

Financial Services Tax News

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PwC Japan Tax Newsletter

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New Independent Agent Exception

Under domestic law, a non-Japanese resident may have had a permanent establishment ("PE") where it conducted business through an agent in Japan ("Agent PE").

On December 13, 2007, the Liberal Democratic Party of Japan released its proposed 2008 Tax Reform package ("2008 Tax Proposals"), in which it recommended the introduction of an independent agent exemption to the definition of an Agent PE under Japanese domestic law.

Following the release of the 2008 Tax Proposals, draft national tax laws were released by the Ministry of Finance, in January 2008. The draft Bill was submitted to the Diet for review and passed the Diet on April 30, 2008.

While the Bill did not amend the national tax laws for the implementation of the independent agent exemption, the Cabinet Order, which was issued with the passage of the 2008 Tax Reforms, amended the existing Corporate Tax Law Enforcement Order ("CTLEO") 186 and Individual Income Tax Law Enforcement Order ("ITLEO") 290, which define an Agent PE for Japanese domestic tax law purposes.

The amendments made by the Cabinet Order exclude from the definition of an agent:

"the person who conducts independently operations relating to the business of a non-resident or a foreign corporation provided in the subsequent items one through three relating to categories of Agent PE, and who conducts operations in the ordinary course of its business"

This exemption is broadly in line with Article 5 of the Organisation of Economic Co-operation and Development's ("OECD") Model Tax Convention on Income and on Capital ("Model Tax Convention"), and is broadly consistent with many other taxation systems of OECD member countries.

Under the Model Tax Convention for an agent to be independent, the agent must be both legally and economically independent, and must provide services to the non-resident in the ordinary course of its business. This approach to an independent agent exception does not provide any safe harbor for certain activities conducted by an agent in Japan, notably such as those found in Singapore, Hong Kong, the US and the UK, but rather requires a case by case analysis as to the independence of each agent.

The revised Enforcement Orders will apply to PE determinations made on or after April 1, 2008.

The independent agent exception was one of the many recommendations put forward by the Financial Services Agency in its plan issued on December 21, 2007 for Strengthening the Competitiveness of Japan's Financial and Capital markets. The implementation of this proposal represents a positive step forward for the financial services sector in Japan and in particular the global and local fund management industry. The changes do not eliminate the taxation risks or the need to manage these risks; however they do generally align Japan's taxation policy in this respect, with the OECD and international global market.

Further details regarding scope and application of the independent agent exemption are expected to be released sometime in Summer 2008, following continuing discussions amongst government agencies, industry bodies, advisors and other interested parties.

For more detailed information, please do not hesitate to your financial tax services representative or any of the following members:

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