

PwC Japan Tax Newsletter

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Draft Proposed 2010 Japanese Tax Reforms: Impact on the Financial Services Industry

On December 18, 2009, the Tax Commission (*Zeisei Chosakai*) released a draft of its proposed taxation reforms for the 2010 budget (Draft 2010 Tax Reform Proposal). A finalized version of the 2010 Tax Reform Proposal is anticipated to be released within this year. Following that release, it is anticipated that the Ministry of Finance will formalize a submission for the Cabinet's approval, forming the basis for draft legislation to be considered by the Diet for approval and enactment from April 1, 2010.

For the financial services community, three of the more important proposals in the 2010 Tax Reform Proposal relate to:

- (i) reduction of taxation of corporate securities for non-resident bond holders;
- (ii) more restrictive rules relating to *tokutei mokuteki kaisha* (TMK) dividend deductibility; and
- (iii) certain liberalization of taxation of overseas investors in investment funds.

The 2010 Tax Reform Proposal also contains other major provisions, including changes to group taxation and the anti-tax haven (or CFC) rules, which will be covered by a subsequent Newsletter in the New Year.

This Newsletter provides an initial summary of these proposed changes as an immediate newsflash. It should be noted that the proposal is not law and may change upon further public and parliamentary review and discussion.

Taxation of corporate securities

(1) Certain interest and redemption gains exempted from taxation

Currently, foreign investors in bonds issued by Japanese issuers (other than Eurobonds and JGBs) are subject to Japanese tax on interest and redemption proceeds in excess of their acquisition or subscription price. Under the 2010 Tax Reform Proposal, qualified investors (primarily, foreign corporations, foreign individuals and certain qualified securities investment trusts, excluding parties related to the issuer) will be exempt from Japanese tax on interest and redemption gains if the bond is a book-entry corporate bond (*Furikae Shasai*), other than a profit-linked bond. For interest, this new rule is expected to apply to interest calculation periods starting on or after June 1, 2010 provided the bond has been issued on or before March 31, 2013. The effective date for redemption gain on short-term bonds is for bonds issued on or after June 1, 2010 and on or before March 31, 2013.

(2) Eurobonds

The existing concessionary tax exemption rule for Eurobonds (*Minkan Kokugai Sai*), which has typically been extended in two years increments, was set to expire on March 31, 2010, but is now proposed to be made permanent. Furthermore, the following changes to the existing regime are being proposed: (i) special concessions currently enjoyed by Eurobonds issued in Switzerland will be abolished (after a transitional period of two years); (ii) profit-linked bonds will be excluded from the scope of the Eurobonds exemption; and (iii) related parties of the Eurobond issuer may not enjoy the exemption.

TMKs

A special purpose investment structure often used to invest in Japanese real estate and certain securities, a TMK may be subject to only a small amount of tax by deducting dividends declared to its shareholders. In order for a TMK to deduct its dividends, certain specific tests must be satisfied, including that the TMK's preferred shares are offered primarily in Japan. Under the 2010 Tax Reform Proposal, a TMK will also have to offer its common shares primarily in Japan to maintain the deductibility of its dividends.

Furthermore, current law also requires a TMK's specified bonds to be offered primarily in Japan. The 2010 Tax Reform Proposal proposed to abolish this requirement.

Taxation of overseas investors in certain investment funds

Under tax reforms enacted from April 1, 2009, overseas investors in certain investment funds may be exempt from Japanese permanent establishment (PE) taxation if certain conditions are met (please see our April Financial Newsletter for details). One required condition is that the investor must not be involved in the management or operation of the fund. The 2010 Tax Reform Proposal provides that an investor will not be considered to be involved in the management or operation of the fund merely by exercising limited rights with regard to certain conflict of interest transactions regulated in the Financial Instruments and Exchange Law.

We will continue to monitor these developments and issue newsletter as appropriate. In the mean time, if any questions, please contact your PwC advisor.

For more detailed information, please do not hesitate to contact your financial tax services representative or any of the following members:

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