



*Financial Services Tax Group*

# **News Letter**

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## **Unification of Taxation on Income from Financial Assets for Individuals**

On June 15, 2004, the sub-committee of the Tax Commission of the Ministry of Finance issued their report "*The Basic View on the Unification of Taxation on Income from Financial Assets*" (the "Report"). In this News Letter, we summarize the contents of the Report.

### **Background and basic rationale for unification**

The Report identifies the significant decline in the savings rate - which is not expected to recover due to the declining birthrate and the rapid aging of the population - as a motivation to encourage utilization of existing financial assets more efficiently in order to stimulate economic growth. One proposed stimulant is a strategy to develop the individual tax framework to shift individual financial assets from deposit savings to investments in listed stocks and stock investment trusts.

The Report considers whether unification of the taxation on income from financial assets will assist in creating a tax system that is: simple; neutral among financial assets; and contributes to the reduction of risk on stock investments for individual investors. To achieve such a tax system, there were essentially two methods discussed in the Report, as detailed further below:

- Equalization of tax system among various financial assets; and
- Aggregation of profit and loss from various financial assets.

## Equalization of tax system among various financial assets

The Report describes the direction of the revisions of the taxation on dividend income, capital gains/losses on bonds, foreign currency deposit and insurance assets as examples of the trend towards equalization of the tax system amongst various financial assets.

Income	Current taxation	Direction of revision
Dividend Income	In principal, dividend income is subject to the comprehensive tax system. There is a special rule that allows separate withholding tax system at source at the rate of 10% (for listed stock) or 20% (for non listed stock), although this rule does not apply to investors who have large shares.	Dividends should be subject to separate assessment tax system and taxed at the rate of 20%. However, a comprehensive assessment tax system should be applied for investors who have large shares.
Capital gains/losses on bonds	Capital gains are exempt from taxation. Capital losses are deemed tax nothings.	Capital gains on bonds should be treated the same as stocks. Capital losses should be treated as transfer losses.
Foreign currency deposit	Exchange gains/losses are categorized as miscellaneous income/loss and are subject to the comprehensive assessment tax system.	Exchange gains should be subject to separate assessment tax system and taxed at the rate of 20%.
Insurance products	If income from insurance products is similar to that from financial assets* such income is subject to separate withholding tax at the rate of 20%. Other income from insurance products is categorized as miscellaneous income or occasional income and subject to the comprehensive assessment tax system.	Income from insurance products should be subject to the separate assessment tax system to the extent such income is similar in nature to that of financial assets.

## **Aggregation of profit and loss from various financial assets**

Currently, income from financial assets is categorized as various type of income for tax purposes and the aggregation of profit and losses amongst the different types of income is strictly restricted. The Report states that since profits or losses in each category of income are considered to have economically the same nature, the risk on stock investments would be reduced by allowing taxpayers to deduct investment losses from profits on other financial assets.

However, the Report goes on to accept the argument that the aggregation of transfer income, such as capital gains on sales of stock, and ordinary income, such as dividend and interest, should be subject to certain limitations. The Report considers that it is inappropriate to aggregate incomes that are subject to different tax systems nor incomes within the same tax system but subject to different tax rates.

The Report made the following recommendations:

Aggregation of the profits and losses from transfer of stocks and transfer of bonds should be allowed.

Aggregation of dividend income and losses from transfer of stocks should be allowed with certain limitations. The losses from the transfer of stocks can be carried forward within the subsequent three years.

Aggregation of interest income and losses from transfer of stocks should be allowed on condition that the assessment tax system and payment record system for interest income is included within the comprehensive assessment tax system.

Capital losses on stocks due to bankruptcy of the issuer corporation should be treated the same as capital losses on the transfers of stocks. Pay-off losses arising from bank insolvencies for depositors, however, should not be treated as a tax loss.

## **Development of tax payment environment**

In the Report, the development of a tax compliance environment was considered important to operate a unified tax system, including appropriate enforcement and convenience for

taxpayers. The Report provided comments on the revision of the ongoing assessment tax system and withholding tax system together with the selective application to taxpayer's identification number.

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