

# *Estate Taxation Highlights*

## Tax Legislation Update for 2014 Tax Reform

Issue 14, May 2014



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On March 20, 2014, the “The 2014 Tax Reform Bill” was approved by the upper house of the Japanese Diet.

This newsletter provides a summary of the 2014 Tax Reform regarding individual taxation and inheritance taxation.  
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The 2014 Tax Reform Bill submitted to the upper house of Parliament (Diet) was approved on March 20, 2014 and was announced with the Cabinet Order on March 31, 2014.

The 2014 Tax Reform with regard to individual taxation and inheritance taxation is as follows:

### **1. Significant reforms**

- (1) Lower cap on employment income deduction
- (2) Graduated taxation on bond interest issued by a family corporation
- (3) Taxation of stock options upon sale to issuer
- (4) Loss from the sale of golf club membership
- (5) Cost basis adjustment upon sale of inherited land
- (6) Additional requirement for qualification of exemption on capital gains tax for donated shares to a public interest corporation
- (7) Suspension and waiver of inheritance tax on inherited interest in certain medical corporations
- (8) Corporate tax on deemed profit under net assets value method for valuation of unlisted shares for inheritance tax and gift tax purposes
- (9) New reporting requirement on transfer of securities to/from an offshore account

### **2. FAQ for offshore asset reporting has been issued by the NTA**

## 1. Significant reforms

### (1) Lower cap on employment income deduction

Employment income deduction is calculated as a certain percentage of annual employment earnings, and is currently capped at JPY 2.45 million. This cap will be further lowered from the 2016 national income tax calculation as summarized below:

(Unit: JPY)

	Current	Cap for 2016 <sup>*1</sup>	Cap for 2017 and following years <sup>*2</sup>
Employment earnings which reaches the cap	15 million	12 million	10 million
Maximum employment income deduction	2.45 million	2.3 million	2.2 million

\*1 This cap of JPY 2.3 million will apply to the 2017 local inhabitants tax, which is calculated based on 2016 income.

\*2 This cap of JPY 2.2 million will apply from the 2018 local inhabitants tax calculation based on 2017 income.

The chart below illustrates the calculation of the employment income deduction.

(Unit: JPY)

Gross earnings	Employment income deduction
650,000 or less	650,000
650,000 to 1,800,000	Employment earnings × 40%
1,800,000 to 3,600,000	Employment earnings × 30% + 180,000
3,600,000 to 6,600,000	Employment earnings × 20% + 540,000
6,600,000 to 10,000,000	Employment earnings × 10% + 1,200,000
Over 10,000,000	Employment earnings × 5% + 1,700,000

### (2) Graduated taxation on bond interest issued by a family corporation

Under the 2013 tax reform, interest on bonds privately issued by a family corporation will be subject to graduated taxation if the bonds are held by shareholders of the corporation. This graduated taxation applies to interest received on or after January 1, 2016. Under the transition rule of the 2013 tax reform, there is an exception that the 20% separate taxation will apply to the interest received on or after January 1, 2016 if the bonds are issued on or before December 31, 2015.

Under the 2014 tax reform, this transition rule is abolished and graduated taxation will apply even if the bonds are issued by the family corporation on or before December 31, 2015.

### (3) Taxation of stock options upon sale to issuer

Grant of certain stock options is taxed when the options are exercised. Under the 2014 tax reform, proceeds from a sale of stock options to the issuing company are taxed as either business income, employment income, retirement income, occasional income or miscellaneous income (i.e., NOT subject to capital gains tax).

### (4) Loss from the sale of golf club membership

Loss from the sale of an asset which is normally not used for daily life is not allowed to offset against ordinary income. Before the 2014 tax reform, a golf club membership was not categorized as an “asset which is normally not used for daily life”, and a loss from its sale could offset other income.

Under the 2014 tax reform, a golf club membership would be categorized as an “asset which is normally not used for daily life”. This change applies to the sale of a golf club membership on or after April 1, 2014.

**(5) Cost basis adjustment upon sale of inherited land**

The cost basis of a piece of land can be adjusted (increased) if the piece of land is disposed within three years and ten months after the inheritance. Under the previous tax law, the adjustment was based on a portion of the inheritance tax allocated to the entire (100%) inherited land even if only part of the inherited land is disposed of.

Under the 2014 tax reform, the adjustment will be limited to the amount of inheritance tax allocated only to the disposed piece of land.

This change will be effective for the disposal of land which is inherited on or after January 1, 2015.

**(6) Additional requirement for qualification of exemption on capital gains tax for donated shares to a public interest corporation**

In the event of a gift of shares from an individual to a corporation, the gifted shares may have built-in gain or loss. In such case, the built-in gain or loss is realized upon the gift. Under the previous tax law, an individual was exempt from the capital gains tax if the gift was made to a public interest corporation under certain conditions and was approved by the tax authorities. Under the 2014 tax reform, an additional requirement is in place to qualify for this exemption - the public interest corporation cannot hold more than 50% of the total issued shares after the transaction.

**(7) Suspension and waiver of inheritance tax on inherited interest in certain medical corporations**

A new rule will be implemented for the inheritance of an interest in certain medical corporations such that a payment of the inheritance tax allocated to this interest can be suspended if certain conditions are met. If the heir will entirely surrender the interest within a certain period, the suspended tax payment will be waived.

The effective date of the above change is not finalized.

**(8) Corporate tax on deemed profit under net assets value method for valuation of unlisted shares for inheritance tax and gift tax purposes**

One of the methods that is available for valuing the unlisted shares of a company for inheritance tax and gift tax purposes is the net asset value method. Under the Asset Valuation Basic Circular, the corporate tax on the “deemed profit” is deductible in calculating the net asset value of a company under the net assets value method. The corporate tax is calculated by multiplying the “deemed profit” by the corporate tax rate. The “deemed profit” represents the built-in gain on the company’s net assets (i.e. the difference between the value of the company’s assets reduced by its liabilities for inheritance/gift tax purposes less the book value of the company’s assets reduced by its liabilities).

Under the 2014 Tax Reform, the corporate tax rate is amended from 42% to 40% due to the reduction of the corporate tax burden associated with the termination of the Restoration Corporation Surtax introduced in 2011.

This amendment is applicable to an inheritance, bequest or gift made on or after April 1, 2014.

**(9) New reporting requirement on transfer of securities to/from an offshore account**

A financial institution in Japan is subject to a new reporting requirement when securities are transferred between domestic and offshore accounts.

This change will be effective for the transfer of securities on or after January 1, 2015.

## 2. FAQ for offshore asset reporting has been issued by the NTA

Offshore asset reporting was newly applicable from last year – for 2013 tax year, due March 17, 2014 (please refer to our Newsletter Issue 12 published in August 2013 for details).

<http://www.pwc.com/jp/en/taxnews-estate-taxation/assets/estate-taxation-issue12-e.pdf>

The National Tax Agency released a FAQ on November 15, 2013 (Japanese only).

[http://www.nta.go.jp/shiraberu/ippanjoho/pamph/hotei/kokugai\\_zaisan/pdf/kokugai\\_faq.pdf](http://www.nta.go.jp/shiraberu/ippanjoho/pamph/hotei/kokugai_zaisan/pdf/kokugai_faq.pdf)

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

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