Partner, Tax Services  
Tel: 03-5770-8870 email: yishizuka@gtjapan.com

**Naoji Sato**

Partner, Transfer Pricing services  
Tel: 03-5770-8848 email: nsato@gtjapan.com

**Hideharu Tanaka**

Partner, International tax services  
Tel: 03-5770-8871 email: htanaka@gtjapan.com

**Kumiko Miyajima**

Partner, International tax services  
Tel: 03-5770-8914 email: kmiyajima@gtjapan.com

**Eric Keuling**

Director, International tax services  
Tel: 03-5770-8898 email: ekeuling@gtjapan.com

**Joseph Daniels**

Director, International tax services  
Tel: 03-5770-8765 email: jdaniels@gtjapan.com

**Yuka Iizumi**

Manager, International tax services  
Tel: 03-5770-8892 email: yiizumi@gtjapan.com

**Akane Hirukawa**

Manager, International tax services  
Tel: 03-5770-8815 email: ahirukawa@gtjapan.com

**Tosh Kamii**

Manager, Corporate services  
Tel: 03-5770-8935 email: tkamii@gtjapan.com

**Adrian Castelino-Prabhu**

Assistant Manager, International tax services  
Tel: 03-5770-8882 email: acastelino@gtjapan.com

Disclaimer

---

The aim of this newsletter is to provide information relating to recent Japanese tax and business. The information is general in nature and it is not to be taken as a substitute for specific advice. Accordingly, Grant Thornton Japan accepts no responsibility for any loss that occurs to any party who acts on information contained herein without further consultation with ourselves.

**グラントソントン太陽ASG税理士法人**  
Grant Thornton Taiyo ASG Tax Corporation

Grant Thornton Taiyo ASG Tax Corporation is a member firm within Grant Thornton International Ltd ('Grant Thornton International'). Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered by the member firms independently.