



# Financial Services Tax News

Financial Services Tax Group

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

## Proposed 2008 Japanese Tax Reforms Impact on the Financial Services Industry

On December 13, 2007, the Liberal Democratic Party released its proposed 2008 Tax Reform package. This was followed by the 2008 National and Local Tax Reform proposals released by the Ministry of Finance and the Ministry of Internal Affairs and Communications respectively on December 19, 2007 (together, the "2008 Tax Reforms").

This Newsletter provides a summary in relation to the following changes proposed included within the 2008 Tax Reforms:

- taxation relating to finance and corporate securities,
- international taxation,
- Tokutei Mokuteki Kaisha ("TMK"); and
- Japanese Real Estate Investment Trusts ("J-REIT").

## 1. The Tax System on Finance and Corporate Securities

### (1) Taxation related to Capital Gains on Listed Stocks

- (a) The existing concessional tax rate of 10% (national 7%, local 3%), which applies to capital gains derived from the disposal of listed stocks, will be abolished on December 31, 2008. Capital gains derived on or after January 1, 2009 will be subject to a tax rate of 20% (national 15%, local 5%).
- (b) A transitional rate of 10% (national 7%, local 3%) will apply to capital gains derived from the disposal of listed stocks up to an annual ceiling of JPY 5 million from January 1, 2009 to December 31, 2010.

### (2) Taxation related to Dividend Income on Listed Stocks

- (a) The existing concessional withholding tax rate of 10% (national 7%, local 3%) which applies to dividend income paid from listed stocks will be abolished on December 31, 2008. Dividends paid to on or after January 1, 2009 will be subject to a withholding tax rate of 20% (national 15%, local 5%).
- (b) A transitional withholding tax rate of 10% (national 7%, local 3%) will apply to dividend income paid from listed stocks up to an annual ceiling of JPY 1 million from January 1, 2009 to December 31, 2010. From January 1, 2009 Japanese resident individuals will be able to elect for the separate taxation assessment at the rate of 20% (national 15%, local 5%) on dividend income from listed stocks.

### (3) Preferential Tax Treatment on aggregation of profit and loss

Where a Japanese resident individual incurs a capital loss from the disposal of listed stocks in the current year, or in any of the three years prior to the current year, such a Capital Loss may be offset against Dividend Income on Listed Stocks (provided a separate taxation assessment is elected by the taxpayer). The above preferential tax treatment will apply to individual income tax imposed on taxable income in 2009 or after and inhabitants tax imposed in 2010 or after.

## 2. International Taxation

### (1) Taxation with regard to interest income earned by non-residents or foreign corporations

The following amendments will apply to bonds issued by foreign corporations on or after April 1, 2008:

- (a) The definition of Japan sourced income will be extended to cover interest on bonds issued by a foreign corporation which are attributable to a business conducted in Japan by the foreign corporation.
- (b) In the case of discount bonds issued outside of Japan by a foreign corporation, where the discount on issue of the bond is attributable to the business conducted in Japan by the foreign corporation, the profit on redemption of the bonds will be subject to Japanese withholding tax at the rate of 18%.
- (c) The withholding tax exemption for interest on bonds issued by Japanese corporations outside of Japan, the coupon on which is also paid outside of Japan (*minkan kokugaisai*), will be extended to apply to interest on bonds issued by certain foreign corporations. In addition, the term of this exemption will be extended a further two years.

(2) Agent Permanent Establishment (“PE”)

Under the 2008 Tax reform proposals, independent agents will be excluded from the definition of an agent PE for Japanese domestic tax purposes. It is anticipated that this independent agent exemption may be broadly in line with the Organisation for Economic Co-operation and Development (“OECD”) model treaty and established precedents.

It is anticipated that the above amendment will apply from April 1, 2008.

(3) Foreign income taxes paid by TMK

The proposed rules will replace the current foreign tax credit system and will be applied to dividends paid from the first fiscal year beginning on or after April 1, 2008. Under the proposed rules foreign income taxes paid by a TMK will be creditable against withholding income taxes imposed on dividends paid from a TMK. The amount of deduction will be limited to the withholding income tax imposed on the dividend.

(4) Special rules on income taxation with regard to a Special Foreign Subsidiary of a domestic corporation (referred to as the “Anti-tax Haven Rules”)

A corporation which is controlled by directors of a Japanese corporation will be included in the category of a family shareholder group; which is used to determine whether a Japanese corporation with its family shareholder group is subject to the Anti-tax Haven Rules.

Further, a corporation which is controlled by directors of a Japanese corporation, special foreign subsidiary corporations and any other related corporations, will be included in the category of related persons with regard to “the non-related person standard” for determining exclusion from application of the Anti-tax Haven Rules.

The above amendment will apply to the first fiscal year of the specified foreign subsidiary corporation **ending** on or after April 1, 2008.

### 3. Taxation related to TMK and Investment Corporation

- (1) The definition of a qualified institutional investor (“QII”) in the context of a TMK structure (e.g., subscriber to TMK Bonds) will be broadened.
- (2) The definition of a “family corporation” for J-REIT purposes will be revised to include companies controlled by one group of shareholders instead of the existing three groups of shareholders.
- (3) The reduced registration tax rate on the transfer of specified real estate properties acquired by a TMK based on its Asset Liquidation Plan will be increased from 0.8% to 0.9% for acquisitions made on or after April 1, 2009, and will be extended a further two years.

### 4. Other Proposals

- (1) The statutory useful life of machinery and equipment will be revised and the depreciation asset classification will be broadened.

This amendment will apply to fiscal years beginning on or after April 1, 2008 and will also apply to depreciation assets which have been acquired before that date.

- (2) The reduced registration tax rate for the transfer of land will be increased progressively and extended a further three years.

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