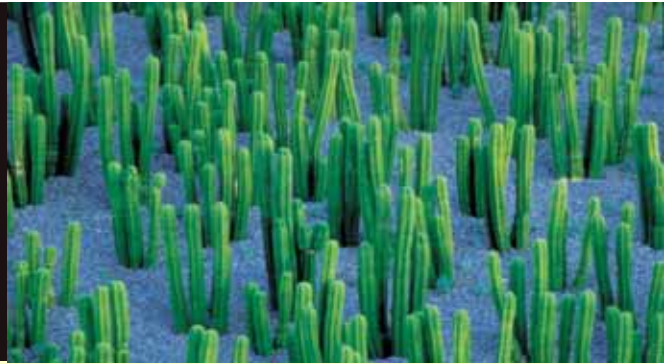


Japan Tax Update

Monthly tax update



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PricewaterhouseCoopers Tax (Zeirishi-Hojin ChuoAoyama) is the largest professional tax corporation in Japan with more than 300 staff. PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services for public and private clients. More than 120,000 people in 139 countries connect their thinking, experience and solutions to build public trust and enhance value for clients and their stakeholders.

This newsletter summarizes the 2005 Tax Reform Act, released on March 31, 2005.

Since this newsletter is intended to provide general information only regarding the 2005 Tax Reform Act, we recommend that you consult with us for specific advice and do not take any action based solely on the contents of this newsletter.

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Outline of 2005 Tax Reform

On March 31, 2005, the 2005 Tax Reform Act was promulgated, which was subsequently enacted on April 1, 2005. This issue exclusively deals with and provides an outline of this tax reform.

1. Overview

2. Corporate Taxation

- Introduction of tax credit for staff training expenses
- Revaluation gains/losses, gains from debt forgiveness and utilization of tax losses for companies under company revitalization plans
- Investment adjustments under consolidated returns
- Documenting e-Commerce transactions
- Basis allocation for Enterprise tax purposes

3. Financial and Securities Taxation

- Transfer of listed stocks kept in a "Special Account"
- Cash settlement of financial futures
- Foreign currency deposit with forward contract
- Deemed dividends
- Abolition of special taxation on capital gains of public stock

4. International Taxation

- Taxation of capital gains from interests in real estate
- Anti-Tax Haven taxation
- Transfer pricing regime
- Attachment certificates of residency to tax treaty applications
- Foreign tax credit for individual taxpayers

5. Changes to the Taxation of Kumiai Investors

- Withholding tax on Kumiai profit distribution to non-resident Kumiai investors
- Capital gain on the disposal of substantial shares in a Japanese corporation by non-resident Kumiai investors
- Treatment of real estate losses for individual Kumiai investors
- Limitation on the deduction of losses incurred in Kumiai business for corporate investors
- Limitation on the deduction of losses incurred in an LLP

6. Individual Taxation

- Temporary tax cut for individual taxpayers (national and local)
- Tax deduction for donation
- Tax deduction for social insurance premiums
- Special tax credits for housing loans

1. Overview

On March 31, 2005, the 2005 Tax Reform Act was promulgated, which was subsequently enacted on April 1, 2005.

In general, the 2005 Tax Reform Act does not have a significant tax impact on corporate or individual taxpayers. Rather, significant amendments to the current Japanese taxation of individuals and financial products are expected to occur as early as the 2006 tax reform cycle. Accordingly, the 2005 Tax Reform Act may be viewed as a preparatory step for much more significant tax reform to come.

On a high level basis, major corporate tax reforms that are contained in the 2005 Tax Reform Act are the introduction of a tax credit for staff training expenses and preferential tax measures for companies under company revitalization plans. The former provides a tax incentive for corporate expenditures on human resources and is targeted as a key strategy to maintaining Japanese corporate competitiveness. The latter is intended to assist in corporate revitalizations tax wise by providing preferential tax treatment for gains from debt forgiveness and assets revaluations.

With regards to taxation of investment income from financial instruments, more significant reforms enacted by the 2005 Tax Reform Act include (1) extending the expiration period for current rules providing preferential tax treatment of transfers of listed stocks kept in "Special Account"; and (2) providing preferential treatment for gains derived from cash settlements of financial futures, including currency and interest futures and financial options. The underlying strategy behind these amendments is to simplify the taxation system on financial instruments and ensure tax neutrality among investment income from various financial instruments.

With regards to individual income tax reforms, the 2005 Tax Reform Act provides limitation of temporary tax cut in the national and local income tax rates for individuals and relaxes certain requirements to claim special tax credits for housing loans.

In summary, although the scale of the 2005 Tax Reform Act is less significant in comparison to other recent tax reforms, it should be noted that much emphasis is put on by the reforms on international taxation and Kumiai taxation. Major reform include (1) expansion of the scopes of the anti-tax haven taxation regime and the transfer pricing regime, (2) new legislation on taxation of capital gain realized from interests in real estate, (3) new legislation on withholding taxation on Kumiai profit distributions to non-resident Kumiai investors, and (4) new limitations on the deduction of losses incurred in a Kumiai business by Kumiai investors. Those measures have been seemingly introduced to combat perceived tax avoidance structures and to ensure proper tax administration of the increasing levels of inbound and outbound investment. Since the 2005 Tax Reform Act will affect investment activities of both Japanese and non-Japanese corporations and individuals, it is very important to analyze the tax implications of these reforms to current and future Japanese investment activities.

Below, an outline of the 2005 Tax Reform Act is provided.

2. Corporate Taxation

Introduction of tax credit for staff training expenses

A corporation filing a blue tax return will be allowed a tax credit against its corporation tax liability for certain increases in staff training expenses (credit allowed in the year of increase) as follows:

- If staff training expenses (as far as they are tax deductible*) reported in applicable years (i.e., fiscal years starting between April 1, 2005 and March 31, 2008, both inclusive) are greater than the corporation's "average staff training expense**," the corporation will be allowed a tax credit in the amount of the smaller of either (a) or (b) below. The credit is claimed in the year when staff training expenses increase, but is not claimed in the year of incorporation or dissolution.
 - (a) 25% of the excess staff training expenses over the average staff training expense
 - (b) 10% of the corporation's Japanese tax liability for the current year
- In lieu of the above calculation methodology, small and medium-sized companies may elect to take a

tax credit for staff training expenses (as far as they are tax deductible) reported in the same time period in the amount of the smaller of either (a) or (b) below. The tax credit is not claimed in the year of incorporation or dissolution.

- (a) If the "staff training expense incremental rate****" is 40% or more, the tax credit will be 20% of the total staff training expenses incurred in the year.

If the staff training expense incremental rate is under 40%, the tax credit will be 50% of the staff training expense incremental rate times the total staff training expenses incurred in the year.

- (b) 10% of the corporation's Japanese tax liability for the current year

- * Staff training expense = corporate expenditures to let employees (excluding directors) learn technology or knowledge necessary for their business activities, or to enhance thereof (such as lecturer's fees for seminars, training and education, rent expense for such seminars, etc...)
- ** Average staff training expense = the average tax deductible staff training expense of the two (2) fiscal years immediately prior to the current fiscal year
- *** Staff training expense incremental rate = (Total staff training expenses for the current year – average staff training expenses for the past 2 years) / average staff training expenses for the past 2 years

In order to claim the above tax credit, a corporation should attach certain required forms to their tax return. It should be noted that a tax credit against corporate inhabitance tax is allowed only to small and medium-sized companies in the applicable years.

Revaluation gains/losses, gains from debt forgiveness, and utilization of tax losses for companies under company revitalization plans

Where (1) a company revitalization plan is approved by the court under the Corporate Rehabilitation Law or Civil Revitalization Law; or (2) an agreement is reached for a company revitalization plan similar to that under the Civil Revitalization Law (provided that certain conditions – for example, the amount of debt claim waivers are determined based on a balance sheet reflecting appropriate valuation of the assets, and two (2) or more financial institutions must waive debt claim – are met), the following measures will apply to the company under the revitalization plan:

- ◇ The company can recognize revaluation gain/loss on its assets as taxable gain or loss
- ◇ When gains are recognized from asset revaluations, debt forgiveness or donation, those gains can be offset by expired tax losses as well as valid tax losses.

In order to apply the above measures, a corporation will need to attach the required forms to its tax return filed for the year in which it applies the measures.

Under the reform, a company attempting to revitalize its business may apply the above measures equally, regardless of its plan under legal or non-legal proceedings.

Any asset revaluation gain or loss that occurs on or after April 1, 2005 is subject to the above treatment. In contrast, only gain from debt forgiveness and/or donation that takes place in a fiscal year ending on or after April 1, 2005 is subject to the above treatment.

Investment adjustment under consolidated returns

For purposes of calculating Japanese tax basis for investments in subsidiaries, new measures have been enacted for companies leaving the group by way of liquidation (except for a merger) that is the tax loss attributable to liquidating consolidated subsidiary (the tax loss for use after leaving the group) or excess amount of the loss over the equity, whichever is the smaller is not subject to the adjustment.

The above reform will apply to a subsidiary that liquidates on or after April 1, 2005.

Documenting e-Commerce transactions

A taxpayer filing a blue tax return/consolidated tax return may have its blue form tax return status or consolidated filing revoked if its documentation of e-Commerce transactions do not follow the legal requirements stated under the tax law for electronic book keeping.

The above reform will apply to documentation of e-Commerce transactions occurring on or after April 1, 2005.

Under the reform, the definition of electrical file is extended to include those file prepared by document scanner.

Basis allocation for Enterprise tax purposes

For corporations having business sites located in more than one prefecture, the method for allocating tax basis for Enterprise tax purposes has been changed as follows:

- For a non-manufacturing company (except for a company engaged in railway operations, or provision of gas, warehousing and electricity), half of the tax basis will be allocated based on the number of business locations (ex. factories and offices in each prefecture) and the rest will be allocated based on the number of employees in each prefecture. Before the reform, the full amount of the taxable base was divided by the number of employees.
- Before the reform, when a company with paid-in capital of 100 million yen or more utilized the number of employees as its allocation basis, it was necessary to make an adjustment to reduce by 50% the number of employees working for sections involving company management at the head office. Under the reform, this adjustment requirement is abolished and no 50% reduction is necessary.

The above reform will apply to fiscal years beginning on or after April 1, 2005.

3. Financial and Securities Taxation System

Transfer of listed stocks kept in a "Special Account"

Case 1

During the period from April 1, 2005 through May 31, 2009, residents or non-residents with a permanent establishment in Japan can transfer listed Japanese stocks not held in a custody account of a securities company to a "Special Account*" provided certain conditions are met.

Prior to December 31, 2004, the above transfer could have been made at either actual or deemed acquisition cost (i.e., defined as an amount equal to 80% of their market price as at October 1, 2001). Under the new provisions, listed stocks may not be transferred at their deemed acquisition cost but can only be transferred at their actual acquisition cost.

If residents or non-residents who have a permanent establishment in Japan holding listed Japanese stocks in a Special Account at a securities company lend their stocks to the securities company, the same company stocks, if returned to the Special Account after the lending period, can be recorded with the same acquisition cost as when the stocks were lent, provided certain requirements are met. This change applies to listed stocks lent on or after April 1, 2005.

The Japan Postal Services Agency is now included in the scope of Special Account custodians. This tax reform will apply to Special Accounts that are opened on or after October 1, 2005.

* Special Account is an account held by residents or non-residents with a permanent establishment in Japan at a securities company to deposit listed Japanese stocks. The securities company must maintain details of the acquisition date and cost, calculate capital gains or losses and prepare an

annual trading report.

Case 2

For residents or non-residents with a permanent establishment in Japan who have owned Japanese listed stocks maintained in a Special Account and subsequently held in a Special Reserve Account after the stocks were de-listed, deemed capital losses under a prescribed formula can be recognized when the corporation is liquidated, provided certain conditions are met.

This treatment applies to stocks kept in a Special Account that were listed stocks and were de-listed on or after April 1, 2005.

As a result of this amendment, on or after April 1, 2005 residents or non-residents with a permanent establishment in Japan can recognize a liquidation loss as a capital loss (provided certain conditions are met) and can use the loss to offset capital gains from a disposal of other stocks.

Cash settlement of financial futures

Previously, gains derived from cash settlements of financial futures, including currency and interest futures and financial options, were classified as business income or miscellaneous income and subject to aggregate taxation.

With this amendment, if residents or non-residents with a permanent establishment in Japan execute certain financial future market transactions under the Financial Futures Law (*Kinyu-sakimono-torihiki-ho*) on or after July 1, 2005, business income or miscellaneous income realized on the settlement of such futures will be subject to the special tax treatment of financial futures. That is, this income will be taxed at a rate of 20% (national tax: 15% and local tax: 5%) separately from other income. Losses, if incurred, can be carried forward for three years.

Foreign currency deposit with forward contract

Exchange gains from transactions involving foreign currency deposits and related forward contracts, where the interest and principal were received in a foreign currency and the gain was calculated as the difference between the principal amount converted at the contracted exchange rate and the spot rate at the time of deposit, are subject to a 20% withholding tax (national tax: 15% and local tax: 9%) once converted into Japanese Yen at the spot rate.

The above reform will apply to deposits made on or after January 1, 2006.

Deemed dividends

Under current temporary measures, if listed companies purchase their own shares through a tender offer, deemed dividends are not recognized. These measures will be extended for a further two years until March 31, 2007.

Abolition of special taxation on capital gains of public stock

A preferential tax treatment (i.e., reduced tax rate) applying to capital gains from transfers of listed stocks was introduced by the 2003 tax reforms. Before the legislation, such preferential tax treatment was only applicable to the transfer of stocks holding before "listed in the market" and transfer after stocks are listed, and measures had been suspended with the legislation of the 2003 tax reform. With the 2005 tax reforms, this suspended measures were abolished.

4. International Taxation

Taxation of capital gains from interests in real estate

Before the 2005 tax reforms, non-resident individuals and foreign corporations without a permanent establishment (PE) in Japan were subject to capital gains taxation on the disposal of shares of a real estate holding company only where the transferor made a “substantial transfer” of shares. Under the 2005 tax reforms, the disposal of shares in a real estate holding company or a beneficial interest in a real estate investment trust is now also subject to capital gain taxation under the following rules:

- ✧ A real estate holding company is defined as a company where 50% or more of its gross asset value represents real estate in Japan. A beneficial interest in a real estate investment trust is a beneficial interest in a specified trust where 50% or more of the value of the trust’s assets represent real estate in Japan.
- ✧ The transferor (i.e the non-resident individual/foreign corporation) owns more than a 5% (in case of a listed corporation or trust) or a 2% (in case of another corporation or trust) interest in the corporation or trust as of the end of the fiscal year immediately prior to the year in which the transfer occurs. It should be noted that if the transferor had invested through a group of special related persons or a Kumiai (partnership), the 2% and 5% thresholds will be analyzed based on the aggregate ownership percentages of the group of special related persons or the Kumiai.

The above reforms will apply to non-resident individuals beginning January 1, 2006 and to foreign corporations for years commencing on or after April 1, 2005.

Any non-resident individual sellers will need to file a Japanese tax return and will ultimately be subject to 15% taxation on the capital gain. Any foreign corporate seller will need to file a Japanese tax return and will ultimately be subject to 30% taxation on the capital gain.

The above taxation will not affect residents of a country that has a tax treaty with Japan, provided that the tax treaty exempts them from Japanese capital gains tax on the transfer of shares in Japanese companies or beneficial interests in trust.

Anti-Tax Haven taxation

To prevent Japanese companies from wrongfully reducing their tax burden by establishing subsidiaries in low tax territories and then retaining earnings in those subsidiaries, the anti-tax haven rules require, if certain conditions are met, that the undistributed income of controlled foreign companies (CFCs) be added to the income of the Japanese parent company and be subjected to Japanese tax.

The 2005 tax reforms contain the following amendments to the anti-tax haven rules:

1. Deduction of 10% of staffing costs from CFCs’ undistributed income

Under the existing anti-tax haven rules, where a CFC has the characteristics of an independent enterprise and there is sufficient economic rationale for carrying out operations in the country of the CFC’s head office or principal place of business, the CFC’s undistributed income may be exempted from Japanese tax, provided that all of the following criteria are met:

- ✧ Business purpose test
- ✧ Substance test
- ✧ Management and control test
- ✧ Unrelated party test or country of location test

Where a CFC meets the first three tests, but not the last test, the 2005 tax reform has introduced a new deduction of 10% of the CFC's staffing costs from the undistributed income that is subject to Japanese taxation under the anti-tax haven rules.

The above reform will apply to undistributed income earned by CFC's in years ending on or after April 1, 2005.

2. Extension of loss carry forward period for CFCs

The period during which losses may be carried forward by a CFC when calculating its undistributed income will be extended from five years to seven years.

This reform will apply to CFCs' losses incurred in years ending on or after April 1, 2005.

3. Change in calculation method of taxable undistributed profits

The calculation of a CFC's taxable undistributed profits is made by multiplying the CFC's undistributed profits by the proportion of the Japanese corporation's direct or indirect interest in the CFC.

However, if the CFC has issued shares with differing rights to profit distributions and/or allocations of surpluses, the calculation of the CFC's taxable undistributed profits allocable to the Japanese corporation will be calculated with reference to these rights.

The above reform will apply to the CFC's years ending on or after April 1, 2005.

4. Extension of period whereby previously taxed earnings may be excluded from taxable dividends

Where a CFC remits as a dividend to a Japanese corporation an amount which represents previously taxed earnings, the Japanese company may exclude the previously taxed earnings from the dividend in order to prevent double taxation in Japan. Prior to the 2005 tax reforms, amounts equal to previously taxed earnings from periods which commenced within the five years up to the date of the payment of the dividend were excludable. The 2005 tax reforms extend this period from five years to ten years.

The above reform will apply to previously taxed earnings included in taxable income during years ending on or after April 1, 2000 when the CFC remits a dividend on or after April 1, 2005.

5. Change in definition of a "foreign related company" for purposes of determining the application of the income aggregation rules for foreign related companies and Japanese companies.

Foreign companies which are subject to the Japanese tax haven rules for the aggregation of income are "foreign related companies" which are further defined as CFCs.

Prior to the 2005 tax reforms, foreign related companies were foreign companies where more than 50% of the issued shares were held either directly or indirectly by Japanese residents or certain Japanese corporations (those which either own directly or indirectly at least 5% of the issued share capital of the foreign related company or are a member of family shareholder groups with such holdings).

As a result of the 2005 tax returns, the share ownerships of any directors (resident and non-resident) and relatives of the Japanese corporation will now be included in determining if the 50% or 5% tests described above are met.

The above reform will apply to a CFC's tax years ending on or after April 1, 2005.

6. Expansion of scope of income aggregation rules to specified overseas trusts

Where Japanese corporations establish overseas trusts that are similar in nature to "specified trusts" (Tokutei Shintaku) established in low-tax jurisdictions, the income retained in such trusts will be subject to the income aggregation rules for the Japanese corporation. No criteria for the exemption of certain

trusts from this rule have been introduced.

The above reform will apply to any income distribution from a “specified trust” beginning on or after April 1, 2005 for the purpose of the corporate tax of the Japanese corporation in the year beginning on or after April 1, 2005.

Transfer pricing regime

Under the 2005 tax reforms, the definition of a “foreign related person” subject to the Japanese transfer pricing regime has been expanded.

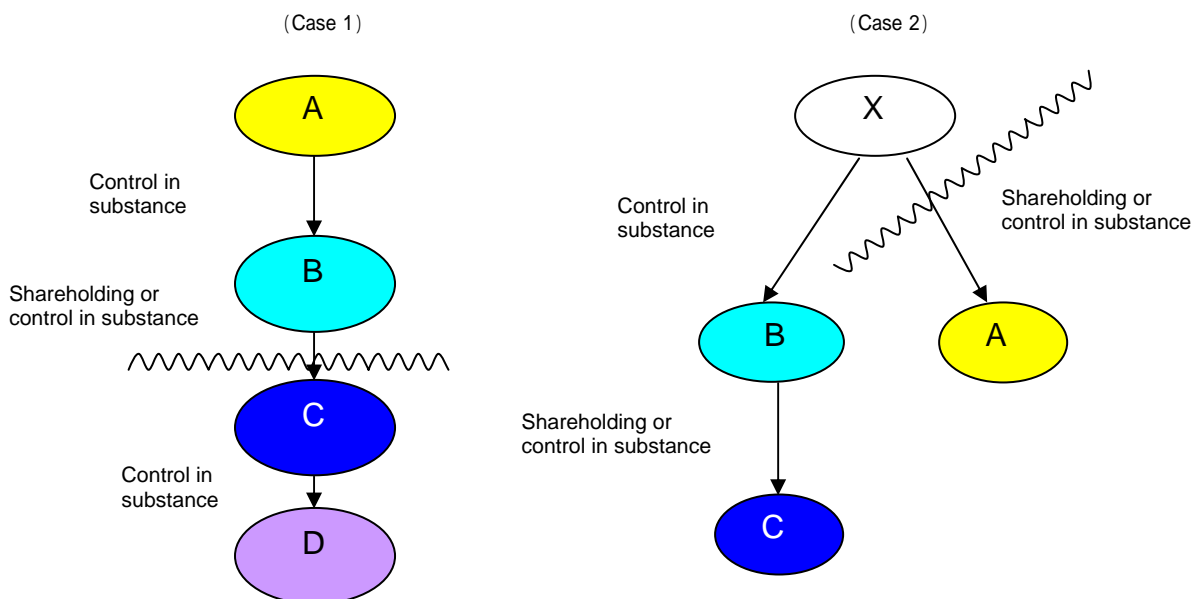
Before the 2005 tax reforms, a foreign related person was a foreign corporation with one of the following particular kinds of relationship:

- Parent-subsidiary relationship between two corporations where one corporation holds (directly or indirectly) at least 50% of the issued share capital of the other corporation
- Sister company relationship between two corporations where the same person holds (directly or indirectly) at least 50% of the issued share capital of both corporations
- “Control in substance” relationship between two corporations where, due to certain specific facts, one corporation is able, in substance, to make decisions regarding a part or the whole of the other corporation’s business policies.

Under the 2005 tax reforms, the following will also be included in the definition of a foreign related person:

- Foreign corporations where there is an indirect control relationship by a Japanese corporation via a chain of “control in substance” relationships and shareholding relationships, or where the foreign corporation is controlled by means of a chain of “control in substance” relationships only (A and C, B and D in Case1).
- Foreign corporations where there is a direct or indirect control relationship by a Japanese corporation by means of the same person controlling both, via “control in substance” relationships and shareholding relationships or by means of “control in substance” relationships only (A and B, A and C in Case 2).

The above reform will apply to corporate tax years beginning on or after April 1, 2005.



Attachment of certificates of residency to tax treaty applications

Some treaties advise that a residency certificate should be attached to the treaty application form to claim a treaty benefit. Under the 2005 tax reforms, this requirement is deemed to have been satisfied if the applicant submits the certificate to the person who is obliged to withhold tax (withholding tax obligator) and the identification of the applicant is confirmed by the person (the notes of the confirmation should be written on the application form). The withholding tax obligator should keep a copy of the certificate for at least 5 years from the date of the submission of the certificate.

The above reform will apply to treaty applications submitted on or after April 1, 2005.

Foreign tax credit for individual tax payers

Under the 2005 tax reform, the foreign tax credit (“FTC”) rules for individuals have been reformed as follows:

- If, after the filing of a tax return on which a foreign tax credit is being claimed, the amount of the foreign tax ultimately paid is less than what was originally claimed, the taxpayer, in lieu of filing an amended return (as was required previously to report the corrected foreign tax credit amount) reflect the adjustment in the amount of foreign taxes eligible for credit in the year of the adjustment.

The above reform will apply to the foreign tax reduced on or after April 1, 2005.

- Foreign taxes eligible for a FTC will not include any tax levied in the source country but excluded from the category of “foreign taxes” for FTC purposes under the definition of “foreign taxes” found in the relevant income tax treaty.

The above reform will apply to individual income tax years beginning January 1, 2006.

5. Changes to the Taxation of Kumiai Investors

Withholding tax on Kumiai profit distribution to Non-resident Kumiai Investors (Non resident individual and foreign corporation)

Before the amendment, the income tax law was silent on the subject of tax treatment for profit distributions to non-resident individuals and corporations (“Non-resident Kumiai Investors”) derived from Kumiai business conducted in Japan. After the amendment, such profit distributions to Non-resident Kumiai Investors are, in principle, subject to withholding tax at 20% as follows;

- Profits from Kumiai business attributed to Non-resident Kumiai Investors are subject to withholding tax at the rate of 20%, which is imposed on the date when the asset is actually distributed to Kumiai investors or two months after the ending date of the Kumiai calculation period (if the period is more than a year, the period will be every single year), whichever comes earlier. Non-resident Kumiai Investors with permanent establishments for use other than in the Kumiai business will not be subject to the above withholding tax, provided certain requirements are satisfied.
- The payer of distribution is required to file record of payments with the tax office within one month of the date of distribution.

The term “Kumiai” in this context includes a “Nin-i-Kumiai” as defined under the Japanese Civil Code, an Investment Limited Liability Partnership (ILLP), a Limited Liability Partnership (LLP) and foreign partnerships similar to the above.

This reform does not involve new taxation for Non-resident Kumiai Investors but is to ensure proper collection of tax through withholding. Non-resident Kumiai Investors are required to file tax returns to report income from Kumiai business and then fix the tax liability by crediting the withholding tax.

The above reforms will apply to the distribution of profit earned during the calculation period beginning on or after April 1, 2005.

Capital gain on the disposal of substantial shares in a Japanese corporation by non-resident Kumiai investors (Non resident and foreign corporation)

Before the amendment, foreign shareholders without permanent establishments in Japan were subject to Japanese tax on capital gain from the transfer of shares in a Japanese company only if the following requirements were both met:

- The aggregate shareholding in the Japanese company by the foreign shareholder and related persons to the foreign shareholder at any time during the preceding three year period was 25% or more of the total issued shares of the Japanese company, and
- The foreign shareholder and related persons transferred 5% or more of the total issued shares of the Japanese company during the fiscal year of transfer of the shares.

After the amendment, the transfer of shares in a Japanese company by a foreign shareholder is also subject to Japanese tax in the following circumstances:

- Where a foreign investor own shares in a Japanese corporation through a partnership vehicle (i.e. a Kumiai, foreign partnerships similar to an NK, etc...), the 25%/5% thresholds are determined based on the ownership percentage at the partnership level rather than at the individual partner level.
- The following transactions are included in the scope of transfer of shares subject to capital gains taxation:
 - Corporate split-ups where assets other than the shares of the succeeding company are transferred to the corporation's shareholders
 - Corporate split-ups where the shares of the succeeding company are not issued on a pro-rata basis
 - Distributions of assets to corporate shareholders as a consequence of a liquidation of or a capital reduction of the corporation

The term "Kumiai" in this context includes an NK, ILLP, LLP and foreign partnerships similar to the above. Any non-resident individual sellers will need to file a Japanese tax return and will ultimately be subject to 15% taxation on the capital gain. Any foreign corporate seller will need to file a Japanese tax return and will ultimately be subject to 30% taxation on the capital gain.

The above reforms will apply to non resident individuals from the calendar year 2006 and to foreign corporations from fiscal years beginning on or after April 1, 2005.

Treatment of real estate losses for individual Kumiai investors

Losses incurred from real estate activities via a Kumiai will be disregarded for the calculation of individual taxable income. This treatment is not applicable to individual investors engaged in important decision-making activities of the Kumiai business, such as negotiations for the conclusion of contracts and/or carrying out operations of the business.

The term "Kumiai" in this context includes an NK, ILLP, LLP and foreign partnership similar to the above.

The above reform will apply to individual income taxation from the calendar year 2006 and individual local income taxation from June 2007.

Limitation on the deduction of losses incurred in Kumiai business for corporate investors

Any losses incurred from Kumiai business that are attributable to corporate investors will be treated as follows:

- Where the liability of the Kumiai corporate investor is in fact limited to its contributed amount to the Kumiai, the losses incurred by the Kumiai business in excess of the contributed amount cannot be deducted from its taxable income.
- Where the profit of the Kumiai corporate investor is guaranteed in a specific agreement, the entire amount of the Kumiai's loss attributable to the corporate investor will be non-deductible from its taxable income.
- Non-deductible losses may be carried forward (under the existing rules for loss carryforwards) and be deductible from income earned by the same Kumiai business, provided a schedule of the calculation is attached to the corporate tax return.

The above treatment is not applicable to (a) corporate investors engaged in the important decision-making of the Kumiai business, negotiations for the conclusion of contracts and carrying out operation of the business; and (b) corporate investors all of whom are engaged in a similar business (as their own business) to that of the Kumai.

The term "Kumiai" in this context includes an NK, Tokumei Kumiai (a silent partnership), ILLP, and foreign partnership similar to the above.

The above reforms will apply to the distribution of losses from a Kumiai agreement that is entered into or transferred (other than as a result of a tax qualified merger) on or after April 1, 2005.

Limitation on the deduction of losses incurred in an LLP (individual and corporate partner)

On May 6, 2005, the Limited Liability Partnership ("LLP") Act was promulgated and will be enacted within 6 months after May 6, 2005. The act incorporates the following treatment of tax losses incurred by an LLP.

Individual partner

Real estate losses, business losses, and forestry losses incurred by an LLP and attributable to the LLP's individual investors are non-deductible from the partners' taxable income to the extent the losses exceed the partners' contributed amounts (after certain adjustments).

Corporate partner

Losses incurred by the LLP that are attributable to corporate investors are non-deductible to the corporate investors to the extent the losses exceed the corporate investors' contributed amounts (after certain adjustments). Non-deductible losses may be carried forward (under the existing rules for loss carryforwards) and be netted against income from the LLP provided a schedule of the calculation is attached to the corporate tax return.

The above treatment will apply to LLP agreements entered into, pursuant to the LLP Act.

	Type of Kumiai				
	NK	ILLP	LLP	YK	Foreign partnership
W/H tax on distribution of Kumiai profit	X	X	X	Art. 212 of Income tax law	X
Capital gain on disposal of substantial shares	X	X	X		X
Capital gain on disposal of interest in real estate holding company	X	X	X		X
Real estate loss from Kumiai business (Individual Kumiai Investor)	X	X			X
Limitation of loss deduction (Corporate Kumiai Investor)	X	X		X	X
Limitation of loss deduction (LLP)			X		

6. Individual Taxation

Temporary tax cut for individual taxpayers (applicable to national and local tax purpose)

A temporary tax cut for both national and local inhabitant tax purposes was enacted in 1999 as part of the government's economy-boosting policy. Per the 2005 tax reform, the rate of tax cuts will be reduced to one half of the current system as shown below.

The amendment will be applicable to calculations of income tax for the year 2006 onward and the local tax payable for June 2006 and onward. The amount of withholding income taxes from salary payment will be increased accordingly.

【Before amendment】

(National income tax)

20% of national income tax
(Maximum limitation: ¥250,000)

(Local inhabitant tax)

15% of local inhabitant tax per income
(Maximum limitation: ¥40,000)

【After amendment】

10% of the national income tax
(Maximum limitation: ¥125,000)

7.5% of local inhabitant tax per income
(Maximum limitation: ¥20,000)

Tax deduction for donation

Under current rules, when an individual makes a donation to the government, local public bodies, nonprofit organizations, etc. ("Specified donation"), an amount as calculated below is tax deductible.

Deductible amount = lower of either "a" or "b" – ¥10,000

- ◇ The total amount of Specified donation paid in the calendar year or
- ◇ 25% of the total income of the year

After the 2005 tax reform, the ceiling of 25% as shown above in "b" will rise to 30% of the total income.

The amendment will be applicable for calculations of income tax for the year 2005 onward and to local tax

payable for June 2005 onward.

Tax deduction for social insurance premiums

Before the 2005 tax reforms, individual tax payers were not required to submit (to the employer) payment of social insurance premiums or attach a certificate to their tax return to claim a tax deduction thereof. However, with the 2005 tax reforms, individual tax payers will be required to submit a year-end tax adjustment to the employer and attach to the tax return a certificate of payment to claim a deduction for national pension premiums.

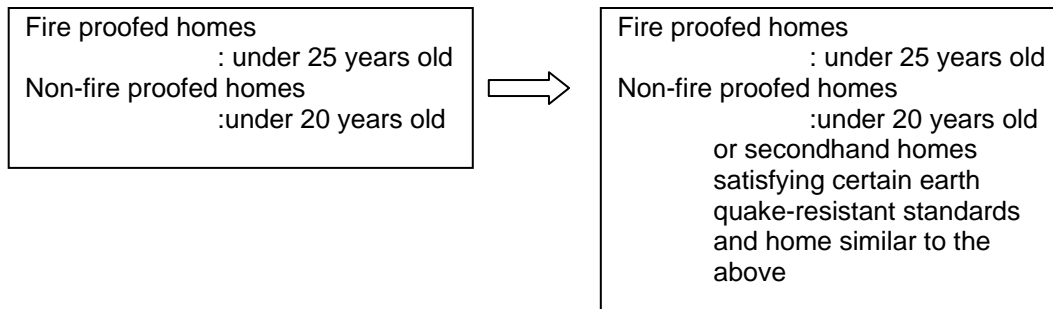
This reform will be applicable for calculations of income tax from the calendar year 2005.

Special tax credits for housing loans

Before the 2005 tax reforms, special tax credits for housing loans were granted for both new and secondhand homes. However, certain conditions had to be satisfied for the secondhand homes. The 2005 tax reforms expand the scope of applicable secondhand homes as follows:

【Before 2005 tax reforms】
(National income tax)

【After 2005 tax reforms】



Besides the above special tax credits, the following laws grant tax benefits to more secondhand home than before:

- Special taxation on replacement of homes or capital gain taxation on exchange of homes
- Special taxation upon inheritance after receiving gifts to purchase home
- Special reduction on registration tax rate upon transfer of title to home
- Special reduction on registration tax upon place a mortgage for a housing loan

The above reforms will apply to secondhand home for residence use acquired or transferred on or after April 1, 2005.

You have a vision. PricewaterhouseCoopers helps bring that vision to reality. We hope you enjoy the current issues in our Japan Tax Update and appreciate your comments about our current issue or ideas for what you'd like to see covered in future issues.

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