

# Financial Services Tax News

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## PwC Japan Tax Newsletter

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## 2008 Tax Reforms Foreign Tax Credit System on J-REITs and TMKs

The 2008 tax reforms amended the foreign tax credit rules for Japanese Real Estate Investment Trusts, Tokutei Mokuteki Kaisha and other similar entities (collectively "J-REITs")<sup>\*</sup>.

Prior to the tax reforms, the foreign tax credit system allowed J-REITs to credit foreign income taxes paid by J-REITs against their Japanese corporate tax liability. However, under the amended rules, foreign income taxes paid by J-REITs are only creditable against withholding taxes imposed on dividend payments made by J-REITs. Furthermore, the amount of the credit is limited to the withholding tax imposed on the dividends.

This Newsletter summarizes the revised foreign tax credit rules for J-REITs.

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\* A reference to a J-REIT in this issue for convenience includes Japanese Real Estate Investment Trusts, Tokutei Mokuteki Kaisha, trustee companies in connection with a Special Purpose Trust, and trustee companies in connection with a Special Investment Trust.

## Background of the Reform

Under the foreign tax credit rules prior to the recent reform, in order to eliminate double taxation, a J-REIT was able to claim any foreign tax credits if it directly paid any income taxes imposed under foreign tax laws (in a way similar to the foreign tax credit for ordinary domestic corporations).

When calculating the foreign tax credit limitation imposed on J-REITs, the calculation could be based on the taxable income of the J-REIT before deducting dividends paid. Under such rule, foreign income tax paid by J-REITs could be credited at the level of J-REITs, and then distributed to its shareholders. Consequently, it was possible for investors in J-REITs to receive, if the tax credit utilized at the J-REIT level was taken account of, an effective foreign income tax refund in overall terms that was larger than their Japanese income tax liability.

To eliminate this excessive foreign tax credit claim for J-REITs, the Japanese foreign tax credit system was modified for J-REITs so that the foreign tax credit no longer applied at the J-REIT level but rather applied to reduce withholding tax imposed on dividend payments to shareholders in J-REITs. The amount of the credit is now limited to the dividend withholding tax liability on the distribution to investors.

## Foreign Tax Credit under the Reform

### (1) Amount of creditable foreign income taxes

Under the 2008 tax reforms, foreign income taxes paid by J-REITs are creditable against but only up to the dividend withholding tax obligation on the distribution to investors.

The foreign income taxes amount creditable against withholding income taxes ("Creditable Foreign Income Taxes Amount") is the total amount calculated using the following formula for each of the following classes of person who receive dividends: (i) residents; (ii) domestic corporations; and (iii) non-residents or foreign corporations. Such Creditable Foreign Income Taxes Amount is limited to the amount of foreign income taxes paid by J-REITs.

$$\frac{\text{Dividends relating to Creditable Foreign Income Taxes Amount}}{(1 - \text{Withholding tax rate imposed on dividends})} - \text{Dividends relating to Creditable Foreign Income Taxes Amount}$$

### (2) Amount of dividends from J-REITs subject to withholding tax

Where the foreign tax credit rule is applied, the Creditable Foreign Income Taxes Amount is added to the cash dividend amount when calculating the withholding tax liability on the distribution to investors.

### (3) Document Retention Requirements

J-REITs who apply the foreign tax credit rules are required to maintain documents that verify the foreign income taxes imposed, as well as other documents which are required under the Ministerial Order, for a period of seven (7) years after the end of year which the J-REITs credited the foreign income taxes.

## Effective Date

The amended foreign tax credit rules are effective to dividends paid for fiscal years beginning on or after April 30, 2008.

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

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