



# Financial Services Tax News

Financial Services Tax Group

October 2005

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## **Agreement in principle on the new tax treaty between Japan and the United Kingdom**

On July 1st 2005, the Ministry of Finance (Zaimusho) announced that negotiations regarding amendment to the Convention between Japan and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income reached agreement in principle between the Japanese and the United Kingdom governments on May 26th 2005.

According to the announcement, the proposed new treaty, whilst taking the OECD model as its basis, comprehensively revises the existing convention and aims to promote investment between the two countries as well as to prevent tax avoidance.

Whilst details of the new treaty have not been made fully public at this stage, it is expected that the new treaty will reduce withholding taxes on dividends, interest and royalties paid between residents of the two countries and introduce detailed measures designed to prevent treaty abuse. One important focus of intention will be the taxation treatment on capital gains from disposal of interests in Japanese real estate and transfer of shares in Japanese corporations, in light of the 2005 Japanese tax reforms.

The timing of release and signing of the new treaty is not yet publicly available. However, the timing of the treaty between Japan and United States, which reached agreement in principle on June 3rd 2003, was signed on November 7th 2003 and became effective on March 30th 2004, might be a good indication of the likely timescale.

The Japanese government is also undergoing treaty negotiations with the Dutch and Indian governments to revise their respective treaties.

This Newsletter notes the major expected amendments in the new treaty.

### **Lower withholding taxes on dividends.**

Withholding tax rates imposed on inter-company dividends are expected to be either eliminated altogether or reduced to 5%/10%, depending on the level of shareholder ownership.

### **Lower withholding taxes on interest.**

The new tax treaty is expected to eliminate withholding taxes on interest paid to financial institutions.

### **Lower withholding taxes imposed on royalties.**

The new tax treaty is expected to eliminate withholding taxes imposed on royalties.

### **Introduction of a limitation on benefits article.**

A significant feature of the new treaty is the expected introduction of various anti-tax avoidance measures, in particular a limitation on benefits article modeled on the recent Japan and United States treaty. A limitation on benefits article imposes a number of detailed tests designed to restrict treaty benefits to appropriately qualified residents in order to prevent treaty shopping abuse.

### **Taxation on income gained through Tokumei Kumiai distributions.**

The new treaty is expected to include specific provisions permitting the imposition of withholding taxes in Japan on income from Tokumei Kumiai distributions, currently exempted from taxation under the existing treaty.

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Detailed compliance provisions will be added to the new treaty together with technically complex treaty articles with the express intention of targeting tax avoidance arrangements and restricting benefits to qualified residents of Japan and the United Kingdom. Accordingly, we recommend that taxpayers consult with their professional tax advisor in the case where they submit the application forms related to the new tax treaty such as an attachment concerning a limitation on benefits article.

A more detailed summary of the new treaty will be distributed as a special edition Newsletter shortly after the new treaty is published.

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