Tax Reform in FY 2018

Key FSA-related Items in the Outline
for the FY 2018 Tax Reform

December 2017

Financial Services Agency

1. Toward Stable Household Asset Building

◆ Allowing investors to purchase financial instruments on the same day as their application for the opening of a NISA account (Financial Services Agency)

[Background and Issues]

○ Since NISA (Nippon Individual Savings Account) was launched, steady growth has been observed in the number of account openings and the purchase value that reached 10.9 million and approx. 11.2 trillion yen, respectively (as of June 30, 2017).

○ Meanwhile, quite a few NISA users never purchase financial instruments after the opening of the NISA account. Necessary measures should be taken to encourage users to invest more actively.

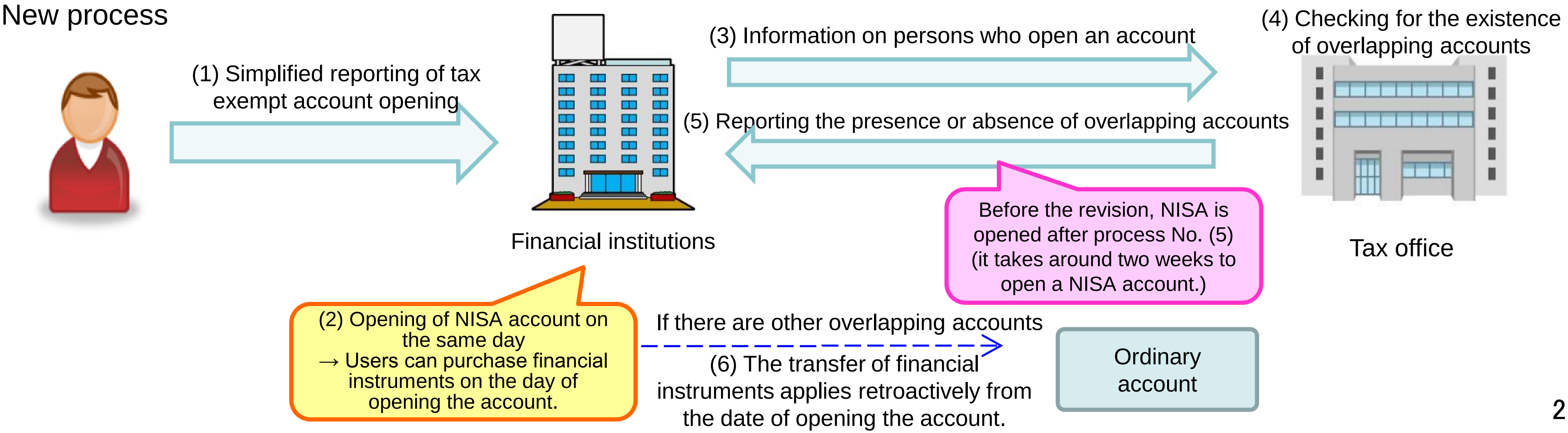
○ One of the reasons for this is that users cannot purchase financial instruments on the same day as the application for the opening of a NISA account is received (since it is necessary to ensure that there are not any other overlapping accounts). Users do not come back to the financial institutions, losing their appetite for investment.

[Outline for the FY 2018 Tax Reform]

○ Users will be able to open a NISA account immediately and purchase financial instruments on the same day.

- A simplified reporting system will be introduced to enable users to open a NISA account before the tax office ensures that there are not any other overlapping accounts.
- The tax office will subsequently check that there are not any other overlapping accounts and reports the results to financial institutions. If there are overlapping accounts, the financial institutions will transfer the financial instruments purchased in the NISA account to an ordinary account, retroactively from the date of opening the account.

New process



◆ Treatment of financial instruments in the NISA account after its nontaxable period is over (Financial Services Agency)

[Background and Issues]

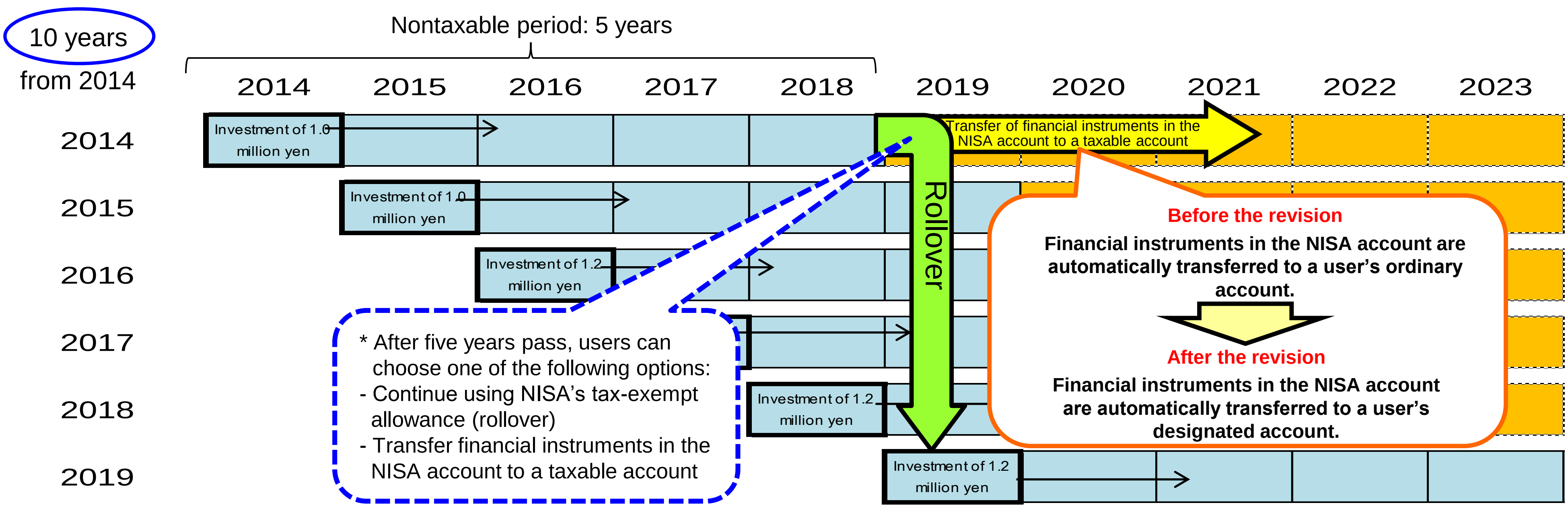
○ In case of the ordinary NISA, users can continue investment using the tax-exempt allowance after the nontaxable period of NISA is over (five years from the initial purchase) (rollover). If users do not choose the rollover, the financial instruments they own will be transferred to their taxable accounts. There are two types of taxable accounts: an ordinary account and a designated account (*). Under the current system, unless users instruct otherwise, financial instruments are transferred to an ordinary account (the same for the Dollar-Cost Averaging-NISA, etc.)

(*) Ordinary account: Users need to prepare an annual statement of transactions and file a tax return.
Designated account: Financial institutions prepare an annual statement of transactions and withhold tax at source (users can choose the final tax return method instead of withholding at source).

(*) Around 75% of all taxable accounts (with balances) are designated accounts. Furthermore, financial instruments deposited in the ordinary account cannot be transferred to the designated account afterwards.

[Outline for the FY 2018 Tax Reform]

○ If users have their designated accounts in the same financial institution, their financial instruments deposited in the NISA account after the expiration of the tax-exempt period will be transferred to their designated account without any special procedures. (If users separately instruct, their financial instruments can be transferred to their ordinary account.)



◆ Elimination of international double taxation on publicly offered investment trusts, etc. in Japan and overseas

(The Financial Services Agency is the main requesting agency. The Ministry of Land, Infrastructure, Transport and Tourism jointly requests this measure.)

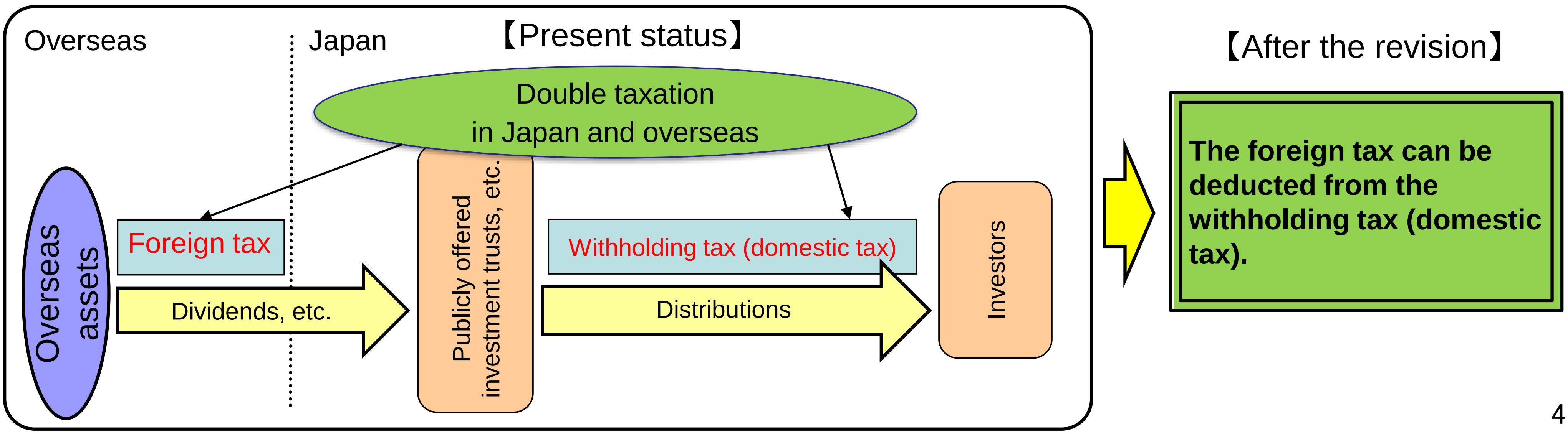
[Background and Issues]

○ If publicly offered investment trusts, etc. invest in overseas assets, tax is levied on dividends, etc. gained from the overseas assets (foreign tax). When such publicly offered investment trusts, etc. distribute profit to investors in Japan, withholding tax is imposed on distributions in Japan. Since there is no system to deduct the above mentioned foreign tax, tax is levied on dividends, etc. both in Japan and overseas.

○ Foreign countries have taken necessary measures to prevent such international double taxation. They allow investors to deduct the foreign tax paid through publicly offered investment trusts, etc. from income tax.

[Outline for the FY 2018 Tax Reform]

○ Adjustment measures that allow investors to deduct the foreign tax paid through publicly offered investment trusts, etc. from the withholding tax on distributions of the relevant publicly offered investment trusts, etc. shall be taken to eliminate double taxation inside and outside of the country.



◆ Unification of financial income taxation (Expansion of scope of profit/loss offset for financial instruments)

(The Financial Services Agency is the main requesting agency. The Ministry of Agriculture, Forestry and Fisheries and the Ministry of Economy, Trade and Industry jointly requests this measure)

[Background and Issues]

○ The scope of profit/loss offset between financial instruments was expanded to specified government or company bonds, etc. in addition to listed stocks and publicly offered investment trusts (implemented in January).

○ The scope is yet to be expanded to derivatives transactions and deposits.

[Outline for the FY 2018 Tax Reform (issue to be examined)]

○ Further unification of taxation on financial income including income from derivatives transactions should be considered on the viewpoint that it will contribute to estabilish a "Comprehensive Exchange" that handles all instruments including securities, derivatives, and commodities as well as that it will create an environment that facilitates investment in various financial instruments. Also, the necessity for effective measures to prevent intended tax avoidance activities by using diversified schemes should be taken into account.

Taxation Methods for Financial Instruments

	Income gains	Capital gains/losses
Listed stocks and publicly offered investment trusts	Separate self-assessment taxation	Separate self-assessment taxation
Specified government or company bonds, and publicly offered bond investment trusts	From January 2016 Separate withholding taxation → Separate self-assessment taxation	From January 2016 Tax exempt → Separate self-assessment taxation
Derivatives transactions	Separate self-assessment taxation	
Bank deposits, etc.	Separate withholding taxation	—

The scope in which profit/loss can be offset.

2. Responses to Financial Globalization

◆ Measures required for controlled foreign company (CFC) taxation (Financial Services Agency)

[Background and Issues]

○ Controlled Foreign Company Taxation (“CFC taxation”) is a taxation system to address tax avoidance (through which the income of a domestic parent company is transferred to offshore subsidiaries that do not conduct substantial business activity) by taxing the income of such offshore subsidiaries with the income of domestic parent company.

○ Under the FY 2017 Tax Reform, the CFC taxation was revised to enhance Japanese companies’ overseas expansion as well as to help the tax authority effectively cope with tax avoidance. However, considering the actual status of various businesses overseas, further consideration is necessary for this year regarding the treatment of some operations of financial institutions.

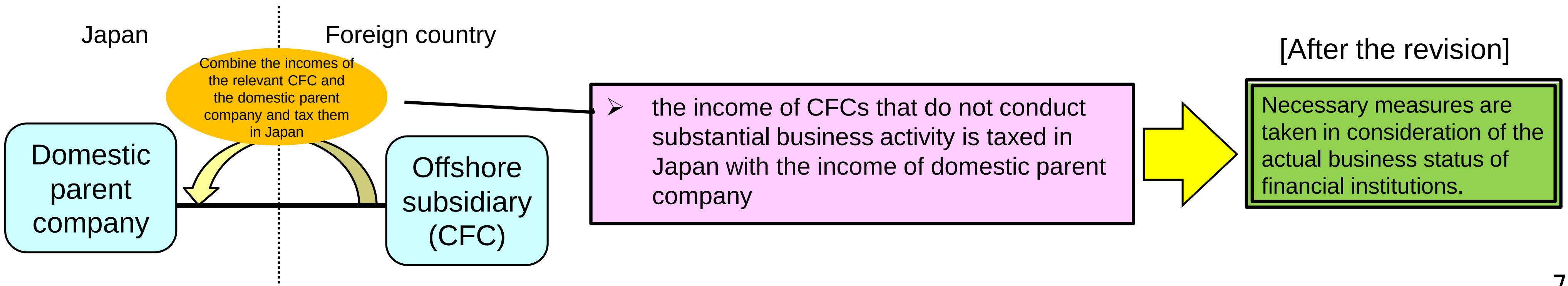
* For example, in some cases, the income of overseas financial holding companies is subject to the CFC taxation due to the foreign government’s investment restrictions, although they do not have any intention of tax avoidance. Necessary measures should be taken for such cases.

[Outline for the FY 2018 Tax Reform]

○ If an overseas financial holding company cannot own 50% or more shares due to the investment restrictions of the country in which it is located, necessary measures will be taken for the company so as not to be taxed under the CFC taxation.

○ For companies which operate in the UK Lloyd’s market, etc., special measures will be taken regarding the requirements to be a “foreign financial subsidiary”, etc.

Outline of the CFC Rules



◆ Perpetuation or extension of the taxation exemption of interest on margin for OTC derivatives transactions
(Financial Services Agency)

[Background and Issues]

○ In OTC derivatives transactions conducted between financial institutions, interest is normally levied on the margin deposited.

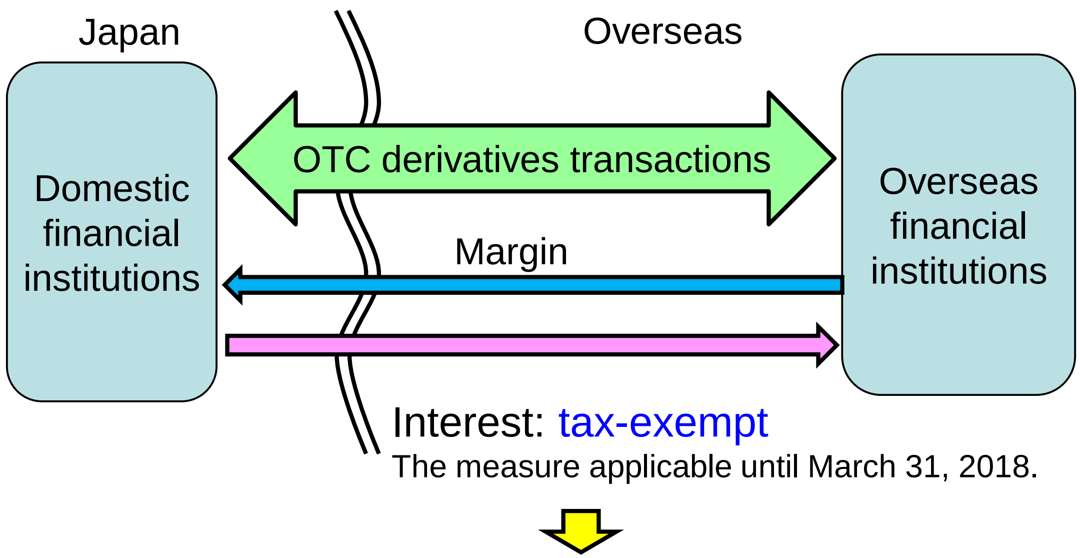
○ The interest was subject to withholding income tax in Japan, while the tax is not withheld at source in foreign countries.

○ To treat domestic financial institutions on an equal footing with the overseas financial institutions, the measure to exempt taxation on interest on margin that foreign financial institutions deposit with the domestic financial institutions was introduced in the FY 2015 tax reform. However, the measure is expired on March 31, 2018.

[Outline for the FY 2018 Tax Reform]

○ The measure to exempt tax on interest on margin for OTC derivatives transactions will be extended by three years (until March 31, 2021).

[Present]



[After the revision]

The validity of the measure will be extended until March 31, 2021.

3. Other Key Items

◆ Enhancement of Deduction of Life Insurance Premiums

[Background and Issues]

○ Under the deduction of life insurance premiums system, a certain amount of life insurance premium paid can be deducted from income for the purpose of calculating the amount of income tax and inhabitant tax.

○ From the viewpoint of improving the environment, for self-help and self-sustainability of citizens, it is necessary to enhance the deduction for life insurance premiums system in light of the revisions to the social security systems.

[Outline for the FY 2018 Tax Reform]

○ “As to the ideal systems relating to corporate pensions, private pensions, savings and investment, insurance, etc. to support self-help efforts to mitigate risks including those related to post-retirement life, wide-ranging examination should be conducted from the perspective of complementing the social security system as well as establishing a fair system that gives rise to no advantage or disadvantage stemming from the difference of working styles.”

Present System

Insurance contracts concluded by the end of December 2011		Insurance contracts concluded in January 2012 and thereafter		
Deduction of life insurance premium	Deduction for individual annuity insurance premiums	Deduction for general life insurance premium	Deduction for Long-term Care and Medical Insurance Premiums	Deduction of individual annuity insurance premium
[maximum exemptions and deductions from income] Income tax: ¥100,000; Local tax: ¥70,000		[maximum exemptions and deductions from income] Income tax: ¥120,000; Local tax: ¥70,000		
Income tax: ¥50,000 Local tax: ¥35,000	+ Income tax: ¥50,000 Local tax: ¥35,000	Income tax: ¥40,000 Local tax: ¥28,000	+ Income tax: ¥40,000 Local tax: ¥28,000	+ Income tax: ¥40,000 Local tax: ¥28,000

Requested System

Requests		
Deduction for general life insurance premiums	Deduction for Long-term Care and Medical Insurance Premiums	Deduction for individual annuity insurance premiums
[maximum exemption and deduntions from income] Income tax: ¥150,000; Local tax: ¥70,000		
Income tax: ¥50,000 Local tax: ¥35,000	+ Income tax: ¥50,000 Local tax: ¥35,000	+ Income tax: ¥50,000 Local tax: ¥35,000

4. Other Requests

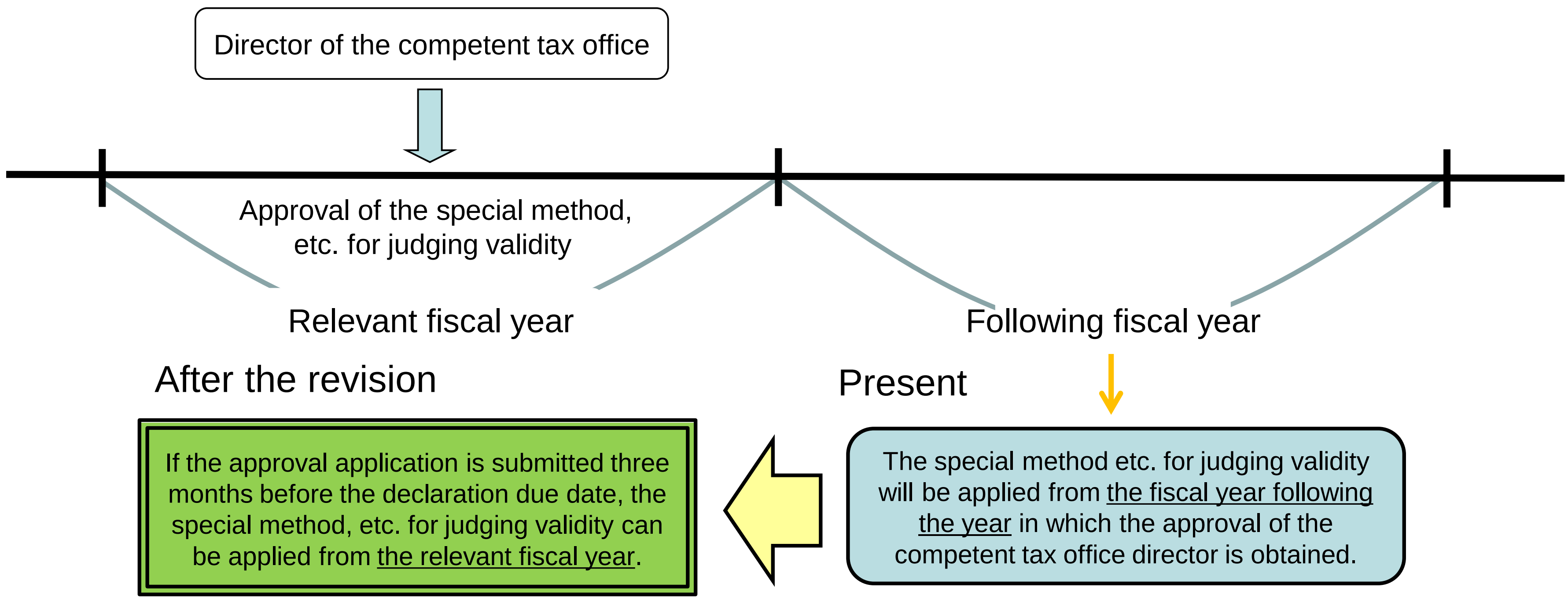
◆ Review of the application start date of the special method, etc. for judging validity in the hedge process
(Financial Services Agency)

[Background and Issues]

- On the condition of the approval of the competent tax office director, enterprises (financial institutions, etc.) that always conduct many derivatives transactions, etc. are permitted to use “the special method, etc. for judging validity,” the criteria for eligibility for the hedge process on tax treatment.
- However, the special method etc. will be applied from the fiscal year following the year in which the approval of the competent tax office director is obtained. This does not suit the situation of corporate activity that requires immediate risk management actions.

[Outline for the FY 2018 Tax Reform]

- The submission due date of the approval application shall be set at “three months before the declaration due date for the initial fiscal year an enterprise seeks the application” so that the special method, etc. for judging validity can be applied from the relevant fiscal year.



◆ Clarification, etc. of the treatment of consumption tax in the transfer of foreign securities, etc. (Financial Services Agency)

[Background and Issues]

○ Under the Consumption Tax Act, the treatment of consumption tax in respect of the transfer of assets shall in principle be determined according to the location of the relevant assets. It is pointed out that the criteria for determining either domestic or foreign transactions regarding the transfer of dematerialized foreign securities, etc. are unclear.

(Note) If the transfer of dematerialized foreign securities, etc. is treated as a domestic transaction (nontaxable sales), there is a possibility that input tax credit will decrease (the ratio of taxable sales will decline), causing the payment of consumption tax to increase.

[Outline for the FY 2018 Tax Reform]

○ The treatment of consumption tax in respect to dematerialized securities, etc. handled by book-entry institutions or similar foreign organizations ("book-entry institutions, etc.") shall be determined according to the location of the book-entry institutions, etc.

○ The treatment of consumption tax in respect to dematerialized securities, etc. other than the above shall be determined according to the location of the head office or main office, and equivalent to the aforementioned offices of the corporations in respect to the relevant securities, etc.

Categorization of consumption tax by the type of transactions

Domestic transactions (subject to taxation)	Foreign transactions (not subject to taxation)
Taxable sales (Commissions, etc.)	No taxes imposed
Nontaxable sales (Interest, consideration for the transfer of securities, etc.)	
Transfer of dematerialized foreign securities, etc.	Transfer of dematerialized foreign securities, etc.

Present

It is pointed out that the criteria for determining either domestic or foreign transactions regarding the transfer of dematerialized foreign securities are unclear.

After the revision

If book-entry institutions, etc. exist outside Japan, the transfer of foreign securities, etc. shall be treated as foreign transactions (no taxes imposed).

◆ Digitization of procedures for deducting life insurance premiums and housing loans, etc.

(The Financial Services Agency is the main requesting agency. The Ministry of Finance jointly requests this measure.)

[Background and Issues]

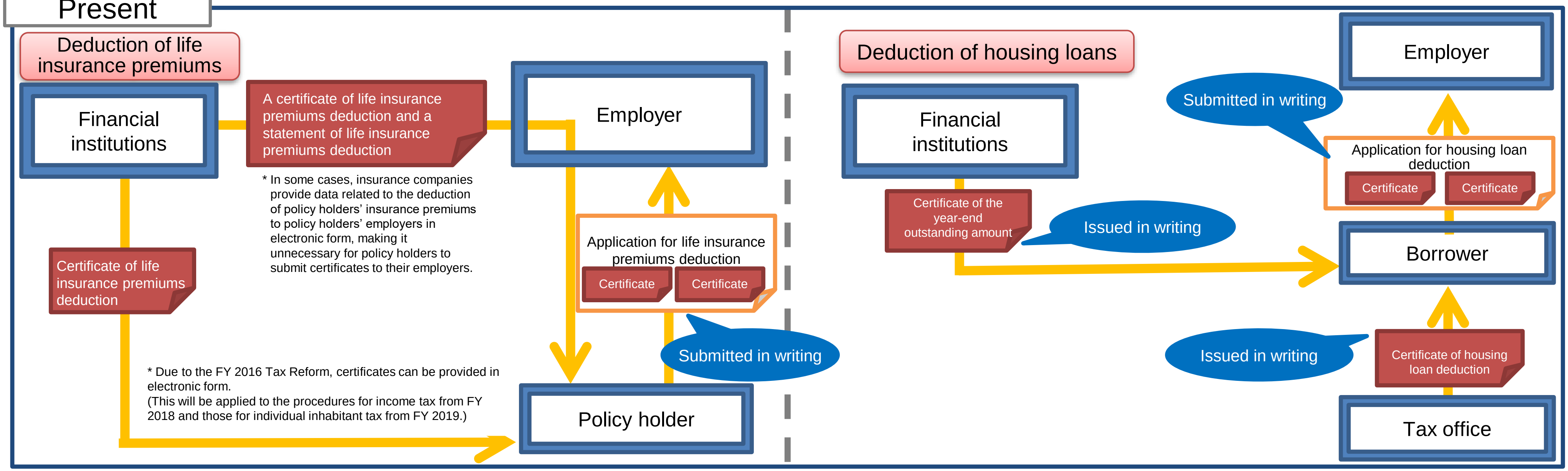
○ The procedures for deducting life insurance premiums and housing loans, etc. (the issuance of certificates by financial institutions to policy holders and borrowers and submission of documents to employers by policy holders and borrowers, etc.) are made by means of documents.

[Outline for the FY 2018 Tax Reform]

○ Certificates issued by financial institutions to policy holders or borrowers will be provided in electronic form (the issuance can be continuously made by means of documents).

○ Applications and certificates submitted by policy holders or borrowers to employers will be provided in electronic form (the submission can be continuously made by means of documents).

Present



After the revision

The issuance and submission of documents (the above marked documents that are presently provided by means of documents) can be also made in electronic form.

◆ Simplification of procedures for the use of Individual Number (Financial Services Agency)

[Background and Issues]

○ When submitting a notice on changes or removal of brokerage accounts, investors are required to provide their individual numbers (unchanged) in addition to their old names and addresses.

[Outline for the FY 2018 Tax Reform]

○ When changing their name and address of their brokerage accounts, etc., investors do not need to provide their individual number, if they show documents that contain their name and address (both old and new name and address).

Investor
(who has already informed his individual number)

Name

Address

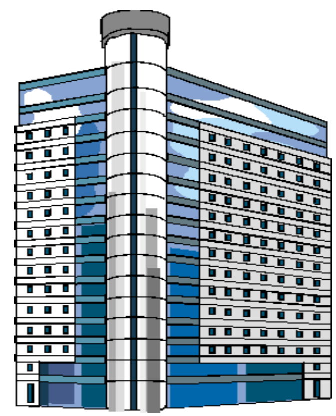
Individual number

Name and address are changed

A notice of changes and a notice of removal are submitted.

Before the revision: Investors are required to provide their individual number (unchanged).

After the revision: Investors <u>do not need to provide their individual number (unchanged)</u> by showing documents that contain their name and address (both old and new name and address).



Stockbroker firms, etc.

◆ Revision of international taxation related to inheritance and gift taxes (Financial Services Agency)

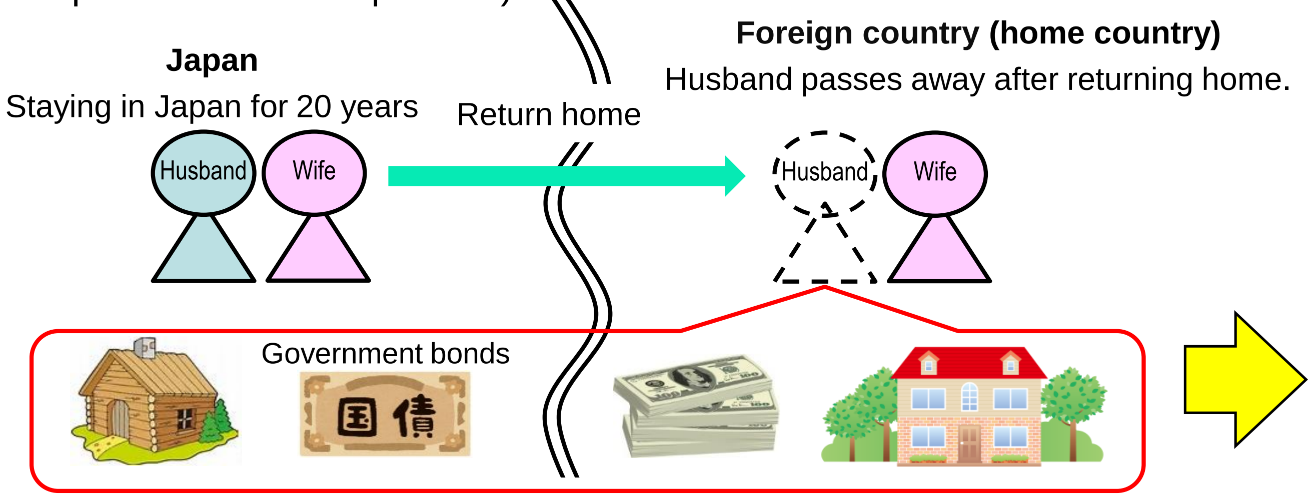
[Background and Issues]

- Under the FY 2017 Tax Reform, Japan's inheritance and gift taxes for short-term foreign residents (staying in Japan for 10 years or less within 15 years) was revised from the viewpoint of attracting more highly-skilled professionals to the country. The subject of the inheritance tax for them was narrowed to assets located in Japan rather than worldwide.
- In addition to the above, to prevent people from avoiding tax through relocating outside Japan, when inheritance occurs between long-term foreign residents (staying in Japan for more than 10 years within 15 years), inheritance and gift taxes are imposed on all their assets worldwide for up to five years after they depart Japan (only assets located in Japan were taxable before the revision).
- Therefore, there are growing concerns that inheritance and gift taxes will be imposed both in Japan and the home country after departing Japan (international double taxation).

[Outline for the FY 2018 Tax Reform]

- If inheritance and gift occur after long-term foreign residents depart from Japan, only assets located in Japan will be taxed in general, except the case where such gift is made after they temporarily relocate outside Japan.

[Present](Example of a matter in question)



All assets (not only in Japan but also in foreign countries) are taxable regardless of their location

[After the revision]

If inheritance and/or gift occur between foreigners after their departure from Japan, only assets located in Japan are taxable in general.