

Estate Taxation Highlights

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PwC Japan Tax Newsletter

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Supreme Court's Decision on Double Taxation of Life Insurance and Pension Benefits - Taxpayer Won the Case -

Zeirishi-Hojin PricewaterhouseCoopers provides tax advisory services on Inheritance tax and / or Gift tax. In particular, we provide business succession advisory services or asset related advisory services to private company owners and high net worth individuals.

To improve our services to clients, we plan to issue newsletter related to the Estates taxation topics (such as inheritance tax, gift tax, capital gain tax, etc.) as "Estates Taxation Highlights" periodically, and plan to introduce the state-of-the-art taxation issue to the clients who are engaged to property related taxation. We hope this information helps you well.

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On July 6th, 2010, the third petty bench of the Supreme Court has decided that imposition of income tax on inherited life insurance pension benefit is no longer valid and the plaintiff (taxpayer) has won the case.

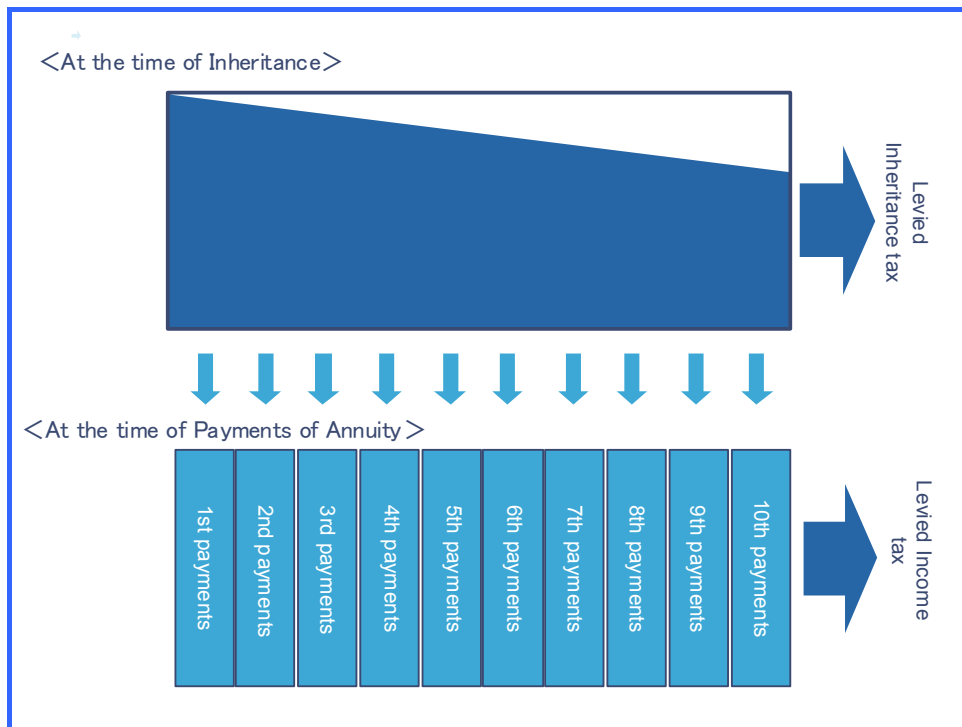
This issue of Estate Taxation Highlights will provide the brief overview of this case and the impact to estate taxation in Japan.

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1. Outline of the case

In this case, the taxpayer challenged that the annuity payments as a result from the life insurance policy inherited (which is subject to inheritance tax) shall be treated as tax exempted income from Japanese income tax point.

The life insurance policy is treated as deemed inherited assets in the inheritance tax law and inheritance tax is levied on the annuity payments received by the beneficiary and under Japanese income tax law, there is clause stating that income tax shall not be levied on income from inheritance, bequests, gifts or donations from an individual. However, the National Tax Agency (NTA) levies income tax on the annuity payments received from an inherited life insurance policy, because they consider that the annuity payments is not income derived from inherited assets.



Ms. X is widow and her deceased husband bought an insurance policy with a life insurance company. Based on the policy, the first annuity was paid to Ms. X on the date her husband was deceased. Based on Japanese income tax law, 10% of amount paid was withheld by the life insurance company and subsequently, she has claimed to refund the withheld income tax from the district tax office. However, the district tax office considered the annuity payments as miscellaneous income of Ms. X and rejected the refund.

2. Brief summary of the judgment of District Court and High Court

The district court upheld her claim as the court considered the vesting rights of annuity which is subject to inheritance tax and the actual annuity payments which is paid to recipient is substantively and economically equal.

On the other hand, the High Court had decided that the annuity payments should not be treated as tax exempted income under the income tax law based on the following:

- The court decided that inherited life insurance policy has two aspects: one is right to claim the insurance benefit and the other is the annuity payments.
- Therefore, the annuity payment and the right to claim of the same insurance policy should be subject Japanese income tax (levied on the annuity payments) and Japanese inheritance tax (levied on the right to claim the insurance benefit).

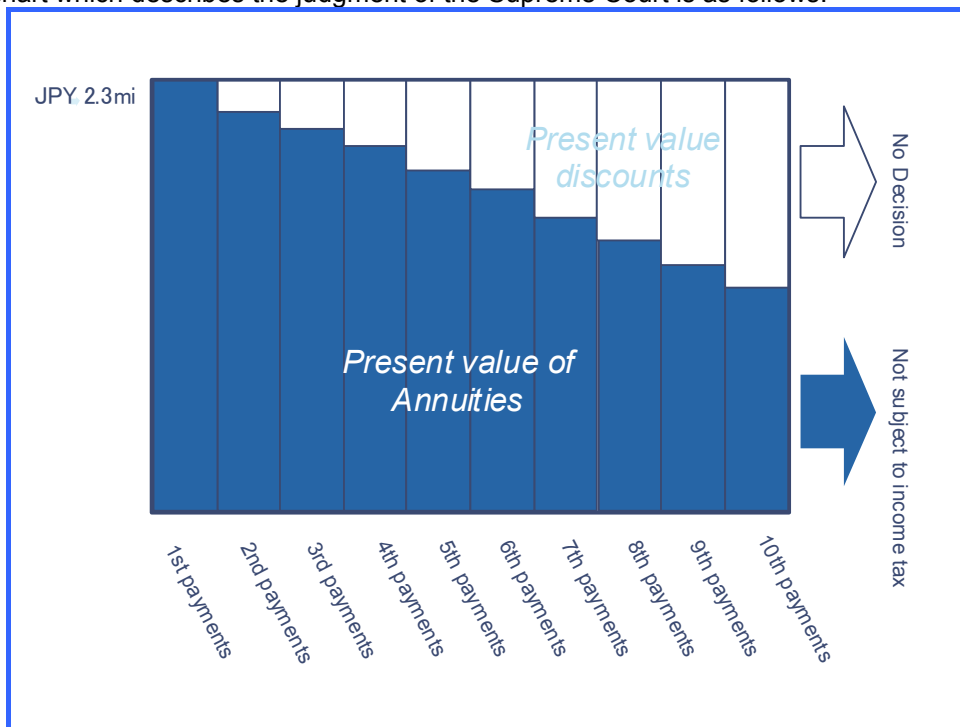
Due to the unfavorable judgment made by High Court, Ms. X appealed to the Supreme Court.

3. Brief summary of the Supreme Court

The Supreme Court has judged that the annuity payments which have been treated as taxable asset for inheritance tax purposes should not be treated as taxable income for Japanese income tax purposes.

- Tax exempted income of income tax law is not the inherited asset itself but the income derived from the asset which the heir has inherited from deceased.
- The purpose of the tax exemption clause of the Japanese income tax act is to abate double taxation on same economic benefit.
- The amount of taxable asset of the inherited life insurance policy reflects the present value discount of the total paid amount of the annuity.
- The 1st annuity payment is made on the same date as the deceased. Therefore, the 1st payment does not have any present value discount. As the result, the whole amount of the 1st annuity payment should not be subject to Japanese income tax.

The chart which describes the judgment of the Supreme Court is as follows:



4. Impact of this decision

The Supreme Court only made the decision on the 1st annuity payment. However, the decision does not cover the treatment on the 2nd annuity payment and after.

The Finance Minister and NTA released their comments on this issue that they will refund the overpaid income tax to taxpayers.

For more information, please consult your international tax representative or contact any of the following members listed below:

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