
2016 Japan Tax Reform Proposal and impact on individuals on international assignments

January 2016

In brief

The 2016 tax reform proposal, known as the *Zeisei Kaisei Taiko* (“Tax Reform Proposal”), was released by the ruling parties on December 16, 2015 and approved by the Cabinet on December 24. The proposed tax law changes will be submitted to the Diet during January, 2016 for consideration with the expectation that the approved reform proposals will be passed into law no later than March 31st. This IAS alert focuses on the 2016 proposed tax reforms impacting individuals on international assignments.

In detail

1. Outline

The main 2016 Tax Reform Proposals that are most relevant to individuals on international assignments and to human resources/ global mobility professionals are: (1) the numerous amendments to the “exit tax” rules, which came into effect on July 1, 2015, (2) an expansion in the scope of the foreign equity employment income reporting requirement, and (3) increases in penalty tax rates for delinquent filings and amended filings.

Other proposed changes include the following:

- The allowance of excess capital losses from listed securities due to the exit tax to be carried forward for up to three years
- Introduction of the “switch OTC medicine deduction” Increase in the maximum amount of tax-exempt commutation allowances
- Home loan credit eligibility for homes purchased during non-resident period
- Corporate tax deductibility of remuneration costs from restricted stocks
- Corporate tax deductibility of director remuneration costs
- Introduction of national tax payments through credit cards
- Acceptance of electronic certificates for life insurance deduction, earthquake insurance deduction and charitable contribution deduction

2. Amendments to exit tax

1) Exclusion of stock options from the scope of exit tax:

Stock options and other similar rights where all or a portion of the income from exercising the right is considered as Japan source income will be excluded from the scope of the exit tax. Taxpayers will still need to pay Japan non-resident income tax on this Japan source income in the future but this change will eliminate the potential for double-taxation previously created by the exit tax.

This change will become effective from tax year 2016.

2) Change in extension of time for tax payment:

The extension period to pay the exit tax will be extended to 5 years and 4 months from the current 5 years. This will become effective for tax payment extensions that will expire on or after January 1, 2016.

3) Change in cost basis step-up rule:

There will be no “step-up” in the cost basis of financial assets to the exit date value if there was no exit tax applied on these assets. This will become effective for taxpayers who return to Japan on or after January 1, 2016.

4) Clarification on the method for distinguishing between assets that have been subject to the exit tax and assets that have been acquired after departure:

There is a need for individuals who have been granted an exit tax payment extension and have disposed of his/her shares after departure, to determine whether disposed shares were the shares held at departure and subject to the exit tax or the same issue of shares were acquired after departure. The following method has been proposed;

- i.) To deem that the shares that are not under the extension of exit tax payment are sold first, and that the shares that are under the extension are sold thereafter. The shares that are subject to exit tax payment extensions in this case would also include shares which were acquired through gifting, and the donor has been granted the extension and
- ii.) In cases where the securities that are under the exit tax payment extension are sold, it is deemed that the shares acquired first are sold first (a “FIFO” like method).

This proposal will become effective on sales of securities from January 1, 2016.

5) Obligation of amended returns and the eligibility of downwards assessment requests for exit tax applied to inherited assets:

An amendment has been proposed in the case exit tax has been applied to deceased residents when assets were transferred to non-resident heirs upon inheritance and the division of the estate between heirs has become different from what has been reported on the original income tax return due to specified events. In such case, the heirs who have succeeded the decedent’s tax liability will be required to file amended returns in case the change results in an additional tax liability, or will be eligible to file downwards assessment requests in case the change should decrease the tax liability. The amended returns or downwards assessment requests are to be filed within 4 months from the date which the “event” has occurred. “Events” for this purpose would include subsequent determination of division of the estate, a change in legal heirs by court order, etc.

This will become effective from specified events occurring from January 1, 2016.

3. Expanded scope of foreign equity reporting

Foreign equity employment income reporting was introduced with the 2012 Tax Reform. When a foreign parent company grants rights for share based compensation to directors or employees of a Japanese subsidiary or a branch, and the directors or employees enjoys economic benefits pursuant to the agreement with the foreign parent, the Japanese subsidiary/branch is obligated to submit a report to disclose specific details of the benefits provided.

Under the 2016 Tax Reform Proposal, the scope of individuals who have received economic benefits to be subject to this reporting obligation is expanded to include the following:

- i) Resident individuals who are former directors or employees of the Japanese subsidiary/Japanese branch of a foreign company.
- ii) Non resident individuals who are, or are former directors or employees of the Japanese subsidiary/Japanese branch of a foreign company and which the economic benefit received includes Japan-source income.

This expanded scope will require companies to track and report equity income related to individuals who were previously on assignment or employed in Japan, including individuals (such as retirees) who may not be currently employed, globally, by the company.

The effective date of this amendment has not been announced.

4. Increase in national penalty tax rates

The proposed revisions in penalty tax rates are as follows:

- i.) The rate for underreporting penalty tax in case of an amended return that is filed voluntarily after notification of a tax audit but without anticipation of a tax assessment (currently 0%) will be increased to 5% of the additional national tax balance owing (The rate applied to the additional tax amount exceeding the greater of the original tax amount and 500,000 yen will be 10%).
- ii.) The rate for failure to file penalty tax in case of a past due return or an amended return that is voluntarily filed after notification of a tax audit but without anticipation of a tax assessment (currently 5%) will be increased to 10% (The rate applied to the additional tax exceeding 500,000 yen will be 15%).

An additional 10% will be added to failure to file penalty tax or heavy penalty tax when both of the following conditions are met:

- 1) An amended return has been filed with anticipation of a tax assessment, or an assessment by the tax authorities has been made (by either correction or determination).
- 2) The taxpayer has been assessed with a failure to file penalty tax (with anticipation of a tax assessment) or a heavy penalty tax on the same tax category within the past 5 years.

The increases in the national penalty tax rates will come into effect on tax returns due on January 1, 2017 or after.

5. Inclusion of deemed listed securities sales under exit tax into loss carryover rule of listed stocks:

Excess capital losses from listed securities due to the exit tax can be carried forward for up to three years

The effective date of this change has not been announced.

6. Introduction of “switch OTC medicine deduction”

In line with the government’s efforts to promote the switch from prescription medicine to over the counter medicine (“OTC”) under proper health management, the “switch OTC medicine deduction” will be introduced as a special measure for the period between January 1, 2017 and December 31, 2021.

Taxpayers who follow specific self health management procedures will be eligible to deduct expenditures used to purchase specified “switch OTC medicine” not covered by insurance which exceeds 12,000 yen, up to a limit of 88,000 yen. Specific self health management procedures would include attending medical check-ups, preventive immunization, etc. Taxpayers who claim this deduction would not be able to claim a medical expense deduction.

7. Increase in the maximum amount of tax-exempt commutation allowances

The maximum amount of tax-exempt commutation allowance paid by employers will be increased to 150,000 yen per month from the current amount of 100,000 yen. This will become effective for commuting allowances to be paid from January 1, 2016.

8. Home loan credit eligibility for homes purchased during non-resident period

The home loan credit will be available on residential properties purchased by taxpayers during their Japan non-resident period. Other conditions for eligibility will be the same as those for resident individuals. This will become effective from purchases of homes on or after April 1, 2016.

9. Corporate tax deductibility of remuneration costs from restricted stocks

Costs from remuneration for an individual's future services in the form of certain restricted stocks shall be deductible for corporate tax purposes in the fiscal year at the time the restrictions to the stocks have been lifted. This will be effective for restricted stocks which the resolution of its issuance is made on or after April 1, 2016.

10. Corporate tax deductibility of director remuneration costs

In Japan, remuneration to directors are, in general, deductible when it meets certain conditions and is categorized as the either of (1) "fixed periodical payments", (2) "fixed payments with advance notice", or (3) "performance bonus determined in proportion to the earnings". Under the proposal, remuneration costs from restricted stocks granted to directors will be categorized as "fixed payments with advance notice" and be deductible for Japan corporate tax purposes. However the filing of an advance notice to the tax authorities will not be required.

The proposal also includes new allowable calculation benchmarks such as return on equity and others for the deductibility of bonuses to directors under "performance bonus determined in proportion to the earnings".

The effective date of this change has not been announced.

11. Introduction of national tax payment through credit cards

Credit cards will be accepted when used to pay national taxes. The credit card transaction date will be considered as the tax payment date. This will become effective for national tax payments made from January 4, 2017.

12. Acceptance of electronic certificates for life insurance, earthquake insurance and charitable contribution deductions

Print-out documents of electronic certificates for the purpose of claiming life insurance deduction, earthquake deduction and charitable contribution deduction will be accepted as necessary attachments to tax returns. This will be effective from the tax year 2018.

Summary of effective dates of the proposed changes

Proposal	Proposed Effective Date
1. Amendments to exit tax	
1) Exclusion of stock options	Effective from tax year 2016
2) Change in extension of tax payment	Effective for tax payment extensions expiring on or after January 1, 2016
3) Change in cost basis step-up rule	Effective for taxpayers who return to Japan on or after January 1, 2016
4) Clarification between assets subject to exit tax and assets acquired after departure	Effective on sales of securities from January 1, 2016
5) Amended return obligation or downward assessment request eligibility for exit tax applied to inherited assets	Effective from specified events occurring from January 1, 2016
2. Expanded scope of foreign equity reporting	Effective date – not announced
3. Increase in national penalty tax rates	Effective on tax returns due on January 1, 2017 or after
4. Excess capital losses from listed securities due to the exit tax to be carry forward up to three years	Effective date – not announced
5. Introduction of “switch OTC medicine deduction”	Special measures for the period between January 1, 2017 and December 31, 2021
6. Increase in tax exempt maximum amount for commutation allowance	Effective for commutation allowance to be paid from January 1, 2016
7. Home Loan Credit eligibility for homes purchased during non-resident period	Effective from purchases of homes on or after April 1, 2016
8. Corporate tax deductibility of remuneration costs from restricted stocks	Effective for restricted stocks which the resolution of issuance are made on or after April 1, 2016
9. Corporate tax deductibility of director remuneration costs	Effective date – not announced
10. Introduction of national tax payment through credit card	Effective for national tax payments made from January 4, 2017
11. Acceptance of electronic certificates for life insurance, earthquake insurance and charitable contribution deductions	Effective from tax year 2018

Let's talk

The 2016 tax reform proposals demonstrate continued development in the application of the evolving exit tax rules as more complex issues arise as well as an increased focus on improving the transparency and disclosure requirements of income that may be taxable in Japan and steeper penalties for non-compliance. For a deeper discussion of how the 2016 Japan tax reform proposals may affect your business and your people, please contact:

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