

Japan tax bulletin

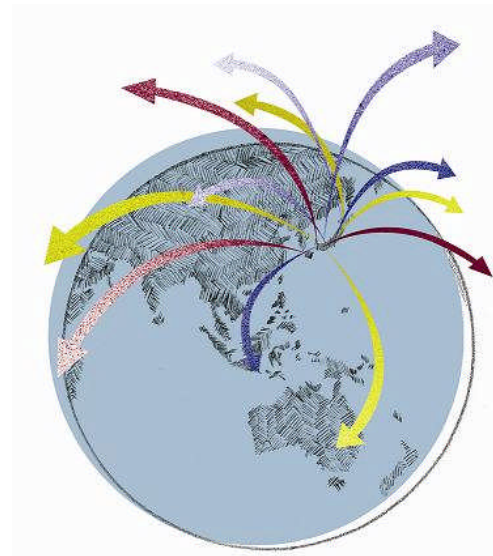
Newsletter on important tax and business developments in Japan

March 2013

In this issue

2013 Tax Reform proposals and proposed amendments to the US - Japan tax treaty

This edition of our newsletter contains an outline of the 2013 tax reform proposals. In addition a Protocol was signed to amend the US – Japan tax treaty. A broad outline of the changes is covered.



2013 Tax Reform proposals

The 2013 Tax Reform proposals

The new government released its 2013 tax reform proposals in January. A broad outline of the main items is given below.

Corporation tax

Increase in tax credit for job creation

Our October 2011 bulletin covered the introduction of a new measure to promote job creation. Companies that met the requirements could benefit from a JPY200,000 tax credit for each additional employee hired. This credit will increase to JPY400,000 per employee under the proposals.

Salary increase incentive

Employers that increase salaries by at least 5% would be able to benefit from a tax credit of 10% on the increase in the salary amount (capped at 10% of the corporation tax liability) under the new proposals. This would apply for financial years that begin between 1 April 2013 and 31 March 2016.

Entertainment expense deduction for SMEs

Currently SMEs are allowed to take a tax deduction for 90% of the first JPY6 million of entertainment expenses. The proposal would increase this to 100% of the first JPY8 million of expenses.

Research and Development credits

Currently Companies benefit from a tax credit of between 8-10% of total qualifying R&D costs for large companies and 12% for SMEs. This credit is limited to 20% of the corporation tax liability. The proposal aims to increase this limit to 30% of the corporation tax liability for 2 years.

Tax incentives to renewable energy equipments

Our May 2012 bulletin covered the introduction of tax incentives for renewable energy equipment. If a corporation which files a blue tax return purchases certain depreciable assets utilized for renewable energy, such as solar power or wind power, by 31 March 2013 and utilizes the assets in the business within one year of purchase, the corporation can benefit from a 100% depreciation deduction in the year of use. This treatment will be extended until 31 March 2015 under the proposals.

Individual income tax

The current highest rate of income tax is 40% on taxable income over JPY18 million. A new 45% rate will apply to taxable income over JPY40 million from 2015. Combined with the employment income deduction cap which applies from 2013 onwards this measure will increase the cost of tax equalisation arrangements for executives seconded to Japan.

Inheritance and gift tax

The proposal included amendments to the scope, basic exemption and rate of inheritance tax and gift tax.

Scope

Under the current law when a foreign national with no domicile in Japan, inherits or receives a gift from a person with domicile in Japan, only the properties located in Japan are liable to Japanese inheritance or gift taxes. The proposal will widen this scope in this situation so that all properties, regardless of location, will be subject to tax in Japan. Although ostensibly this amendment is to reduce the scope for inheritance tax planning for Japanese high net worth individuals, it also affects expats, senior executives and entrepreneurs living in Japan.

Basic exemption

Currently an exemption of the first JPY50 million plus JPY10 million per statutory heir is available against inheritance estates. The proposals will reduce this to JPY30 million plus JPY6 million per heir.

Tax rate

Under the current rules, heirs pay inheritance at a top rate of 50% if their share of the estate after the basic exemption is greater than JPY300 million, and 40% is if their share is between JPY100 million and JPY300 million.

The proposals will introduce a new top tax rate and additional bands as follows:

Taxable share (JPY)	Proposed rate	Current rate
100 million to 200 million	40%	40%
200 million to 300 million	45%	
300 million to 600 million	50%	50%
Over 600 million	55%	

In addition, the top rate of gift tax will increase from 50% to 55%.

Consumption tax

In our August 2012 bulletin we discussed a new Consumption tax bill which will raise the rate of consumption tax in Japan from 5 % to 8% from 1 April 2014 to 30 September 2015, and to 10% from 1 October 2015 onwards.

At the time the Government was considering measures to prevent the rate rise from affecting those with low incomes disproportionately. The main measure included in the proposal related to housing loan credits.

The purchase of residential housing incurs consumption tax in Japan and so the rate increase has a large effect on the size of mortgage needed to purchase a house. Currently a taxpayer can take an income tax credit equal to 1% of the outstanding loan capped at a loan amount of JPY 20 million for normal houses and JPY 30 million for certified environmentally-friendly houses. The credit period was due to expire at the end of 2013. The proposal extended this period to the end of 2017. In addition the maximum loan amount will be JPY 40 million and JPY 50 million respectively from 1 April 2014 if the rate increase remains in place.



Amendments to the US – Japan tax treaty

The current US – Japan tax treaty was signed in 2003. On 25 January of this year Japan and the US signed a Protocol to amend the treaty. Although the amendments still need to be approved by both governments, a broad outline of the changes is given below.

Dividends

Currently in order to benefit from a 0% withholding rate a company has to own **more than 50%** of the voting stock of the company paying the dividends for a period of **twelve months**. The Protocol amends this to a shareholding of **at least 50%** for a period of **6 months**.

Interest

Currently the withholding tax rate on interest is **10%**. This will be reduced to **0%**. However if the interest is determined by reference to receipts, sales, income profits or other cash flow of the debtor, the withholding rate will remain at 10%.

Capital gains

Under the current treaty, when a US resident sells shares in a Japanese company that derives at least 50% of its value from real property in Japan, any gain on the disposal of the shares is taxable in Japan.

The amendment removes the requirement for the company holding the property to be resident in Japan. If a company derives its value principally from real property situated in Japan, then any gain on the disposal of its shares by a US resident will be taxable in Japan, regardless of where the company is resident. This amendment broadens considerably Japan's taxing rights.

Mutual Arbitration Procedure

In our May 2012 bulletin we discussed the failure of the Mutual Agreement Procedure, requested Takeda Pharmaceutical Company Limited, to reach a conclusion after 3 years of consideration.

The amendments to the Treaty will introduce a provision for independent binding arbitration in cases where the competent authorities are unable to reach agreement within two years of the request for mutual agreement.

Assistance with collection of taxes

The provision in the current tax treaty for mutual assistance will be widened to cover corporate and individual income tax, inheritance tax and gift tax. Currently the provision only covers assistance in cases of treaty shopping.

Summary

The amendments to the tax treaty will make it easier for multi-national groups that operate in both countries. However the increase in the scope of mutual assistance is indicative of the aggressive approach the Japanese tax authorities are taking to cross-border investigations.

Contact us for any enquiry on our services;

Yoichi Ishizuka

Managing Partner, Tax Services
Tel: 03-5770-8870 email: yoichi.ishizuka@jp.gt.com

Toshiya Kimura

Director, Transfer Pricing Advisory
Tel: 03-5770-8829 email: toshiya.kimura@jp.gt.com

Hideharu Tanaka

Partner, International Tax Services
Tel: 03-5770-8871 email: hideharu.tanaka@jp.gt.com

Kumiko Miyajima

Partner, International Tax Services
Tel: 03-5770-8914 email: kumiko.miyajima@jp.gt.com

Yuka Iizumi

Manager, International Tax Services
Tel: 03-5770-8892 email: yuka.iizumi@jp.gt.com

Akane Hirukawa

Manager, International Tax Services
Tel: 03-5770-8815 email: akane.hirukawa@jp.gt.com

Tosh Kamii

Manager, Corporate Services
Tel: 03-5770-8935 email: toshiya.kamii@jp.gt.com

Adrian Castelino-Prabhu

Assistant Manager, International Tax Services
Tel: 03-5770-8882 email: adrian.castelino@jp.gt.com

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グラントソントン太陽ASG税理士法人
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