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Estate Taxation Highlights

2014 Tax Reform Proposals: Impact on Income and Estate Taxation on High Net Worth Individuals

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The 2014 tax reform proposal was released on December 12, 2013 upon approval by the Tax Commission of the government's ruling parties. This newsletter focuses on the proposed reforms which may have an impact on high net worth individuals.

The proposed law changes will be submitted to the Diet in early 2014 for consideration.

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) Suspension and waiver of inheritance tax of inherited interest in certain medical corporations

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

(8) 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 currently capped at JPY 2.45 million. This cap will be further lowered from 2016 national income tax calculation as summarized below:

(Unit : JPY)

	Current	Cap for 2016[*1]	Cap for 2017 and following years[*2]
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 2017 local inhabitants tax, which is calculated based on 2016 income.
*2 This cap of JPY 2.2 million will apply from 2018 local inhabitants tax calculation based on 2017 income.

The chart below illustrates the calculation of employment income deduction.

(Unit: JPY)

Gross earnings	Employment income deduction
650,000 or less	650,000
650,000 to 1,625,000	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 will be 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 their issuing company are taxed as either of 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. Currently, golf club membership is not categorized as an “asset which is normally not used for daily life”, and a loss from its sale is usable to absorb other income.

Under the 2014 tax reform, golf club membership will be categorized as an “asset which is normally not used for daily life”. This change applies to 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 current tax law, the adjustment is 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) Suspension and waiver of inheritance tax of inherited interest in certain medical corporations

A new rule will be implemented to the inheritance of 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.

(7) 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 current tax law, the individual will be exempt from the capital gains tax if the gift is made to a public interest corporation under certain conditions and is 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.

This change will be effective for shares donated on or after April 1, 2014.

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

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

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

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

Offshore asset reporting is newly applicable from this 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 FAQ on November 15, 2013 (Japanese only).
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:

Zeirishi-Hojin PricewaterhouseCoopers
Kasumigaseki Bldg. 15F, 2-5, Kasumigaseki 3-chome, Chiyoda-ku, Tokyo 100-6015
Telephone: 81-3-5251-2400, http://www.pwc.com/jp/tax

Partner	Kazuya Kobayashi	81-3-5251-2752	kazuya.kobayashi@jp.pwc.com
	Kojiro Endo	81-3-5251-2443	kojiro.endo@jp.pwc.com
Manager	Bunta Mochizuki	81-80-3592-6071	bunta.mochizuki@jp.pwc.com
	Kaori Fukada	81-80-4104-5412	kaori.fukada@jp.pwc.com
	Mami Sasaki	81-80-3592-6111	mami.sasaki@jp.pwc.com
	Morito Yamada	81-80-4104-5411	morito.yamada@jp.pwc.com
	Yoko Shionoya	81-80-3592-6068	yoko.shionoya@jp.pwc.com
	Yoshitaka Hamaoka(Osaka)	81-6-7670-0952	yoshitaka.hamaoka@jp.pwc.com

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