



Financial Services Tax News

Financial Services Tax Group

December 2005

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*We wish our clients and friends
a Happy New Year
Rainen mo Yoroshiku Onegai Itashimasu*

Proposed 2006 Japanese Tax Reforms Impact on the Financial Services Industry

On 15 December 2005, the Liberal Democratic Party issued their proposed 2006 tax reform package. This was followed shortly thereafter by the 2006 national and local tax reform proposals by the Ministry of Finance on 19 December 2005 and the Ministry of Internal Affairs and Communications on 20 December 2005 respectively (together, the "2006 tax reforms").

The next steps in approving the 2006 tax reforms involve a summary of the proposals prepared by the Ministry of Finance for approval by the Cabinet. Subsequently, the 2006 tax reforms will be drafted as changes to Japanese tax laws and regulations and then submitted for approval to the Diet.

Summarized below is an outline of the principal 2006 tax reforms as they affect the financial services industry. Further substantive details will be clarified after drafts of the new laws and related cabinet orders are released publicly.

Real property taxation

1. Registration tax on real property

Ordinary corporation

The reduced registration tax rates on the transfer of ownership of land by sale and entrustment of ownership of land will be extended for two years as follows:

		to March 31, 2006	from April 1, 2006 to March 31, 2008	from April 1, 2008
Transfer of ownership by sale	land	1.0%		2.0%
	building	1.0%	2.0%	
Entrustment of ownership	land	0.2%		0.4%
	building	0.2%	0.4%	
Initial registration of ownership		0.2%	0.4%	
Transfer of ownership by merger		0.2%	0.4%	

TMK and J-REIT

The reduced registration tax rates on the transfer of ownership of real property by sale by TMKs and J-REITs will rise to 0.8% but be extended for two years as follows:

	to March 31, 2006	from April 1, 2006 to March 31, 2008	from April 1, 2008
Transfer of ownership by sale	0.6%	0.8%	2.0%

2. Real property acquisition tax

(1) Building for residence, land for residence, land other than for residence in a commercial area

The reduced registration tax rates on building for residence, land for residence and land other than for residence in commercial areas will be extended for three years.

to March 31, 2006	from April 1, 2006 to March 31, 2009	from April 1, 2009
3.0%		4.0%

(2) Building other than certain shops and offices

The reduced registration tax rates on buildings other than certain shops and offices will be abolished; However, a concessionary rate of 3.5% will be applicable for two years.

to March 31, 2006	from April 1, 2006 to March 31, 2008	from April 1, 2008
3.0%	3.5%	4.0%

International taxation

1. Thin capitalization rules

The thin capitalization rules will be expanded as follows:

- (1) Debt on Japanese repos (*Saiken-Gensaki*) where the borrowing and lending are related is excluded from the category of debt.
- (2) The following items are included in the category of debt (and interest on debt):
 - (a) debt obtained from a third-party company if the repayment is guaranteed by the corporate parent and certain affiliates (“corporate parents”), the interest on such debt, and the guarantee fee paid to the corporate parents;
 - (b) debt obtained from a third-party company with a bond held as collateral which is borrowed from the corporate parents, the interest on such debt, and the consideration of borrowing bond paid to the corporate parents; and
 - (c) debt, the interest on debt, guarantee fees and consideration paid to the corporate parents in case of combined transactions of (a) and (b) above.

2. Extension of concessionary tax relief

The following concessionary exemptions from taxation are extended for a further two years:

- (1) Interest or discount on bonds issued by Japanese corporations outside of Japan (*Minkan Kokugaisai*);
- (2) Interest on deposits in offshore accounts (*Tokubetsu Kokusai Torihiki Kanjo*); and
- (3) Interest received in connection with Japanese repo (*Saiken-Gensaki*) transactions by foreign financial institutions.

New Company Law legislation

1. Dividend

- (1) Distributions of surpluses continue to be treated as redemption of capital or dividends in accordance with the composition of the surpluses.
- (2) If a corporation issues different classes of stocks, the capital amount when calculating deemed dividends in the case of acquiring the corporation’s own shares is determined in accordance with the class of shares. In addition, provisional measures will be released for corporations that issued classed stocks on or before 31, March 2006.

2. Exercise of the right of buy-back

Shareholders need not recognize capital gains or losses arising from the transfer of shares, when the

shareholder transfers their shares to the issuer upon exercising a right to request the issuer to buy back the shares and receive in return another class of shares from the issuer.

3. Others

In addition, a several tax treatments will be released with respect to transactions involving shares defined under the new company law provisions

Miscellaneous reforms

The 2006 tax reforms include the following additional measures:

1. Application of tax loss carry-forward is restricted if a corporation acquires a subsidiary with a tax loss for tax avoidance purposes.
2. Salary payments to a managing member by a non-family company may be treated as deductible under certain conditions.
3. The definition of “family company” and the related calculation formula of undistributed profits will be amended.
4. Certain eating and drinking expenses are to be excluded from the category of non-deductible entertainment expenses.

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