

Financial Services Tax News

May 2008

PwC Japan Tax Newsletter

Tax Practice of PricewaterhouseCoopers Japan (Zeirishi-Hojin PricewaterhouseCoopers) is one of the largest professional tax corporations in Japan with more than 530 professionals. Within this practice, our Financial Services Tax Group is comprised of approximately 100 professionals, dedicated specifically to advising the financial services industry. In addition to tax compliance services including the preparation of corporation income tax, individual income tax, and consumption tax returns, our tax professionals are experienced in providing tax consulting advice in all aspects of domestic/international taxation including financial and real estate, transfer pricing, M&A, group reorganization, global tax planning, and the consolidated tax system to clients in various industries.

The firms of the PricewaterhouseCoopers global network (www.pwc.com) provide industry-focused assurance, tax and advisory services to build public trust and enhance value for clients and their stakeholders. More than 146,000 people in 150 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

This Tax News is provided for general guidance only, and does not constitute the provision of advice or professional consulting of any kind. Before making any decision or taking any action, you should consult your usual PwC contact with all the pertinent facts relevant to your particular situation.

Zeirishi-Hojin PricewaterhouseCoopers
Financial Services
Kasumigaseki Bldg., 15F
2-5 Kasumigaseki 3-chome
Chiyoda-ku, Tokyo 100-6015
Telephone: 81-3-5251-2400
<http://www.pwc.com/jp/tax>

*connectedthinking

2008 Tax Reforms on Interest Taxation

The 2008 Tax Reform Bill was passed by the Diet on April 30, 2008. This newsletter focuses on amendments to the taxation of interest on bonds issued to foreign investors. (A summary of the 2008 tax reform proposals was included in our December 2007 newsletter.)

Scope of interest included in Japan source income

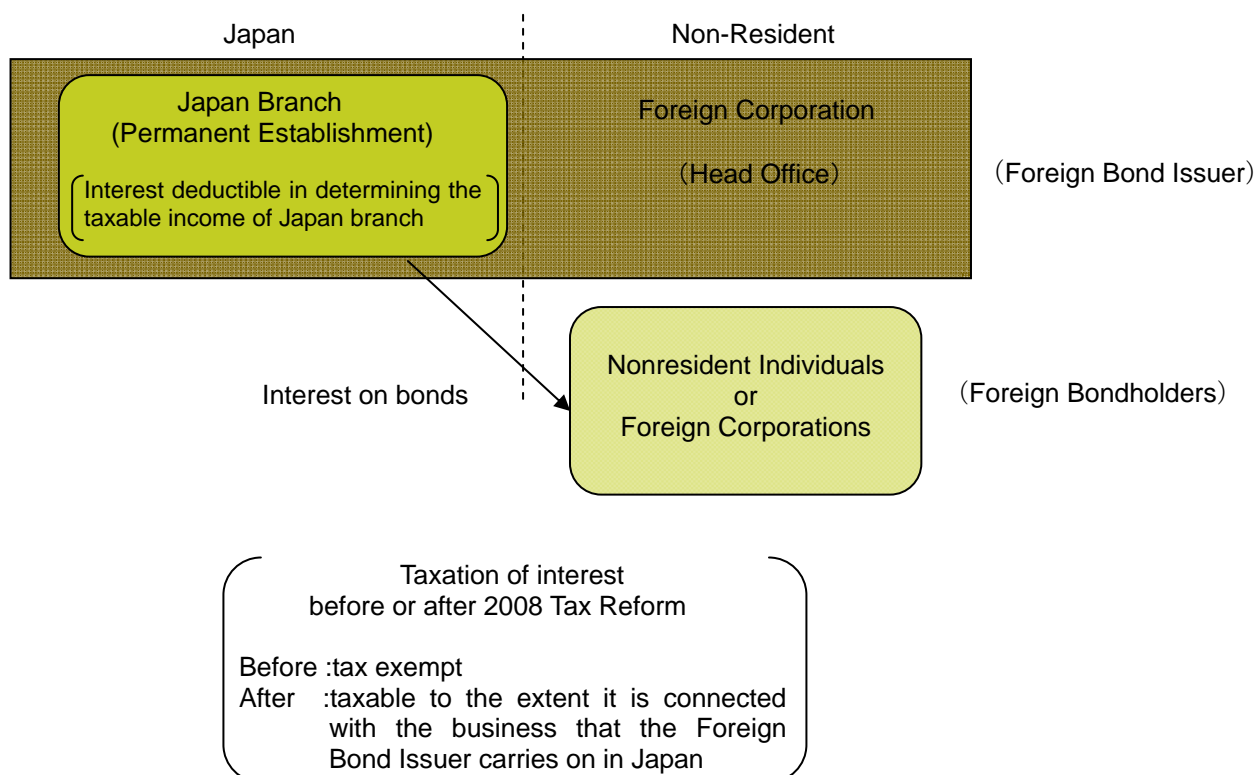
Outline

The Japanese source rule was amended such that interest on bonds received by nonresident individuals or foreign corporations (“Foreign Bondholder”) would be treated as having arisen in Japan, where the bonds are issued by a foreign corporation (“Foreign Bond Issuer”) and interest on the bonds is connected with the business that the Foreign Bond Issuer carries on in Japan*¹. Unless a double tax treaty applies, such interest would be subject to 15% Japanese withholding tax in principle*². This amendment applies to interest on bonds issued on or after May 1, 2008.

*¹ Interest on bonds connected with the business in Japan means any interest which is connected with the business that the Foreign Bond Issuer carries on through a permanent establishment in Japan.

*² If a Foreign Bondholder itself has a permanent establishment in Japan, such interest may also be subject to individual or corporate income tax in Japan.

Japanese withholding tax on interest received by foreign bondholders (example)



Background

If a foreign corporation has a permanent establishment in Japan it is subject to Japanese corporate tax in principle on its Japan source income*³. In determining its taxable income, a foreign corporation is allowed deductions for operating or other expenses to the extent those expenses are incurred in respect of its business to generate Japan source income. Accordingly, if the Foreign Bond Issuer pays interest on bonds and this interest is connected with the business it carries on in Japan, the Foreign Bond Issuer is generally able to deduct such interest in determining its taxable income in Japan.

*³ The scope of income subject to corporate tax could vary, depending on the type of permanent establishment, and could also be modified by the application of a tax treaty.

On the other hand, interest received by Foreign Bondholders on such bonds had been exempt from Japanese withholding tax even if the interest was incurred in connection with the business conducted by the Foreign Bond Issuer in Japan and deductible in Japan by the Foreign Bond Issuer. The Foreign Bond Issuer was able to reduce its taxable income in Japan by deducting the interest paid, and the Foreign Bondholders were exempt from Japanese withholding tax on interest received.

Furthermore, interest on bonds issued by a foreign corporation are deemed to arise in Japan by a tax treaty between Japan and the jurisdiction of the foreign bondholder in general if the foreign corporation has a permanent establishment in Japan and the bonds are connected with such a permanent establishment. Under these circumstances, there developed a finance structure (so-called "Double SPC Scheme") designed to eliminate Japanese withholding tax, whereby a foreign corporation (SPC 1) issued bonds to investors resident in a treaty jurisdiction with Japan through a foreign corporation (SPC 2) situated in a jurisdiction with which Japan did not have a tax treaty. These 2008 tax reform amendments impose Japanese withholding tax on interest paid under the Double SPC Scheme.

Taxation of discount bonds and tax exempt bonds

In line with the above, related tax law provisions were amended, which apply to interest on bonds issued on or after May 1, 2008.

- (1) If bonds are issued at a discount by a foreign corporation, 18% withholding tax is imposed on premiums at the time of issue, provided the bonds are issued outside Japan and the premiums are connected with the business that the foreign corporation carries on in Japan.
- (2) Interest on bonds, including premiums, may be exempt from Japanese withholding tax, provided the bonds are issued outside Japan and the interest is paid outside Japan (*Minkan Kokugaisai*). This exemption, which had been limited to bonds issued by Japanese corporations, now extends to bonds issued by a foreign corporation, if those bonds are issued outside Japan and the interest is connected with the business that the foreign corporation carries on in Japan^{*4}. This general rule was expected to be limited to bonds issued on or before March 31, 2008, but has been extended for two years until March 31, 2010.

^{*4} This exemption does not apply to bonds issued by a foreign corporation with nil or extremely low corporate tax (as defined under the corporation tax law) in a jurisdiction where the head or main office of the foreign corporation is situated.

For more detailed information, please do not hesitate to your financial tax services representative or any of the following members:

Zeirishi-Hojin PricewaterhouseCoopers

Financial Services
Kasumigaseki Bldg. 15F
2-5 Kasumigaseki 3-chome
Chiyoda-ku, Tokyo 100-6015
Telephone: 81-3-5251-2400
<http://www.pwc.com/jp/tax>

Partner	Sachihiko Fujimoto	81-3-5251-2423	sachihiko.fujimoto@jp.pwc.com
	Katsuyo Oishi	81-3-5251-2565	katsuyo.oishi@jp.pwc.com
	Yuka Matsuda	81-3-5251-2556	yuka.matsuda@jp.pwc.com
	Tetsuo Iimura	81-3-5251-2834	tetsuo.iimura@jp.pwc.com
	Akemi Kitou	81-3-5251-2461	akemi.kitou@jp.pwc.com
	Hiroshi Takagi	81-3-5251-2788	hiroshi.takagi@jp.pwc.com
	Raymond Kahn	81-3-5251-2909	raymond.a.kahn@jp.pwc.com
	Stuart Porter	81-3-5251-2944	stuart.porter@jp.pwc.com
Managing Director	Marc Lim	81-3-5251-2867	lim.marc@jp.pwc.com
Senior Manager	Kenji Nakamura	81-3-5251-2589	kenji.nakamura@jp.pwc.com
	Yoko Kawasaki	81-3-5251-2450	yoko.kawasaki@jp.pwc.com
Manager	Nobuyuki Saiki	81-3-5251-2570	nobuyuki.saiki@jp.pwc.com
	Akiko Hakoda	81-3-5251-2486	akiko.hakoda@jp.pwc.com
	Mami Sasaki	81-3-5251-2471	mami.sasaki@jp.pwc.com
	Kyoko Imamura	81-3-5251-2855	kyoko.imamura@jp.pwc.com
	Satoshi Matsunaga	81-3-5251-2586	satoshi.matsunaga@jp.pwc.com
	Soichi Toyama	81-3-5251-6212	soichi.toyama@jp.pwc.com
	Takashi Nonaka	81-3-5251-2417	takashi.nonaka@jp.pwc.com
	Hiroko Suzuki	81-3-5251-2156	hiroko.x.suzuki@jp.pwc.com
Daniel Lutz	81-3-5251-6640	daniel.lutz@jp.pwc.com	