



Financial Services Tax Group

News Letter

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New U.S./Japan Double Tax Treaty – Effective

The New U.S./Japan double tax treaty has been ratified by both the U.S. and Japan legislatures and the instruments of ratification were exchanged earlier today. The new treaty was passed without amendment from when it was originally signed by both countries on November 6, 2003.

The ratification today signifies the expeditious entry into force of the new treaty. Since ratification occurred prior to April 1, 2004, the new treaty will apply to Japan or U.S. withholding taxes for amounts paid or credited from July 1, 2004. For changes affecting taxes other than withholding, the treaty applies for the taxable year beginning on or after January 1, 2005. The effective dates of the new treaty are summarized below, however please note that the date of entry into force of the new treaty may be delayed by a taxpayer's election for a period of 12 months.

U.S. / JAPAN TREATY	WITHHOLDING TAXES	OTHER TAXES
Effective Date	July 1, 2004	January 1, 2005

Ratification timeline

New treaty signed	Japan issues 2004 proposed tax reforms	Japan Cabinet approves tax reforms	U.S. JCT releases explanation of new treaty	U.S. Senate Committee on Foreign Relations hearing	Submitted to Japan Diet	U.S. Senate Committee on Foreign Relations approval	U.S. Senate Approval	Japan Diet approval	Instruments of ratification exchanged
Nov 6 2003	Dec 19 2003	Jan 16 2004	Feb 19 2004	Feb 25 2004	Feb 27 2004	Mar 4 2004	Mar 9 2004	Mar 18 2004	Mar 30 2004

Implementation

Japan The Ministry of Finance announced proposals on December 19, 2003, to introduce new legislation in an updated treaty policy. This legislation is intended to clarify the treatment of business entities that are subject to different tax treatment in Japan than they are in the U.S. to ensure only those eligible obtain treaty benefits.

U.S. On February 19, 2004, the U.S. Joint Committee on Taxation (JCT) released its explanation of the new treaty which provides detailed information on the policy process and application of the treaty articles, based on the U.S. Department of Treasury's Technical Explanation.

Key Changes:

- **Eliminates withholding tax on dividends at source for certain residents**
 For certain residents, the new tax treaty eliminates the withholding tax at source on direct dividends paid to certain residents of the other contracting state. The zero rate is only available to certain shareholders holding more than 50% in the dividend paying company and to pension funds. Withholding tax is reduced to 5% where at least 10% of the shares in the dividend paying company and in all other cases the withholding rate is reduced to 10%.
- **Eliminates withholding tax on royalties at source**
 From July 1, 2004, all royalties paid by residents of one contracting state to residents of the other contracting state can be paid without suffering withholding tax at source. This treaty benefit will not apply where the royalty is not an arm's length amount, falls within the anti-conduit rules or does not meet the limitation on benefits article.
- **Eliminates withholding tax on interest at source for certain residents**
 For financial services companies, government bodies or pension funds resident in the other contracting state (subject to certain qualifications), there will be no tax imposed at source on interest income. For other residents, the withholding tax on interest will continue to be imposed at 10%.
- **Anti-conduit provisions**
 The new treaty contains provisions that specifically deny or restrict treaty benefits applicable to interest, royalties and other income to transactions where the nominal/legal owner serves only as a conduit. An anti-conduit rule for preferred stock is also contained within the treaty.
- **Limitations on benefits test**
 In order to combat treaty shopping, this comprehensive article prevents benefits being claimed under the treaty unless the claimant is a qualifying person (as defined), or is able to establish that it is entitled to claim treaty benefits.

Topics provided in this Financial News Letter are based only on general case studies. For practical application to an individual case or a transaction structure, please refer to your usual PwC contact.

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