Japan: Non-permanent residents to be taxed on sale of personal property outside of Japan

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In brief

The scope of taxation for Non-Permanent Resident (NPR) taxpayers of Japan will increase effective January 1, 2017. Income from the sale of personal property located outside of Japan will be taxable in Japan even if the proceeds are not remitted into Japan.

The 2017 Japan Tax Reform Proposals, which were released on December 8, 2016, provide a potential exemption on the issue of capital gains taxation on foreign-transacted securities sales for NPRs but the new rule on income from the sale of other personal property will still apply.

In detail

Change in the scope of taxable income for NPRs

As a result of the 2014 Japan Tax Reforms, the scope of taxable income for NPR taxpayers of Japan (foreign nationals who have resided in Japan for less than 5 years within the last 10 years) has changed. Previously, the taxable income for NPRs was defined as "Japan source income and other income that is paid in Japan or remitted into Japan." Effective January 1, 2017, the taxable income for NPRs will be "income other than foreign source income and foreign source income that is paid in Japan or remitted into Japan."

The 2014 Japan Tax Reforms also newly define "foreign source income" while revising "Japan source income" to be aligned with the adoption of the Authorized OECD Approach (AOA) as a basic principle.

Change in capital gains taxation for NPRs

Because the revised Japanese income tax law actively defines foreign source income in addition to Japan source income, certain income does not fall under either category. Such income includes capital gains from the sale of personal property (this does not include real estate property) located outside of Japan. For example, the law effective January 1, 2017 does not consider capital gains on the sale of US stock through a US broker as foreign source income.

Due to the change in the definition of taxable income for NPRs, which now focuses on "income other than foreign source income" rather than "Japan source income", capital gains from the sale of certain personal financial property located outside of Japan will be taxed for NPRs from January 2017, even if the proceeds are not paid in Japan or remitted into Japan. This is because such income is not defined as foreign source, and it is therefore treated as "income other than foreign source income".

Exemption provided by the 2017 Tax Reform Proposals

The 2017 Tax Reform Proposals were released on December 8, 2016 and include a provision to exempt NPRs from capital gains taxation on the sale of certain personal property, effective April 1, 2017. However, this exemption is limited to income from the sale of securities (as defined in Japanese Income Tax Law) that are:

- Sold through financial exchanges located outside of Japan; or
- Sold outside of Japan through overseas securities brokers; or
- Held in offshore accounts of overseas securities brokers.

The exemption would apply to transactions on or after April 1, 2017 on income from sales of securities (as described above) acquired prior to April 1, 2017 (the effective date of the exemption) and securities acquired on or after April 1, 2017 when the taxpayer was not an NPR within the past 10-year period.

Securities acquired when an NPR within the past 10-year period, but limited to acquisitions on or after April 1, 2017, would be taxable even if sold on or after April 1, 2017.

Please note that the exemption is only effective from April 1, 2017 whereas the law comes into effect January 1, 2017. Therefore, the exemption would not apply to any income realized between January 1 and March 31, 2017. Income during this period would be subject to Japan tax.

The takeaway

Through December 31, 2016, Japan NPR taxpayers are not subject to Japanese income tax on income from the sale of personal property located outside of Japan, unless it is paid in Japan or remitted into Japan. Effective January 1, 2017, however, NPRs will be taxed on sale of certain personal property located outside of Japan, even if the proceeds are not remitted into Japan.

The exemption of the capital gains taxation for NPRs introduced in the 2017 Tax Reform Proposals provides some relief for a common type of income (i.e., income from the sale of securities outside of Japan). However, please note that the exemption will not be effective until April 1, 2017 and the past 10-year period lookback test will result in some taxpayers not benefitting from the exemption.

Also, for expatriates under company tax equalization programs, companies may need to review their policies to determine whether such tax on income from personal property is within the scope of their policy coverage. If not, they should consider how to apply the tax equalization policy to settle the tax.

Furthermore, if NPR assignees are responsible for Japanese tax on personal income, companies may wish to consider a communication to the assignees as these individuals will need to be made aware of the new capital gains taxation rule.

We recommend that impacted individuals and companies review their situations in more detail prior to the end of 2016 to determine whether any action should be taken before the new rule comes into effect on January 1, 2017.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your regular PwC Global Mobility Services engagement team or one of the following professionals from PwC Japan:

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