# Update: Japan Non-Permanent Residents to be Taxed on Sale of Personal Property Outside of Japan

*May 2017*

## In brief

Effective January 1, 2017, there has been an increase in scope of taxation for Non-Permanent Resident ("NPR") taxpayers of Japan. Income from the sale of personal property located outside of Japan is in principle taxable in Japan even if the proceeds are not remitted into Japan.

The 2017 Japan Tax Reform Proposals, which was passed in the Diet into law on March 27, 2017, provide an exemption on the issue of capital gains taxation on foreign-transacted securities sales for Non-Permanent Residents but the new rule on income from the sale of other personal property will still apply (this does not include real estate property located outside of Japan).

This is an updated version of our December 2016 alert to include additional details that became available through the revised Japan income tax law enforcement orders and regulations.

## In detail

### 1. Change in the scope of taxable income for Non-Permanent Residents

As a result of the 2014 Japan Tax Reforms, the scope of taxable income for Non-Permanent Resident ("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 is "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 defined "foreign source income" while revising "Japan source income" to be aligned with the adoption of the Authorized OECD Approach ("AOA") as a basic principle.

### 2. Change in capital gains taxation for Non-Permanent Residents

Because the revised Japanese income tax law actively defined 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 Non-Permanent Residents, 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”.

## 3. Exemption through the 2017 Japan Tax Reforms

On March 27, 2017, the Diet passed the 2017 Tax Reform Proposals into law, which include a provision for exempting Non-Permanent Residents 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:

a) Sold through financial exchanges located outside of Japan; or
b) Sold outside of Japan through overseas securities brokers; or
c) Held in offshore accounts of overseas securities brokers.

The exemption applies 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 came 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.

<table>
<tr><th colspan="4">Transacted outside of Japan</th></tr>
<tr><th rowspan="3">Acquired more than 10 years before sale</th><th colspan="3">Acquired within 10 years from sale</th></tr>
<tr><th rowspan="2">Acquired while not NPR</th><th colspan="2">Acquired during NPR period</th></tr>
<tr><th>Acquired before April 1, 2017</th><th>Acquired on or after April 1, 2017</th></tr>
<tr><td>Non-Taxable*</td><td>Non-Taxable*</td><td>Non-Taxable*</td><td>Taxable</td></tr>
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*Applicable for securities sold on or after April 1, 2017. Taxable if the proceeds are paid in Japan or remitted into Japan.

## 4. Acquiring substantially same securities before and after April 2017

The introduction of the exemption for certain capital gains transactions would require taxpayers to track when they acquired securities. One of the common questions arose when the 2017 tax reforms proposal came out in December 2016 was the treatment of the same (or substantially same) securities that individuals purchased before and after April 1, 2017. The Income Tax Law Enforcement Orders clarify this area.

In the case of multiple purchases of same securities, the enforcement order clarifies that the exemption of capital gains for NPR is determined based on the acquisition dates of the securities sold in the first-in-first-out manner. Furthermore, if acquisition of new securities are resulted from certain events relating to securities that taxpayers have held (such as stock splits, issuance of spin-off shares, stock option exercises), then such newly acquired securities are deem to be the same securities as the previously held securities in determining the capital gains exemption.

### 5. Income Tax Treaty (Double Taxation Agreement) Consideration

As mentioned above, the new definition of taxable income for NPR per the law effective January 1, 2017 focuses on "income other than foreign source income" and the revised Japanese income tax law (also effective January 1, 2017) actively defined foreign source income. Under the revised law, for capital gains from a sale of securities in the country which has the right to tax the gains under a tax treaty with Japan, and is treated as taxable at that country under its domestic laws, such gains may be considered a foreign source income, and therefore, not taxable for NPR.

## *The takeaway*

Until December 31, 2016, Japan Non-Permanent Resident taxpayers were not subject to Japanese income tax on income from sale of personal property located outside of Japan, unless it is paid in Japan or remitted into Japan. Effective January 1, 2017, however, NPRs are taxed on sale of certain personal property located outside of Japan (this does not include real estate property), even if the proceeds are not remitted into Japan.

The exemption of the capital gains taxation for NPRs introduced in the 2017 Tax Reforms 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 was not effective until April 1, 2017 and the past 10-year period look-back test will result in some taxpayers not benefitting for 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, and if not, how to apply the tax equalization policy to settle the tax.

Furthermore, if Non-Permanent Resident 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 for NPRs.

## *Let's talk*

For a deeper discussion of how this issue might affect your business, please contact:

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