2017 Japan Tax Reform Proposals: Casting a wide net
The Dbriefs Special Edition – International Tax series
David Bickle / Brian Douglas / Sam Gordon / Ken Saga-Hardie
22 February 2017
Agenda

• Introduction
• 2017 Japan Tax Reform – Part I
  – Corporate reorganizations
  – Individual tax
  – Anti-tax haven regime
• Transfer pricing update
• 2017 Japan Tax Reform – Part II
  – Other corporate tax reforms
  – Inheritance tax
• Japan tax treaty update
• Questions & answers
Overview of 2017 Tax Reform
Measures for a virtuous economic cycle

- **Innovation management strategy**
  - Better environment for corporate governance / business restructuring
  - Expanded definition of qualified reorganizations
  - Revision of mark-to-market valuation of non-qualified share-for-share exchange

- **Reform of working style**
  - Revision of (special) spousal deductions

- **Local Abenomics measures**
  - Revision of international taxation
  - Expanded capital investment tax measures for SMEs
  - Revision of international tax
    - Overhaul of anti-tax haven (CFC rules), etc.
### Overview of 2017 Tax Reform

#### Corporate reorganizations

<table>
<thead>
<tr>
<th>Items</th>
<th>Outline</th>
<th>Effective date</th>
</tr>
</thead>
</table>
| **Corporate divisions / distributions in kind** | • Revision of scope of qualified corporate split  
• Revision of scope of qualified distribution in kind  
• Amendments to treatment of shareholders in distribution of all shares in a 100% subsidiary  
• Revision of qualification requirements for reorganizations consisting of a series of transactions | Reorganizations on or after **1 April 2017** |
| **Absorptions / share-for-share exchanges** | • Revision of qualification requirements for absorption type merger / share-for-share exchange  
• Inclusion of squeeze-outs utilizing callable shares in the scope of corporate reorganization | Reorganizations on or after **1 October 2017** |
| **Mark-to-market valuation of assets** | • Revised definition of assets subject to mark-to-market valuation in non-qualified share-for-share exchange, or at time of entry into tax consolidated group | Reorganizations on or after **1 October 2017** |
| **Requirements for qualified reorganizations** | • Revision of controlling continuity test for horizontal type corporate division  
• Revision of controlling continuity test of merger for joint business  
• Revision of qualification requirements for an reorganization consisting of a series of transactions | Reorganizations on or after **1 October 2017** |
| **Others** | • Revision of amortization method for goodwill  
• Expanded scope of non-deductible capital losses on specified assets of entities with NOLs controlled by specified shareholders | Reorganizations on or after **1 April 2017** |
## Overview of 2017 Tax Reform

### Corporate, individual, and inheritance tax

<table>
<thead>
<tr>
<th>Items</th>
<th>Outline</th>
<th>Effective date</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Anti-tax haven (CFC) rules</strong></td>
<td>- Taxation of shell companies, etc.</td>
<td>Fiscal years of foreign corporations beginning on or after 1 April 2018</td>
</tr>
<tr>
<td></td>
<td>- Inclusion of passive income without substance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Fundamental revision of the exemption criteria (change to economic activity criteria)</td>
<td></td>
</tr>
<tr>
<td><strong>Director compensation</strong></td>
<td>- Expanded deductibility of restricted stock compensation</td>
<td>On or after 1 October 2017 for revisions to retirement compensation, restricted stock compensation and stock options, and on or after 1 April 2017 for other revisions</td>
</tr>
<tr>
<td></td>
<td>- Revision of the scope of deductible profit linked compensation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Amendments to rules for other director compensation (e.g., trust-type stock compensation, employee stock options)</td>
<td></td>
</tr>
<tr>
<td><strong>R&amp;D tax relief</strong></td>
<td>- Revision of general type R&amp;D tax credit rate</td>
<td>Fiscal years beginning on or after 1 April 2017</td>
</tr>
<tr>
<td></td>
<td>- Abolition of incremental type tax credit; Expanded scope of R&amp;D expenses eligible for tax credit</td>
<td></td>
</tr>
<tr>
<td><strong>Tax relief for wage increases</strong></td>
<td>- Revision of eligibility requirements</td>
<td>Fiscal years beginning on or after 1 April 2017</td>
</tr>
<tr>
<td></td>
<td>- Increase in tax credit limit</td>
<td></td>
</tr>
<tr>
<td><strong>SMEs</strong></td>
<td>- Reduction of the scope of eligible SMEs</td>
<td>Fiscal years beginning on or after 1 April 2019</td>
</tr>
<tr>
<td><strong>Inheritance / gift tax</strong></td>
<td>- Revision of valuation method for unquoted shares (comparable method)</td>
<td>On or after 1 January 2017 for revisions to valuation of unquoted shares, tax liability for foreign assets and requirements for tax payment deferral, and on or after 1 January 2018 for determination criteria of specified controlling shareholders</td>
</tr>
<tr>
<td></td>
<td>- Inclusion of convertible bonds in the determination of specified controlling shareholders</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Revision of tax liability for foreign assets</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Revision of requirements for tax payment deferral</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Amendment to the order of property applied to tax payment</td>
<td></td>
</tr>
</tbody>
</table>
2017 Japan Tax Reform
Part I
Corporate reorganizations
Horizontal split
Business spin-offs for non-controlled companies to be tax qualified

Qualification requirements

<table>
<thead>
<tr>
<th>#</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>✓ No consideration other than proportional shares</td>
</tr>
<tr>
<td>2</td>
<td>✓ Continuity of non-controlling status</td>
</tr>
<tr>
<td>3</td>
<td>✓ Transfer of key assets / liabilities</td>
</tr>
<tr>
<td>4</td>
<td>✓ Employee retention – 80% or more</td>
</tr>
<tr>
<td>5</td>
<td>✓ Business continuity</td>
</tr>
<tr>
<td>6</td>
<td>✓ Management continuity</td>
</tr>
</tbody>
</table>

Non-tax qualified
- Company A – capital gain
- Shareholders – generally deemed dividend only, unless boot received

Proposed
Tax qualified

Applicable to horizontal splits carried out on or after 1 April 2017
Distribution in kind
Spin-offs of non-controlled company subsidiaries to be tax qualified

# Qualification requirements

<table>
<thead>
<tr>
<th>#</th>
<th>Qualification requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>✓ No consideration other than proportional shares</td>
</tr>
<tr>
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<td>✓ Continuity of non-controlling status</td>
</tr>
<tr>
<td>3</td>
<td>✓ Employee retention – 80% or more</td>
</tr>
<tr>
<td>4</td>
<td>✓ Business continuity</td>
</tr>
<tr>
<td>5</td>
<td>✓ Management continuity</td>
</tr>
</tbody>
</table>

Current

Non-tax qualified
- Company A – capital gain
- Shareholders – generally deemed dividend only, unless boot received

Proposed

Tax qualified

Applicable to distributions in kind carried out on or after 1 April 2017
Distribution in kind of foreign shares
Exception to no capital gain recognition for foreign shareholders

<table>
<thead>
<tr>
<th>Treatment of foreign shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Even if qualification 1 (on previous slide) met</td>
</tr>
<tr>
<td>If Company A shares held by PE of foreign shareholder</td>
</tr>
</tbody>
</table>

Applicable to distribution in kind carried out on or after **1 April 2017**
Squeeze out

Tax consistency among squeeze out transactions

<table>
<thead>
<tr>
<th></th>
<th>Absorption merger</th>
<th>Share-for-share exchange</th>
<th>Utilization of callable shares</th>
<th>Reverse stock split</th>
<th>If ≥ 90% demand for sale of shares</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxation for target</strong></td>
<td><strong>Current</strong></td>
<td>Capital gains / losses recognized on transferred assets / liabilities</td>
<td>Certain assets marked-to-market</td>
<td>No taxation</td>
<td>No taxation</td>
</tr>
<tr>
<td><strong>Proposed</strong></td>
<td></td>
<td></td>
<td></td>
<td>Generally taxable*</td>
<td>If corporate reorganization requirements met, tax qualified</td>
</tr>
</tbody>
</table>

Cash distribution to minority shareholders will no longer trigger tax provided that majority shareholder owns **at least two thirds of shares**
Squeeze out
Boot paid by 2/3rds shareholder no longer disqualifies squeeze out

**Qualification requirements**

<table>
<thead>
<tr>
<th>#</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>✓ No boot or cash used in transfer  <em>(Proposed: not applicable where majority shareholder’s interest in Target ≥ 2/3rds)</em></td>
</tr>
<tr>
<td>2</td>
<td>✓ Continuity of controlling relationship</td>
</tr>
<tr>
<td>3</td>
<td>✓ Employee retention – 80% or more</td>
</tr>
<tr>
<td>4</td>
<td>✓ Business continuity</td>
</tr>
</tbody>
</table>

Current: Non-tax qualified

Proposed: Tax qualified

Applicable to corporate reorganization on or after **1 October 2017**
Mark-to-market evaluation
Most internally generated goodwill excluded from mark-to-market rules

Exclusion of assets with book value **less than JPY 10 million** from mark-to-market valuation
- In non-qualified share-for-share exchange
- At time of entry into a tax consolidated group

<table>
<thead>
<tr>
<th>Mark-to-market</th>
<th>Type of asset</th>
</tr>
</thead>
</table>
| Subject to mark-to-market valuation | • Fixed assets  
• Land held as inventory (including rights on the land)  
• Securities  
• Monetary claims  
• Deferred assets |
| Excluded assets | • Depreciable assets which have been depreciated in an accelerated manner for the last five fiscal years  
• Securities held for trading  
• Securities held to maturity  
• Assets with built-in losses less than either JPY 10 million or 50% of capital stock and capital reserve, whichever is smaller  
• **Assets with book value less than JPY 10 million** |

Applicable to corporate reorganizations on or after **1 October 2017**
Dispositional transferor shares no longer disqualifies certain corporate splits.

**Continuity of ownership requirement**

Applicable to corporate reorganizations on or after 1 October 2017.
Individual tax
Change in taxation of non-permanent residents

• Definition of non-permanent resident
  – Maintains a domicile in Japan or has maintained an abode in Japan for one year or more
  – Does not possess Japanese nationality
  – Has maintained a domicile or abode in Japan for 5 years or less in the preceding 10 years

• Former basis of taxation
  – A non-permanent resident would be taxed on Japan source income and non-Japan source income if paid, remitted or effectively remitted to Japan

• Current basis (effective 1 January 2017)
  – A non-permanent resident is taxed on all income except foreign source income that is not paid, remitted or effectively remitted to Japan
Impact for taxation of capital gains on shares / securities

- Capital gains arising on the disposal of shares and securities held overseas are not contained within the list of income that may be considered foreign source in nature.
- From 1 January 2017 this means all disposals of shares / securities should be considered from a Japanese perspective even for non-permanent residents who previously would not have been taxed on their gains had they not been remitted or effectively remitted to Japan.
- Gains are determined with reference to the Japanese yen value of the shares / securities at acquisition and disposal. Depending on FX movements this may mean that a loss overseas could be a gain in Japan (and vice versa).
- For shares / securities that have been acquired in multiple transactions, Japan does not have any share matching rules and would determine the cost basis based on an averaging method.
- Limited treaty protection exists.
Impact for taxation of capital gains on shares / securities (Cont’d)

• Recognizing the additional burden the change in rules will place on individuals temporarily in Japan. A new regime will take effect 1 April 2017

• From 1 April 2017
  – Gains on shares acquired after 1 April 2017, within the previous 10 years and when the taxpayer was a non-permanent resident (NPR) remain taxable for a non-permanent resident
  – Otherwise they may be treated as a foreign source of income and, if non-permanent resident when realized, taxable on the remittance basis

• Non-permanent residents may wish to consider delaying the sale of shares until after 1 April 2017 (for shares acquired pre 1 April 2017) and / or after their departure from Japan (for shares acquired post 1 April 2017)
Other changes

Spousal deductions

- The spousal earnings threshold from which the spouse deduction and special spouse deduction will begin to be withdrawn is to be increased from JPY 1.03m to JPY 1.5m (JPY 850,000 for non-employment income)

- To fund the increase in availability of the deduction, the spouse deduction and special spouse deduction will be withdrawn completely for individuals earning more than JPY 12.2m

- Individuals earning between JPY 11.2m and JPY 12.2m will have reduced deductions depending on the income of the principle earner and their spouse

Long Term NISA

- From 1 January 2018, a new long term NISA will exist in parallel to the existing system

- An individual may invest JPY 1.2m as normal or up to JPY 400,000 in the new type of account. Gains and dividends for shares held in the new style account will be tax exempt for up to 20 years
Anti-tax haven (Controlled Foreign Corporation (CFC)) regime
Japan BEPS scorecard

**Action 1**
**Digital economy**

- From 1 October 2015 the place of supply for cross-border digital services will change to be the office or domicile of the recipient and supplies are classified as B2B digital supplies and B2C digital supplies according to their nature or service terms for Japanese Consumption Tax (JCT) purposes.
- A reverse charge applies to B2B digital services. On the other hand, foreign suppliers of B2C digital services must file a JCT return and pay JCT liability through its appointed JCT representative.

**Action 2**
**Hybrids**

- A foreign dividend exclusion no longer applies to foreign dividends deductible in the source country; a foreign tax credit may be taken for foreign withholding tax (WHT) on the relevant dividends.
- Reform is applicable to dividends received by Japanese companies from their foreign subsidiaries for tax years beginning on or after 1 April 2016 with certain applicable grace periods.

**Action 3**
**CFC**

- In the 2017 tax reform, revisions are proposed that broaden the taxation of income arising in a foreign subsidiary without sufficient economic substance while excluding income generated in a foreign subsidiary with economic substance through introducing a new category of CFC and updating the economic activity exception.
- Reform is effective for tax years beginning on or after 1 April 2018 of the foreign related company.

**Action 6**
**Treaty Abuse**

- Japan has historically included a Limitation of Benefits (LOB) provisions in many of its treaties. Recently, in line with BEPS, Japan has concluded several treaties that incorporate the Principal Purpose Test (PPT) only or a combination of the PPT and a LOB clause.

**Action 13**
**CbC, master / local file**

- The OECD three tier documentation recommendations (master file, local file, and CbC report) were contained in the 2016 tax reform package (released in December 2015).
- The master file and the CbC report requirements will be implemented for the fiscal years beginning on or after 1 April 2016, and the due date is one year after the end of the relevant fiscal year.
- The local file requirement will be implemented for the fiscal years beginning on or after 1 April 2017 and the due date is the same with filing of income tax returns (generally within 3 months – 2 months plus 1 month extension – after the end of the relevant fiscal year).

**Action 15**
**Multilateral instrument**

- Japan is expected to sign multilateral instrument amending its treaties, however, specifics not yet determined.
Japanese CFC rules
Expanded definition of CFC

- Controlled foreign corporation? YES → Specified company? YES → ETR <30%? NO → Out of scope
- Controlled foreign corporation? YES → Specified company? NO → ETR <20%? YES → Satisfy Economic Activity Test? NO → Out of scope
- Controlled foreign corporation? YES → Specified company? NO → ETR <20%? NO → Passive income taxation
- Controlled foreign corporation? NO → Out of scope

Applicable to fiscal years starting on or after 1 April 2018 for the CFC
Specified company
Addition of new category of CFC

Controlled foreign corporation? YES
Specified company? YES
ETR < 30%? NO
Out of scope

Specified company? YES
ETR < 30%? NO
ETR < 20%?
YES
Satisfy Economic Activity Test?
YES
Passive income taxation
NO
Passive income taxation
NO
Out of scope

Controlled foreign corporation? NO
Specified company? NO
ETR < 30%?
YES
ETR < 20%?
YES
Satisfy Economic Activity Test?
YES
Passive income taxation
NO
Passive income taxation
NO
Out of scope

Paper company
Fails both of the following
Substance test
Management / control test

Cash box company
Both of the following are satisfied
Passive income to Total Assets ratio > 30%
Passive Assets to Total Assets > 50%

Black listed company
Head office located in jurisdiction designated by the Finance Minister

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Economic activity test
Revisions in determining economic substance

<table>
<thead>
<tr>
<th>Test</th>
<th>Amendment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main business test</td>
<td>Aircraft leasing business will be treated as satisfying the requirement</td>
</tr>
<tr>
<td>Substance test / administration</td>
<td>An insurance consignor will be treated as satisfying the requirement under</td>
</tr>
<tr>
<td>and control test</td>
<td>certain conditions</td>
</tr>
<tr>
<td>Country of location test</td>
<td>The foreign related company is considered to be independently engaged in</td>
</tr>
<tr>
<td></td>
<td>the important part of the manufacturing business in the location of its</td>
</tr>
<tr>
<td></td>
<td>head office</td>
</tr>
<tr>
<td>Unrelated party test</td>
<td>Predetermined transaction with an unrelated party is treated as a related</td>
</tr>
<tr>
<td></td>
<td>party transaction. An insurance consignee’s transaction is treated as a</td>
</tr>
<tr>
<td></td>
<td>unrelated party transaction.</td>
</tr>
</tbody>
</table>

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## Types of income subject to passive income taxation

### Expanded definition of passive income

<table>
<thead>
<tr>
<th>Passive income (current law)</th>
<th>Passive income (Proposal)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond interest</td>
<td>Interest</td>
</tr>
<tr>
<td>Profits arising from bond redemption</td>
<td>Dividend (excluding dividends from a company which is owned (at least 25%) by a foreign related company)</td>
</tr>
<tr>
<td>Dividend from a company less than 10% is owned by the foreign related company</td>
<td>Consideration from lending securities</td>
</tr>
<tr>
<td>Capital gains arising on the disposal of shares that are less than 10% owned by the foreign related company</td>
<td>Capital gain / loss on securities</td>
</tr>
<tr>
<td>Capital gains on the disposal of bonds</td>
<td>Profit and loss arising on derivatives transactions</td>
</tr>
<tr>
<td>-</td>
<td>Foreign exchange gain or loss</td>
</tr>
<tr>
<td>-</td>
<td>Other income related to above a to f</td>
</tr>
<tr>
<td>Consideration from ship/aircraft leasing</td>
<td>Consideration from tangible fixed assets leasing</td>
</tr>
<tr>
<td>Royalties on patent right etc. (except for those royalties that are self-developed patent rights etc.)</td>
<td>Royalties from intangible assets etc.</td>
</tr>
<tr>
<td>-</td>
<td>Capital gain or loss on intangible assets etc.</td>
</tr>
<tr>
<td>-</td>
<td>Certain “irregular amount” income</td>
</tr>
</tbody>
</table>

◎ Exempt from CFC taxable income for financial subsidiaries etc. who satisfy certain conditions
※ Exempt from CFC taxable income where those income is derived from activities that are fundamental, important and necessary to the business (other than shareholding business etc.)
Other amendments to Japan CFC Rules
Recalculation of indirect shareholdings; additional documentation required

- **Changes to indirect holding ratio calculation of the foreign related company**
  - Amended to testing the shareholding ratio owned by the intermediate foreign holding company, more than 50% owned by the Japanese parent company

<table>
<thead>
<tr>
<th>Example 1</th>
<th>Example 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Japanese Co X</strong></td>
<td><strong>Public</strong></td>
</tr>
<tr>
<td>60%</td>
<td></td>
</tr>
<tr>
<td><strong>Foreign Co Y</strong></td>
<td><strong>Japanese Co X</strong></td>
</tr>
<tr>
<td>70%</td>
<td>50%</td>
</tr>
<tr>
<td><strong>Foreign Co Z</strong></td>
<td><strong>Foreign Co Y</strong></td>
</tr>
<tr>
<td></td>
<td>50%</td>
</tr>
</tbody>
</table>

**Indirect shareholding ratio of Z by X**

<table>
<thead>
<tr>
<th></th>
<th>Example 1</th>
<th>Example 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>60% × 70% = 42% ≤ 50% (<strong>Non-CFC</strong>)</td>
<td>If Foreign Co. Y has 1 or more Japanese shareholder &gt; 50% (<strong>CFC</strong>)</td>
</tr>
<tr>
<td>Proposal</td>
<td>100% × 70% &gt; 50% (<strong>CFC</strong>)</td>
<td>No consideration of Public’s indirect holding (<strong>Non-CFC</strong>)</td>
</tr>
</tbody>
</table>

- **Document required for submission in relation to the foreign related company**
  - Presumption of being a paper company or not satisfying the economic activity test if supporting documents not provided upon request by the tax authority

- **Requirement to attach foreign related company’s financials to the Japan company’s tax return**

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Transfer pricing update
Transfer pricing documentation reform

**Timeline**

- **Tax Reform 2016 adopted**
  - March 2016

- **Documents recognized as necessary for calculating arm’s length prices (audit manuals)**
  - June 2016

- **Transfer pricing documentation FAQs**
  - October 2016

- **Tax Reform 2017 announced**
  - December 2016

1: **The 2016 Tax Reform** introduced the so-called three-tiered approach to documentation, which is generally consistent with BEPS Action 13 Guidance

2: **Documents recognize as necessary for calculating arm’s length prices** is a collection of illustrative examples of the kinds of documents the Japanese tax authorities consider relevant for preparing a local file

3: **Outline of the revision of the transfer pricing documentation** explains at a high level the different documents which need to be prepared or submitted under the new rules including contents, format, timing, exceptions, etc.

4: **Transfer pricing documentation FAQs** provides responses to Japanese taxpayers’ frequently asked questions
Transfer pricing documentation reform
Notification for ultimate parent entity

• In January 2017, the National Tax Authorities (NTA) released three additional documents with respect to notification for ultimate parent entity
  – Input procedures for records concerning CSV file
  – Getting started e-Tax procedure for reporting information on multinational corporations
  – Provisional translation of country-by-country reporting XML schema
• Deadline for filing the notification is the last day of the ultimate parent entity’s fiscal year
• Acceptance of notification filings are expected to be 21 March 2017
## Transfer pricing documentation reform

Details Japanese transfer pricing documentation

<table>
<thead>
<tr>
<th>Information required</th>
<th>CbC Report</th>
<th>Master File (MF)</th>
<th>Local File (LF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Submission method</td>
<td>Submission to the district director of the tax office by e-Tax</td>
<td>Submission is not mandatory</td>
<td></td>
</tr>
<tr>
<td>Submission timing</td>
<td>Within one year of the end of the ultimate parent entity’s fiscal year</td>
<td>Within 45 or 60 days upon a request ※2</td>
<td></td>
</tr>
</tbody>
</table>
| Threshold ※3         | Filing threshold – consolidated group revenue of JPY 100 billion or more in the previous fiscal year | Either of the following in the prior fiscal year
  • JPY 5 billion of total related-party transactions or
  • JPY 300 million of related-party intangible property transactions |                    |
| Penalties            | Up to JPY 300,000 | Presumptive taxation |                    |
| Start                | Ultimate parent entity’s fiscal year beginning on or after 1 April 2016 | Fiscal years beginning on or after 1 April 2017 |                    |
| Language             | English     | Japanese or English | Not specified    |

※1 LF requirements prescribed in the Act on Special Measures Concerning Taxation Enforcement Order Article 22-10
※2 Timing is maximum of 45 or 60 days but will be set by the particular tax auditor
※3 The transactions that is excluded from contemporaneous documentation requirements can still be subject of a tax audit, and may be required to provide support for their transfer prices to the Japanese tax authority within 60 days upon a request
Transfer pricing documentation reform
An example – key dates for an ultimate parent entity and a Japanese taxpayer with a 31 December year end

- MF / CbCR: first year – year ending 31 December 2016
- LF (and PE TP documentation): first year – year ending 31 December 2017

<table>
<thead>
<tr>
<th>FYE Dec</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 2 3 4 5 6 7 8 9 10 11 12</td>
<td>1 2 3 4 5 6 7 8 9 10 11 12</td>
<td>1 2 3 4 5 6 7 8 9 10 11 12</td>
<td>1 2 3 4 5 6 7 8 9 10 11 12</td>
</tr>
<tr>
<td>Japan MF/CbCR</td>
<td>Submission of Notification</td>
<td>Submission deadline of CbC report</td>
<td>Contemporaneous reparation deadline of Local File</td>
<td></td>
</tr>
<tr>
<td>Japan LF</td>
<td>First fiscal year</td>
<td>First fiscal year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PE</td>
<td>First fiscal year</td>
<td>First fiscal year</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Implementation of transfer pricing documentations in other countries

<table>
<thead>
<tr>
<th>Country</th>
<th>For fiscal year beginning</th>
<th>No requirements</th>
<th>Existing regulations</th>
<th>First taxable year beginning 1 January 2016</th>
<th>Consistent with OECD</th>
<th>Generally consistent with OECD recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>United States</strong></td>
<td>1 July 2016 onwards</td>
<td>Consistent with OECD</td>
<td>No requirements</td>
<td>Consistent with OECD</td>
<td>First taxable year beginning 1 January 2016</td>
<td>Consistent with OECD</td>
</tr>
<tr>
<td><strong>Korea</strong></td>
<td>1 January 2016 onwards</td>
<td>Consistent with OECD</td>
<td>For fiscal year beginning 1 January 2016 onwards</td>
<td>Consistent with OECD</td>
<td>First taxable year beginning 1 January 2016</td>
<td>Consistent with OECD</td>
</tr>
<tr>
<td><strong>China</strong></td>
<td>1 January 2016 onwards</td>
<td>Consistent with OECD</td>
<td>For fiscal year beginning 1 January 2016 onwards</td>
<td>A China Master File needs to be prepared</td>
<td>First taxable year beginning 1 January 2016</td>
<td>Consistent with OECD</td>
</tr>
<tr>
<td><strong>India</strong></td>
<td>1 April 2016 onwards</td>
<td>Consistent with OECD</td>
<td>Announced but currently no requirement</td>
<td>A China Local Files needs to be prepared</td>
<td>Consistent with OECD</td>
<td>Generally consistent with OECD recommendations</td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td>1 January 2016 onwards</td>
<td>Consistent with OECD</td>
<td>For fiscal year beginning 1 January 2016 onwards</td>
<td>Consistent with OECD</td>
<td>First taxable year beginning 1 January 2016</td>
<td>Consistent with OECD</td>
</tr>
</tbody>
</table>

※1 Reporting under the secondary mechanism beginning 1 January 2017
Transfer pricing documentations reform
What’s the client doing in Japan

• Updating tax compliance calendar, workplace and data collection to reflect TP documentation requirements
• Centralization of local transfer pricing documentation preparation and management
  – Reduces inconsistency of information
  – Reduces cost
• Considerations for greater localization
  – Translation
  – Variations of content requirements
  – Differences in analytical approach
• Modularization of transfer pricing documentation
• Greater reliance on technology-enabled solutions
OECD BEPS Actions 8-10
Status in Japan

• Currently there have been no changes to Japanese laws or regulations resulting from Actions 8-10

• Nevertheless, NTA is expected to apply principles of Actions 8-10 in its transfer pricing audits. Examples include
  – Delineation of the actual transaction
  – Important functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles (DEMPE)
  – Valuation methods
2017 Japan Tax Reform
Part II
Additional corporate tax reforms
Revision of director compensation
Deductible compensation expanded, but with limited effect on foreign multinationals

Effective dates
- Revisions to retirement compensation, restricted stock compensation and stock options: applicable to compensation the payment or provision of which is to be resolved on or after 1 October 2017
- Other revisions: applicable to compensation the payment or provision of which is to be resolved on or after 1 April 2017
Small / medium sized enterprises (SMEs)
Reduced scope of companies eligible for certain SME benefits

Average income (average of income in three previous fiscal years) less than JPY 1.5 billion will also be a requirement for special measures

**Major taxation for SMEs***

<table>
<thead>
<tr>
<th>Corporate Tax Law</th>
<th>Special Taxation Measures Law</th>
<th>Extra tax credit</th>
<th>Preferential measures for SMEs*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Reduced tax rate (19%)</td>
<td>1. R&amp;D taxation</td>
<td>1. R&amp;D taxation</td>
<td></td>
</tr>
<tr>
<td>2. Allowance for bad debts</td>
<td>2. Wage increase incentive</td>
<td>2. Wage increase incentive</td>
<td></td>
</tr>
<tr>
<td>3. Net loss</td>
<td>3. Reduced tax rate (15%)</td>
<td>3. Reduced tax rate (15%)</td>
<td></td>
</tr>
<tr>
<td>4. Taxation on retained income</td>
<td>4. SME* investment incentive</td>
<td>4. SME* investment incentive</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5. Incentive for commerce, service and agriculture, forestry, fishery industry</td>
<td>5. Incentive for commerce, service and agriculture, forestry, fishery industry</td>
<td></td>
</tr>
<tr>
<td></td>
<td>6. Special measures for depreciable assets</td>
<td>6. Special measures for depreciable assets</td>
<td></td>
</tr>
</tbody>
</table>

* A “SME” is a company whose stated capital is JPY 100 million or less, and whose majority shares are not held by a large company (companies with stated capital of over JPY 100m) and 2/3 shares are not held by two or more large companies

Applicable to fiscal years beginning on or after **1 April 2019**
Revision to R&D tax credit
Technology driven services in scope for eligible R&D costs

Abolish incremental credit

Simplify certain procedures

Decide credit ratio depending on increase / decrease of gross R&D costs

Incremental credit

Special R&D credit (with universities, national research organization, etc.)

Gross-type credit

Below expenses for quaternary industries included in the scope of R&D costs for quaternary industries*

<table>
<thead>
<tr>
<th>Costs included</th>
<th>Targeted operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cost of materials</td>
<td>• Collecting large volumes of data with automated devices or technology</td>
</tr>
<tr>
<td>• Personnel expenses</td>
<td>• Specialist analysis of the collected data to find principles</td>
</tr>
<tr>
<td>• Administrative expenses</td>
<td>• Designing new services with the detected principles</td>
</tr>
<tr>
<td>• Outsourcing expenses</td>
<td>• Verification of the detected principles</td>
</tr>
<tr>
<td></td>
<td>• Reviewing the new designed services</td>
</tr>
</tbody>
</table>

* Examples for quaternary industries
  - Customizing / matching services using big data
  - Automatic operations (AI, Drone delivery system, etc.)
  - Designing new services using IoT sensor data

Expected to be applicable to fiscal years beginning on or after 1 April 2017
Inheritance tax
Inheritance / gift tax

• A new category of tax payer to be introduced for inheritance and gift taxes from 1 April 2017

• From 1 April 2017, individuals who are temporarily residing in Japan will only be subject to Japanese inheritance and gift tax on Japan sited assets provided the exchange is with another temporary resident or a foreign national outside of Japan

• An individual will be considered temporarily living in Japan if they have lived here for less than 10 out of the last 15 tax years and living in Japan under a visa covered by Table 1 of the Immigration Control and Refugee Recognition Act (Table 1 covers work type visas but not spouse / dependent of a Japanese national or permanent resident categories)

• The lookback period for Japanese nationals remaining within the scope of Japanese inheritance and gift taxes after leaving Japan will extend from 5 years to 10 years

• Foreign nationals who have left Japan will also now be covered by the lookback rules
## Inheritance / gift tax

Revised
Revision of tax liability for foreign assets

### Recipient / Heir

<table>
<thead>
<tr>
<th>Donor / Decedent</th>
<th>Domicile in Japan (Regardless of nationality)</th>
<th>No domicile in Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Domicile in Japan within 10 years (Currently 5 years)</td>
<td>Japanese nationality</td>
</tr>
<tr>
<td></td>
<td>No domicile in Japan within 10 years (Currently 5 years)</td>
<td>No Japanese nationality</td>
</tr>
</tbody>
</table>

### Domicile in Japan

<table>
<thead>
<tr>
<th>Domicile in Japan within 10 years (Currently 5 years)</th>
<th>Worldwide property taxable (Property in Japan and property overseas)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domicile in Japan within 10 years (Currently 5 years)</td>
<td>Revised</td>
</tr>
<tr>
<td>No domicile in Japan within 10 years (Currently 5 years)</td>
<td>Revised</td>
</tr>
</tbody>
</table>

### Worldwide property taxable

- Only property in Japan taxable

(*1) Only assets in Japan taxed if recipient temporarily stays in Japan (i.e., less than 10 out of last 15 years) with certain residence status

(*2) Excluding where recipient of gift or inheritance are non-Japanese nationals and temporarily stay in Japan

Applicable to inheritance / gift tax on assets acquired on or after 1 April 2017

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Tax treaty update
Tax treaty update

PPT introduced in most new treaties

Recently concluded treaties

- Belgium (amended)*
- Slovenia (new)*
- Latvia (new)*
- Chile (new)
- Austria (amended)*

* Assuming treaty ratified in 2017, effective on transactions from 1 Jan 2018

Treaties under negotiation

- Estonia
- Lithuania

Recent trends

BEPS driven anti-avoidance clauses

- Limitation on benefits (LOB)
- Principal purpose test (PPT)

Implementation of AOA

- Recognition of internal dealings between head office and PE

Reduction in WHT rates

- Dividends
- Interest
- Royalties

OECD multilateral convention on tax treaties

- Japan expected to sign, however no official announcement as of today
### Summary of recent updates in Japan’s treaty network

<table>
<thead>
<tr>
<th>WHT</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>Interest</td>
</tr>
<tr>
<td>Companies with certain ownership (minimum %)</td>
<td>Other</td>
</tr>
</tbody>
</table>

#### Belgium / Japan Tax Treaty

<table>
<thead>
<tr>
<th>Existing</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5% (25%, paid by Belgium)</td>
<td>15%</td>
<td>10%</td>
<td>10%</td>
<td>Exempt</td>
<td>N/A</td>
</tr>
<tr>
<td>10% (25%, paid by Japan)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amended</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0% (10%)</td>
<td>10%</td>
<td>0%</td>
<td>10%</td>
<td>0%</td>
<td>Exempt</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Recognized</td>
<td>LOB(^2) PPT(^3)</td>
</tr>
</tbody>
</table>

#### Slovenia / Japan Tax Treaty

<table>
<thead>
<tr>
<th>New</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
<td>Exempt</td>
<td>Recognized</td>
</tr>
</tbody>
</table>

#### Latvia / Japan Tax Treaty

<table>
<thead>
<tr>
<th>New</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0% (non-individuals)</td>
<td>10% (individuals)</td>
<td>0%</td>
<td>10%</td>
<td>0%</td>
<td>Exempt</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Recognized</td>
<td>LOB(^2) PPT(^3)</td>
</tr>
</tbody>
</table>

#### Chile / Japan Tax Treaty

<table>
<thead>
<tr>
<th>New</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5% (25%)</td>
<td>15%(^5)</td>
<td>4%</td>
<td>10%</td>
<td>2%(^4)</td>
<td>10%</td>
</tr>
</tbody>
</table>

- “Qualified interest” means with respect to Belgian interest paid and beneficially owned by enterprises, etc., with respect to Slovenia interest received by governments, etc., with respect to Latvia interest paid to persons other than individuals and not determined by reference to receipts, sales, income, profits, or other cash flow of the debtor; to any change in value of any property of the debtor, or to any dividends partnership distribution or similar payment made by the debtor or related person, and with respect to Chile interest paid to a financial institution or interest paid for indebtedness on credit sales of machinery and equipment.
- A “limitation on benefits” clause limits treaty benefits to residents that meet a series of objective criteria.
- The “principle purpose test” operates to deny treaty benefits if one of the principle purposes of a transaction was to obtain treaty benefits.
- Royalties for the right to use industrial, commercial or scientific equipment. Other royalties may be taxed up to 10%.
- Exempt for pension funds.

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Contact information

David Bickle
Tax Partner
Deloitte Tokyo, Japan
david.bickle@tohmatsu.co.jp

Brian Douglas
Tax Senior Manager
Deloitte Tokyo, Japan
brian.douglas@tohmatsu.co.jp

Sam Gordon
Tax Partner
Deloitte Tokyo, Japan
samuel.gordon@tohmatsu.co.jp

Ken Saga-Hardie
Tax Senior Manager
Deloitte Tokyo, Japan
ken.saga-hardie@tohmatsu.co.jp

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