



Financial Services Tax Group

News Letter

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Changing procedures for obtaining exemption from withholding tax on certain income for foreign corporations and non-permanent residents in Japan

As a general rule, certain domestic income from sources in Japan, received by non-resident individuals and foreign corporations, is subject to Japanese withholding income tax, which is deducted at source by the income payer from their domestic income. However, certain types of domestic income (e.g. rent income) received by the individuals and foreign corporations who have permanent establishments in Japan are exempt from the withholding tax, if the individuals and foreign corporations provide the withholding exemption certificate which is issued by the National Tax Office (“NTO”) under Income Tax Law in Japan. The procedures for obtaining exemption from the said withholding tax has changed from the “providing method” to the “presenting method” as a result of the 2004 tax reforms.

This change will apply to certain types of income where the payment is to be made on or after July 1, 2004. If individuals and foreign corporations possess current withholding exemption certificates, which were issued by the NTO and provided to the payer of the income on or before June 30, 2004, the current withholding exemption certificate still remains effective until the termination of its validity.

However, the blank forms of current withholding exemption certificates (“spare certificates”) usually held by foreign corporations for future tenants of rent income which were issued by the NTO but have not been provided to the payer of the income on or before June 30, 2004, became invalid on June 30, 2004. As such, the spare

certificates cannot be used on or after July 1, 2004. It is recommended that foreign corporations who have obtained the spare certificates for unexpected tenant changes receive a new certificate by June 30, 2004 so that they may use the new certificate at any time on or after July 1, 2004.

Additionally, both the payer and the receiver of income must follow certain book entry requirements concerning the new certificate as a result of the 2004 tax reforms. The payer needs to keep the record, which includes the name of the income receiver and the effective date of the new certificate. The income receiver has to record on the book the name and address of the income payer and the presenting date of the certificate.

Please note that the details of the procedural changes have not been announced by the NTO yet. It is possible that the official announcement could be made just before June 30, 2004 (or after July 1, 2004). If the situation arises whereby a foreign corporation makes a new lease agreement with a new tenant after July 1, 2004, please contact the NTO in order to address the relevant problems.

The “presenting method” for obtaining exemption from withholding tax on interest on loans received by foreign banks has been in use since before June 30, 2004 in accordance with the provision of the Special Taxation Measures Law article 42-2-2. If a foreign bank has a valid certificate on July 1, 2004, the current withholding exemption certificate which is presented to borrowers before July 1, 2004 will remain effective until the termination of its validity *even if the interest is paid after June 30, 2004*. However, it is also necessary to obtain the new “presenting method” exemption certificate in order to be exempt from withholding tax on income received from contracts with *new clients engaged on or after July 1, 2004*. Therefore, we recommend that the new withholding certificate should be available as soon as possible for presentation on or after July 1, 2004. The book entry requirements, in accordance with the Administrative Institution of the National Tax Agency concerning the Special Taxation Measures Law No.42-2-2-1, and No. 42-2-2-3, have been imposed on both the foreign banks and the borrowers, and the same book entry requirements must be satisfied on or after July 1, 2004 as well.

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