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Japan: Inbound Tax Alert

Japan - UK Tax Convention - Announcement

November 2014, No. 9

On November 12, 2014, the governments of Japan and the UK exchanged diplomatic notes to amend their income tax treaty ("Current Treaty"). Following the exchange, the updated income tax treaty ("Updated Treaty") will enter into force on December 12, 2014.

Date of Application

For Japanese tax purposes:

- The provisions concerning taxes withheld at source are applicable for **amounts taxable on or after 1 January 2015.**
- The provisions concerning taxes on income which are not withheld at source are applicable for **tax years beginning on or after 1 January 2015.**[1]

Significant Updates[2]

The Updated Treaty:

- Reduces the ownership requirement from 50% to 10% for exemption on dividend withholding tax for qualified taxpayers.
- Introduces an interest withholding tax exemption to all qualified taxpayers (previously the exemption was only available to financial and government institutions).
- Removes the requirement that capital gains on the sale of shares must be "subject to tax" in the UK in order to obtain an exemption from taxation in Japan.
- Amends the Business Profits article language to require recognition of internal dealings (i.e. transactions between a permanent establishment in Japan and other parts of the enterprise).
- Introduces mandatory binding arbitration for mutual agreement procedure cases.
- Clarifies the definition of an "Equivalent Beneficiary" in the Limitation on Benefits ("LOB") article.[3]

Deloitte's view

With the entering into force of the Updated Treaty, taxpayers in the UK and in other jurisdictions may want to reconsider investment opportunities in Japan through the UK as the tax costs for qualified taxpayers should be reduced due to favorable revisions.

Certain taxpayers currently claim reduced withholding tax in relation to certain income (e.g. interest income), which does not require the satisfaction of the LOB article. However, under the Updated Treaty the withholding tax exemption is only available if the LOB is satisfied. Conversely, if the LOB criteria is not met, the exemption is not available, and as there is no longer a reduced rate, such taxpayers will have to pay the domestic withholding tax rate of 20.42% (a 10% rate may still be available for certain dividends). So for these taxpayers the withholding tax may actually increase. It is recommended that such taxpayers review the conditions in the LOB article and discuss with their tax advisors.

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1 The amendments to the Business Profits article shall be applicable at a later date to be agreed between both governments through another exchange of diplomatic notes. Until then, the provisions under the Current Treaty will continue to apply.

2 For further details regarding significant updates, please see our January 2014, No. 1 issue tax alert.

3 The Current Treaty requires a person to be a resident of jurisdiction that has a double tax treaty with Japan and the benefits being claimed must meet the following condition (among others) for such person to be considered an "Equivalent Beneficiary" : "…with respect to an item of income… that resident would be entitled under that convention to a rate of tax … for which the benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention, under conditions in that convention which are no less restrictive than those in this Convention;…" The underlined phrase has caused some confusion among taxpayers regarding whether certain owners (especially, those resident in the U.S.) of a UK company can be considered an "Equivalent Beneficiary". However, this language is deleted in the Updated Treaty.

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