



Financial Services Tax Group

News Letter

January 2004

Outline of Proposed FY 2004 Japanese Tax Reform

Financial Services impact

On January 16, 2004 the Cabinet approved the proposed fiscal year 2004 tax reform package issued by the Democratic Party on December 17, 2003. The main impacts for the financial services industry are outlined below.

Taxation of Financial Assets and Stocks

The taxation of Publicly Offered Stock Investment Funds will be amended so that:

- Capital gains on their sale will be subject to a separate tax (at the same rate of listed stocks) of 10% (comprising national tax of 7% and local tax of 3%) for the period from January 1, 2004 to December 31, 2007.
- These investments will be added to the scope of assets that may be held in a “special account” under which tax will be withheld and the income of which may not be required on the filing of tax returns.
- Capital losses may be carried forward for 3 years; the same period as permitted for capital losses on listed stocks.
- When certain financial institutions repurchase investments from the investors, and then consequently the investments are redeemed by the financial institutions, profit

distributions from those redemptions may be exempt from withholding tax under certain requirements.

We note that banks, *Kyodoshiki-kinyukikan* and registered financial institutions, will be allowed to operate “special accounts”.

The tax rate on the capital gains of unlisted stocks will be reduced to 20% (comprised of national tax of 15% and local tax of 5%) from the current 26% from January 1, 2004.

Redemption gains of the following bonds are exempt from withholding tax at the time of issuance.

- (1) book-entry transfer short-term bonds (so called “Denshi CP”) issued by foreign corporations, and;
- (2) discount short-term government bonds, for which a book-entry transfer is made on accounts opened by qualified foreign intermediaries.

System of payment slips concerning transfer and redemption of short-term bonds will be prepared.

International Taxation

Procedural measures will be introduced in the context of applying the new Japan-US tax treaty, including clarification regarding:

- Business entities that are treated differently in Japan and US for the purposes of applying in particular the fiscally transparent rules; and
- Details will be set out regarding the practical application and compliance with the new comprehensive limitation on benefits article, which prevents treaty benefits being applied unless the resident satisfies certain criteria.

Procedures regarding exemption from withholding tax applicable to certain Japan sourced income received by non-residents and foreign corporations having a branch in Japan will be revised.

The thin capitalization rules will be amended so that the total debt/net asset ratio of one fiscal year in the past three years of a similar corporation may be applied when a similar

