

Financial Services Tax News

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PwC Japan Tax Newsletter

Tax Practice of PricewaterhouseCoopers Japan (Zeirishi-Hojin PricewaterhouseCoopers) is the largest professional tax corporation in Japan with more than 500 professionals. Our Financial Services Tax Group is comprised of approximately 100 professionals, dedicated specifically to advising the financial services industry.

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New Japan-Australia Tax Treaty

The Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes of Income (the "New Treaty") was signed on January 31, 2008. Upon completion of ratification by the two countries, the New Treaty will replace the current Japan-Australia treaty, which was concluded in 1969.

This Newsletter focuses on the headline amendments to the articles regarding dividends, interest, royalties, and permanent establishment as well as new articles regarding *tokumei kumiai* profit distributions, operation and alienation of real property, and limitation on benefits in the New Treaty.

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	Current Treaty		New Treaty		
Dividends	Any beneficial owner	15%	A beneficial owner in the following circumstances:	A company that has held directly shares representing at least 80% of the voting power of the company paying the dividend for the 12 month period prior to the date on which entitlement to the dividends is determined and that (1) is a qualified person; (2) has its aggregate vote and value owned 50%, directly or indirectly, by five or fewer companies that are qualified persons; or (3) meets certain other requirements.	0%
				A company holding shares of at least 10% of the voting power of the company paying the dividend.	5%
				Where (1) the company paying the dividend is a Japanese corporate resident entitled to a deduction for dividends paid to its shareholders in computing its taxable income (e.g., TMKs and J-REITs); and (2) such company's assets consists more than 50% of real property located in Japan.	15%
				Other than above	10%
Interest	Any beneficial owner	10%	Interest income received by the following beneficial owners: <ul style="list-style-type: none"> • Governmental bodies; • Financial Institutions; and • Certain other enumerated entities. 	0%	
				Other than above	10%
Royalties	Any beneficial owner	10%	Any beneficial owner	5%	
Tokumei-Kumiai (TK)	Silent	20% (under Japanese domestic law)	No exemption from taxation in the source country	20%	

Withholding tax on dividends, interests and royalties

Dividends

Under the New Treaty, dividends can be exempted from withholding tax when paid to a beneficiary who satisfies certain requirements. These requirements are satisfied when: (1) dividends are paid to a corporation that owns directly shares representing at least 80% of the voting power of the company paying the dividends for the 12 month period ending on the date on which entitlement to the dividends is determined; (2) the company is either a “qualifying person” under the New Treaty or is owned, directly or indirectly, by 5 or fewer companies who are “qualifying persons,” or (3) certain other situations apply. A withholding tax rate of 5% is imposed on dividends paid to a corporation that directly owns shares representing 10% or more of the voting power of the company paying the dividends. A withholding tax rate of 10% will apply in all other circumstances.

However, dividends paid by a *tokutei mokuteki kaisha* (a special purpose company often used in real estate investments in Japan) or a J-REIT (Japan Real Estate Investment Trust), which, subject to certain conditions, can deduct dividends paid from their income, are not entitled to either the 5% reduced rate or the full exemption. Dividends from these entities will instead be subject to a 15% withholding tax rate if more than 50% of their assets consist, directly or indirectly, of real property situated in Japan, or a 10% rate otherwise.

Interest

Interest income received by certain entities (such as governmental entities, financial institutions and certain other enumerated entities) is exempt from withholding tax in the source country. For other circumstances, a 10% withholding tax will be imposed.

Royalties

The New Treaty has reduced the previous withholding tax rate of 10% imposed on royalties to 5%.

Anti-conduit provisions

The New Treaty contains provisions that specifically deny or restrict treaty benefits applicable to preferred dividends, interest and royalties to transactions where the nominal or legal owner serves only as a conduit for indirect investors not otherwise entitled to equivalent treaty benefits.

Tokumei Kumiai (“TK”) profit distributions

The New Treaty specifically affirms that TK profit distributions to non-resident TK investors without a permanent establishment in Japan are subject to a 20% domestic withholding tax rate.

Limitation on benefits

Under the New Treaty, a comprehensive limitation on benefits provision is included in order to limit treaty benefits to qualifying residents of Japan and Australia. The limitation on benefit test applies to business profits in general, or to investment income that may be fully exempted under the New Treaty, including certain dividends, interest and capital gains.

The benefits in the New Treaty with respect to such income are available only to qualified persons, a definition which includes individuals, qualified governmental entities, certain pension funds, or any of the following:

- A company if its principal class of shares is listed or registered and regularly traded on a recognized stock exchange;

- A person other than an individual or a company, if the principal class of units in that person is listed or admitted to dealings and regularly traded on a recognised stock exchange;
- Certain charitable or other tax exempt organisations; or
- A person other than individual if qualified persons own, during a certain holding period, directly or indirectly, at least 50% of the aggregate vote and value or 50% of the beneficial interests in such person.

In addition, qualification under an active business test may be claimed in certain circumstances and a right to appeal to a hearing with a competent authority is made available in the New Treaty.

Residency

The New Treaty introduces a comprehensive provision that defines residency and provides rules for the determination of residency with regard to entities that have different entity classifications for Japanese and Australia tax purposes.

Of note is that certain Australian real estate trusts are viewed as residents under the New Treaty.

Other

The New Treaty introduces “Income from Real Property” and “Alienation of Property” clauses, under which income and gains derived from the operation and disposal of real property located in Japan (including shares of companies that derive 50% or more of their value directly or indirectly from real estate in Japan) may be taxed in Japan. The New Treaty also updates the “Permanent Establishment”, “Business Profits”, and “Exchange of Information” clauses to generally conform to the latest OECD model convention.

Effective dates

The New Treaty shall enter into force on the 30th day after the date of exchange of diplomatic notes indicating approval by the Diet in Japan and the Parliament in Australia and the formal constitutional processes required for entry into force have been completed. If the New Treaty enters into force on or before December 31, 2008, it shall be applicable in the following manner:

In Japan:

- With respect to taxes withheld at source, for amounts taxable on or after January 1, 2009.
- With respect to taxes on income which are not withheld at source, for income for taxable years beginning on or after January 1, 2009.
- With respect to other taxes, for taxes for taxable years beginning on or after January 1, 2009.

In the Australia:

- With respect to withholding tax on income that is derived by a resident of Japan, for amounts derived on or after January 1, 2009.
- With respect to other taxes, for taxable years beginning on or after July 1, 2009.

Qualifying conditions under the New Treaty are significantly more detailed than under the existing treaty and this extends to treaty application forms for Japanese tax reduction or exemption. The above is a general summary only and investors are advised to seek detailed advice when applying or interpreting the provisions of the New Treaty to their particular circumstances.

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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