

Financial Services Tax News

November 2008

PwC Japan Tax Newsletter

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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

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New Japan-Australia Tax Treaty

On November 3, 2008, diplomatic notes were exchanged between Japan and Australia to bring into effect "The Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes of Income" (the "New Treaty"), which was signed on January 31, 2008. Following this exchange, the New Treaty will come into effect on December 3, 2008, replacing the existing Japan-Australia treaty (the "Old Treaty"), which came into force in 1970.

The New Treaty will apply:

In the case of Japan

1. with respect to taxes withheld at source, for amounts taxable on or after January 1, 2009;
2. with respect to taxes on income which are not withheld at source, for income for taxable years beginning on or after January 1, 2009; and
3. with respect to other taxes, for taxes for taxable years beginning on or after January 1, 2009; and

In the case of Australia

1. with respect to withholding tax on income that is derived by a resident of Japan, for amounts derived on or after January 1, 2009; and
2. with respect to other taxes, for taxable years beginning on or after July 1, 2009.

With the exception of benefits provided under Article 15 of the Old Treaty, relating to income derived by professors or teachers within a certain period, the benefits of the Old Treaty shall cease to be effective from the day prior to the benefits of the New Treaty, described above, apply.

In order to enhance the investment relationship between Japan and Australia, the New Treaty mitigates taxation on income from investment (dividends, interests and royalties) in the source country, and introduces detailed measures, including a limitation on benefit article, to prevent treaty abuse. Furthermore, the New Treaty also introduces "Income from Real Property" and "Alienation of Property" clauses, as well as a clause regarding a limitation on the Transfer Pricing correction period.

This Newsletter notes the major amendments in the New Treaty.

Comparison of income from investment

Under the New Treaty, taxation in the source country on dividends, interests, royalties and sleeping partnership contracts (the "Tokumei-Kumiai") is limited as follows:

	Old Treaty		New Treaty	
	Beneficial Owner	Maximum tax rate	Beneficial Owner	Maximum tax rate
Dividends	Any beneficial owner	15%	A company that has held directly shares representing at least 80% of the voting power of the dividend paying company for the 12 months ending on the date on which entitlement to the dividend is determined, and meets certain other requirements ^(*)	0%
			A company holding directly shares representing at least 10% of the voting power of the dividend paying company ^(*)	5%
			A resident of Australia that is a beneficiary of dividends paid by a Japanese corporation entitled to a deduction for dividends paid to its shareholders where more than 50% of the assets of such company consist, directly or indirectly, of real property situated in Japan (e.g. J-REITs or TMKs)	15%
			Other than above	10%
Interests	Any beneficial owner	10%	Certain governmental bodies or financial institutions, etc.	0%
			Other than above	10%
Royalties	Any beneficial owner	10%	Any beneficial owner	5%
Tokumei-Kumiai	Silent	20% (under Japanese domestic law)	No exemption from taxation in source country	20%

^(*) not including a resident of Australia that is a beneficiary of dividends paid by a Japanese corporation entitled to a deduction for dividends paid to its shareholders (e.g. J-REITs or TMKs)

Introduction of measures to prevent treaty abuse

Under the New Treaty, a comprehensive limitation on benefits provision is included in order to limit treaty benefits to qualifying residents of Japan and Australia. Qualified residents generally include (i) individuals, (ii) qualified governmental entities, (iii) a certain listed companies, (iv) pension funds and (v) charitable entities. The limitation on benefits test applies to business profits, or to investment income that may be fully exempted under the New Treaty.

In addition, the New Treaty contains provisions that deny or restrict treaty benefits applicable to preferred dividends, interest and royalties to transactions where the nominal or legal owner serves only as a conduit or the purpose of such transactions are considered treaty abuse.

Other amendments

The New Treaty modifies the definition of residency and provides specific rules for the determination of residency with regard to entities that have different classifications for Japanese and Australia tax purposes.

The New Treaty introduces “Income from Real Property” and “Alienation of Property” clauses, under which capital gains derived from transfers of the following property, may be taxed in the country of source:

- Transfer of real property;
- Transfer of shares in a company that derives 50% or more of its value directly or indirectly from real property;
- Transfer of 5% or more of the shares in a company where the alienator (together with its related parties) held 25% or more of the total issued shares, provided the gain is not otherwise subject to tax in the alienator’s country of residence; and
- Transfer of a property that forms part of the business property of a permanent establishment in the source country.

With the introduction of a limitation on benefit article, the documentation requirements necessary for the application of benefits under the New Treaty are far more complicated than the Old Treaty. The above is a general summary only and investors are advised to seek our detailed advice when applying or interpreting the provisions of the New Treaty to their particular circumstances.

For more detailed information, please do not hesitate to contact 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
	Kimihito Takano	81-3-5251-2698	kimihito.k.takano@jp.pwc.com
	Nobuyuki Saiki	81-3-5251-2570	nobuyuki.saiki@jp.pwc.com
Manager	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
	Kotaro Fujino	81-3-5251-2036	kotaro.fujino@jp.pwc.com
	Koichiro Ito	81-3-5251-6525	koichiro.ito@jp.pwc.com
	Daniel Lutz	81-3-5251-6640	daniel.lutz@jp.pwc.com