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Japan – Tax Reform Includes Exit Tax on Wealthy Departing Individuals

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On 31 March 2015, the Diet, Japan's parliament, passed the 2015 Tax Reform Proposals[1] which had been agreed by the ruling coalition in Japan[2] at the end of December 2014. This tax reform plan includes the introduction of a so-called "exit tax" starting July 2015, which applies to the gains of certain residents moving out of Japan who have "financial assets" of JPY 100 million or more.

Why This Matters

From 1 July 2015, this will affect Japanese nationals who own a certain amount of financial assets.

As the exit tax will not apply to non-Japanese long-term residents in Japan after 1 July 2015, they need not take immediate actions. However, the exit tax may apply to some of them after 1 July 2020, and proper planning, such as the review of the individual's current visa status, would be helpful in terms of mitigating the exit tax in the future.

1. Exit Tax upon Departure from Japan

In order to prevent wealthy individuals from avoiding tax on capital gains in Japan by moving out of Japan with appreciated financial assets and subsequently selling those assets, a special measure (exit tax) to impose income tax on unrealized capital gains on financial assets at the time of departure has been introduced.

(1) Eligible person and eligible assets

Eligible person	A resident individual departing from Japan(*1) and satisfying both of the following conditions: (a) Total amount of the following is JPY100 million or more: − The value of eligible assets in (i) below held by the person as of departure from Japan − Profits/losses to be derived from deemed settlements of eligible assets in (ii) below as of departure from Japan. (b) The person has lived in Japan(*2) for more than 5 years in the last 10 years before departure.	
Eligible assets	(i)	-- Securities stipulated in the Income Tax Law -- Contributions under a Tokumei-Kumiai agreement
	(ii)	-- Unsettled derivatives transactions -- Unsettled margin transactions -- Unsettled when-issued transactions (e.g., trading transactions in advance of shares being issued)

(*1) 'Departing from Japan' means to cease to have either domicile or residence in Japan.

(*2) The period of living in Japan includes the grace period described in (5)(ii) below, but excludes the period of staying in Japan with a status of residence under Table 1 of the Immigration Control and Refugee Recognition Act. Furthermore, the period of staying in Japan before 1 July 2015, with a status of residence under Table 2 of the above Act is also excluded from the period of living in Japan as a transitional measure.

As a consequence, the exit tax will not apply to foreign expatriate employees staying in Japan with working visas, such as an intra-company transferee or engineer/specialist in humanities/international services under 2 of Table 1. While a foreign person staying in Japan with a status of residence as under Table 2 (e.g., permanent resident, spouse or child of Japanese national) could be an eligible person, he or she will not be subject to the exit tax until 1 July 2020, by virtue of the transitional measure.

Status of Residence under the Immigration Control and Refugee Recognition Act

Table 1	1	Diplomat, Official, Professor, Artist, Religious Activities, Journalist
	2	Highly Skilled Professional, Business Manager, Legal/Accounting Services, Medical Services, Researcher, Instructor, Engineer/Specialist in Humanities/International Services, Intra-company Transferee, Entertainer, Skilled Labor, Technical Intern Training
	3	Cultural Activities, Temporary Visitor
	4	Student, Trainee, Dependent
	5	Designated Activities
Table 2	Permanent Resident, Spouse or Child of Japanese National, Spouse or Child of Permanent Resident, Long-Term Resident	

(Status of residence under Table 1 was amended from 1 April 2015. The above table reflects such amendments.)

(2) Calculation of Taxable Income

Taxable income (business income, capital gains or miscellaneous income) will be calculated assuming that capital gains/losses on eligible assets were realized at the time of departure from Japan at the following value depending on the case described below/on the following page.

Cases	Value of the eligible assets as of departure
• In cases where a notification for appointment of a tax agent is submitted prior to the filing due date of the final income tax return for the year of departure • In cases where the final income tax return for the year of departure is filed on or after the date of departure without appointing a tax agent • Where a determination is made with respect to the income tax for the year of departure	• The value (or profits/losses to be derived from deemed settlements) of eligible assets as of departure
• Other than the above	• The value (or profits/losses to be derived from deemed settlements) of the eligible assets as of the day 3 months before the departure (or as of the acquisition date if the eligible assets are acquired after that day)

Note that condition (i) of the eligible person discussed in (1) will also be determined using the above value depending on the case.

(3) Applicable Tax Rate

The unrealized capital gains will be taxed at 15.315 percent (including special reconstruction income tax) in principle. (Local inhabitant taxes will not be imposed.)

(4) Filing Tax Returns and Tax Payments

The eligible person will be required to file his or her final income tax return to declare unrealized capital gains on eligible assets together with the other income earned in the year of departure and pay income tax by the due dates as shown in the table below/on the next page.

	Filing due dates	Payment due dates
In cases where a notification for appointment of a tax agent is submitted prior to the departure	15 March of the following year	Where collateral is provided by the filing due date: - Grace period for tax payments is applicable (please see (5)(i)-(iv)) Other than the above: -- 15 March of the following year
Other than the above	Date of departure	Date of departure

(5) Main Points to be Considered

The main points to be considered for the measure are as follows:

(i) In the case of returning to Japan within five years from departure

- Where an individual who was subject to exit tax returns to Japan within five years from the departure, the exit tax on unsold eligible assets will be reversed by filing a request for correction.
- When the grace period (please see (ii) below) is extended to 10 years and the person returns to Japan within 10 years from departure, the above treatment will also be applied.

(ii) Grace period for tax payments

An individual subject to the exit tax will be allowed to enjoy a tax payment grace period for five years (subject to extension, upon an application, of up to 10 years) only when all of the following conditions are met:

- The individual must make an application for the grace period in, and attach certain details to, the final income tax return for the year of the departure.
- The individual must provide collateral equivalent to the amount of the exit tax subject to the grace period prior to the filing due date of the final income tax return for the year of the departure.
- The individual must submit a notification for appointment of a tax agent prior to the departure.

The income tax liability subject to the grace period will be (a) less (b):

(a) Income tax liability for the year of departure;

(b) Income tax liability for the year of departure calculated on the assumption that the exit tax was not imposed.

An individual enjoying the grace period will be required to submit a notification for the eligible assets subject to the grace period held as of 31 December of each year to the competent tax office by 15 March of the following year.

If the notification is not submitted in time, the grace period will be terminated on the day that falls four months after the filing due date.

(iii) In cases where the eligible assets are sold prior to the expiration of the grace period

- The amount of exit tax corresponding to the eligible assets sold within the grace period should be paid within four months after the sale.
- Interest tax corresponding to the grace period should also be paid.
- If the selling price of the eligible assets falls below the value of the assets as of the departure, the exit tax will be reduced by filing a request for correction.
- When foreign income tax is imposed on capital gains on the eligible assets and the double taxation is not eliminated in the foreign country, the foreign tax credits will be applicable in Japan by filing a request for correction assuming that the foreign income tax was paid in the year of departure.

(iv) Termination of grace period

- The amount of the exit tax liability should be paid at the end of the grace period.
- Interest tax corresponding to the grace period should also be paid.
- If the value of the eligible assets at the date of the termination falls below the value of the assets as of departure, the exit tax will be reduced by filing a request for correction.

(6) Timing of Application

The above new rules discussed in 1 ("Exit Tax upon Departure from Japan") will be applied when eligible persons depart from Japan on or after 1 July 2015.

2. Exit Tax in Cases of Gift, Inheritance or Bequest

In cases where the appreciated financial assets are transferred to a nonresident individual by gift, inheritance, or bequest, the exit tax will also be applied with the assumption that the unrealized capital gains/losses on those assets were realized at the time that the gift, inheritance, or bequest occurs.

This exit tax will be imposed when eligible persons' eligible assets are transferred to nonresident individuals upon a gift, inheritance, or bequest on or after 1 July 2015.

3. Special Measure for Foreign Exit Tax

When a resident individual who already paid a foreign exit tax on his or her eligible assets sells the eligible assets, the double taxation on the eligible assets will be eliminated by increasing the acquisition cost of the eligible assets for Japanese tax purposes to the value that was subject to the foreign exit tax.

This special measure for foreign exit tax will be applicable when events equivalent to events subject to exit tax in Japan occur in foreign countries on or after 1 July 2015.

4. Statute of Limitation

The statute of limitations for reassessment/determination of individual income tax by the tax office is five years in principle. When the exit tax regime (discussed in 1. and 2. above) is applied (excluding certain cases, e.g., where both a tax agent and a tax representative are appointed), the statute of limitations will be extended to seven years.

This amendment will become effective on 1 July 2015.

KPMG Note

More details of the enforcement plans for the exit tax will be unveiled in the subsequent cabinet orders and ministerial ordinances.

Footnotes:

1 For an English-language version of the tax reform plan from Japan's Ministry of Finance, see: http://www.mof.go.jp/english/tax_policy/tax_reform/fy2015/tax2015a.pdf .

2 The Liberal Democratic Party and KOMEITO.

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The information contained in this newsletter was submitted by the KPMG International member firm in Japan. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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