Tax Insights
from Global Mobility

Japan: Gift and inheritance tax issues for expatriates

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In brief

It has been more than a year since the 2013 Tax Reform broadened the scope of who would be subject to Japan gift and inheritance taxes. In addition, future changes are fast approaching (effective from January 1, 2015) that will increase the gift/inheritance tax rates and lower exemption deductions.

These changes have generated much discussion and concern among the expatriate community in Japan and have prompted global mobility professionals to consider the effects on policies like tax equalization, and the resulting impact on mobile employees in Japan.

This alert provides a high-level overview of the Japanese Gift & Inheritance Tax system, recent tax law changes, and some issues to consider for global mobility personnel with regards to their expatriates and global mobility programs in Japan.

In detail

Japanese gift and inheritance tax is imposed on the recipients of the property, as opposed to the person transferring the property. As such, even if the recipient is not resident in Japan that person may be subject to Japan gift/inheritance taxation.

The following provides an overview of the tax system.

Who is subject to tax – limited versus unlimited taxpayers

If an individual inherits assets while his/her *Jusho* is in Japan (see definition of *Jusho* below), then he/she is considered an 'unlimited taxpayer' and inheritance tax may be levied on the value of assets inherited, regardless of whether the decedent's *Jusho* was in Japan at the time of his/her death.

If the beneficiary's *Jusho* is outside of Japan, the beneficiary is considered to be a 'limited taxpayer' and inheritance tax is only levied on those assets situated in Japan at the time of the decedent's death.

However, as a result of the Tax Reform (effective April 1, 2013), if the decedent has a *Jusho* in Japan, the beneficiary will now be classified as an unlimited taxpayer, and is taxed on worldwide assets inherited. Therefore, for non-Japanese beneficiaries, the *Jusho* of the decedent will now come into play when determining the scope of taxability.

Beneficiaries who are Japanese nationals may be considered unlimited taxpayers even if residing outside of Japan if they or the decedent had a *Jusho* in Japan within 5 years of the inheritance or gift.

Definition of Jusho

Non-Japanese nationals with a *Jusho* in Japan will also be subject to the Japanese gift and inheritance tax assessment. There is no clear definition under the Japanese law for what constitutes as *Jusho* but it is generally understood to be a person's 'principal place of living' as determined based on individual 'objective facts and circumstances'.

Some factors that are considered in determining one's *Jusho* include, but are not limited to, the following:

- location of the person's spouse and other family members
- location of where the person maintains social, business and professional contacts (including where one works)
- location of where the person owns substantial assets/property
- citizenship

Jusho is not the same as the concept of permanent home as defined in other locations. Rather, it is more similar to the concept of residency under the Japan income tax law.

Expatriates on an assignment with an initial intention of staying for more than one year and shifting their 'principal place of living' to Japan, will have a potential Japanese inheritance tax exposure on any amounts inherited and a Japan gift tax exposure for any gifts received while residing in Japan. This tax exposure is regardless of their status as non-permanent residents or permanent residents (living in Japan for more than 5 years within the past 10 years) for income tax purposes.

Therefore, for foreigners it is possible to be taxed on Japan source income only for income tax purposes, but be subject to Japan inheritance and gift tax on worldwide inheritances and gifts.

Exemptions & credits for inheritance tax

The law provides a basic exemption of 50 million yen and an additional exemption of 10 million yen for each statutory heir. However, effective January 1, 2015, the basic exemption will decrease to 30 million yen and the amount for each statutory heir will decrease to 6 million yen.

The surviving spouse is entitled to a substantial credit against the assessed inheritance tax. For decedents' with net worth in excess of 165 million yen, the best case scenario is 50% of the net worth could be shielded from Japan inheritance tax through the use of this credit (if the net worth is less than 165 million yen then there would be no inheritance tax payable if the spouse inherits all of the assets).

Unlike other jurisdictions, Japan inheritance tax on the death of the first spouse cannot be deferred or avoided until the death of the second spouse if the net worth is more than 165 million yen.

In general, inheritance or estate tax paid in another country may potentially be taken as a foreign tax credit against the Japan inheritance tax liability to avoid or mitigate double-taxation.

Note however that Japan inheritance tax may not be completely reduced in these situations, especially when the Japan inheritance tax rate is higher than the foreign jurisdiction (e.g., for US citizens and US domicile residents who's net estate value is less than the basic exemption amount of US$5.34 million for 2014, it will result in no US tax liability and only Japan inheritance tax).

Change in tax rates

Effective January 1, 2015, the Japan inheritance tax rate for the highest tax bracket will be increased to 55% for a taxable amount of more than 600 million yen. For gift tax, the highest tax bracket will also be increased to 55% for a taxable amount of more than 30 million yen, which is increased to 45 million yen if from lineal ascendants to a descendant 20 years or older.

Example: With the new lower exemptions which will be in effect starting January 1, 2015, an individual with two statutory heirs (a surviving spouse and a child) would have a maximum exemption of 42 million yen [30 million yen basic exemption plus 12 million yen (6 million yen per statutory heir)].

Gift tax

Gift tax is imposed on recipients of gifted assets transferred to them. There is an annual exemption of 1.1 million yen for a taxpayer (recipient of gift) on each year's taxable gift. An annual gift tax return is required if the taxable gift exceeds the exemption and any tax is due.

In principle, properties acquired by gift are included in taxable gift, but certain amounts, most importantly living expenses (including medical and education support) for dependents, are exempt from gift tax.

Scenarios to highlight who is subject to tax

Scenario 1: Taxpayers receiving gifts/inheritances while having a Jusho in Japan

Residing and having a *Jusho* in Japan means the expatriate and his/her family members will be classified as unlimited taxpayers subject to tax on worldwide gifts received. A gift tax filing will be required if a taxpayer receives more than the annual exemption amount of 1.1 million yen per calendar year.

Example: If an expatriate's child receives a gift of 2 million yen from grandparents who live outside of Japan, the child will need to file a gift tax return in Japan by March 15th of the following year and pay gift taxes on the amount over the 1.1 million yen annual gift exemption.

Worldwide inheritances received by individuals while having a *Jusho* in Japan will also be treated as taxable under the Japan inheritance taxation system.

If an expatriate receives an inheritance with assets located outside of Japan from a relative who passes away outside of Japan, the assets inherited may be treated as taxable. An inheritance tax return will need to be filed to report the taxable inheritance, taking into consideration exemptions, deductions and foreign tax credits.

Scenario 2: Taxpayers receiving gifts/inheritances while NOT having a Jusho in Japan

Old law: If an expatriate is living in Japan on an expat assignment (example: for 3 years) and his/her children (non-Japanese citizens and not minors) are living overseas, any non-Japan situs gifts the expatriate makes to the children would not have been taxable in Japan under the old law. This is due to the fact that his/her children are non-Japanese nationals (without a *Jusho* in Japan).

Donor/Decedent \ Donee/Heir		Jusho of Donee/Heir	
		Jusho in Japan	No Jusho in Japan
Jusho of Donor/Decedent	Jusho in Japan	Unlimited taxpayer - the donee/heir has Jusho in Japan, worldwide assets regardless of situs will be taxable.	Unlimited taxpayer - Even though the donee/heir does not have Jusho in Japan, the donor/decedent's Jusho in Japan will make worldwide assets taxable regardless of its situs. *
	No Jusho in Japan	Unlimited taxpayer - the donee/heir has Jusho in Japan, worldwide assets regardless of situs will be taxable.	Limited taxpayer - both the donee/heir & donor/decedent do not have Jusho in Japan, only Japan situs assets will be taxable**

* With the tax reform effective April 1, 2013, if the donor/decedent has Jusho in Japan, the Non-Japanese beneficiary will be classified as an unlimited taxpayer taxed on worldwide assets.
** If the Donee/Heir is a Japanese National, both the Donor/Decedent and the Donee/Heir have to break Jusho for at least 5 years.

New law: However, with the new tax reform, since the expatriate (the donor) would likely be considered as having a *Jusho* in Japan, any gifts the expatriate makes to his/her children, in the above example will now be considered as taxable in Japan even though the children do not have *Jusho* in Japan. This rule also applies under the inheritance tax concept. Please see the summary chart above.

The takeaway

Impact to expatriates

In addition to the Japan gift and inheritance tax reform which has broadened the scope of who will be affected, there is an effort to increase gift and inheritance tax compliance in Japan by the tax authorities. There is an increasing number of information sharing agreements between countries with further plans to automate this process within OECD countries.

Japan has also introduced the Offshore Asset Reporting requirement starting with tax year 2013 whereby all Japanese nationals and permanent resident taxpayers who have over 50 million yen of value in offshore assets have a reporting requirement.

Against this backdrop, the likelihood of gift and inheritance implications impacting the expatriate population is increasing. Foreigners with *Jusho*, and/or their accompanying family members, can be subject to gift and inheritance tax if they receive gifts or inheritance. Furthermore, if they are the donor/decedent, the recipients of their assets can also be subject to taxation.

Current market practice typically would not cover gift and inheritance taxes under a company tax equalization policy. However, with the advent of the 2013 Tax Reform, many companies are now revisiting their policies to take this matter under consideration.

Potential approaches

Communication to expatriates – Educating current expatriates residing in Japan of their potential gift/inheritance tax exposure is important to potentially avoid any inadvertent and unexpected tax liabilities (for example, seminars to educate employees and employers to make them aware of these issues).

Pre-assignment planning – In many cases, gift and inheritance tax implications may be managed through appropriate planning prior to the Japan assignment. For instance, the acceleration of gifts to the pre-assignment period that would have been made during the Japan assignment period would avoid the Japan gift taxation and decrease the expatriate's net worth for Japan inheritance tax exposure. In addition, proper titling of properties would minimize inheritance tax exposure. The gift and estate tax implications in the home country would also need to be considered.

Estate tax planning – Companies may consider providing professional personal financial planning assistance to senior executives. Often times, executives fail to consider the affect of a long-term assignment on their estate planning, not realizing their home country planning may no longer be fully effective.

Tax protection/tax equalization – Obtaining a better understanding of the exposure to gift and inheritance taxes for your expatriates in Japan should be on the agenda of all company HR and mobility professionals.

We recommend that companies take a moment to review their current tax equalization policies to see if any clarification is needed on gift and/or inheritance tax matters. Similarly, companies may want to review their tax protection policies and the applicable tax ceiling coverage limits.

Let's talk

For further information and assistance on these matters, please contact your PwC Japan Tax representative or any of the PwC Japan IAS professionals listed below:

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