

Japan: Inbound Tax Alert

Japan's Inheritance Tax – A Reminder

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Japan's Inheritance Tax: What has happened and what requires your attention

Under the 2013 tax reform, Japan's inheritance and gift tax law was amended with effect for bequests or gifts made on or after 1 April 2013 to increase the scope of gifts or inheritance that could be captured by the rules and subject to tax. As a result of the reform, now, non-Japanese nationals living outside of Japan could be subject to Japan's inheritance and gift tax (including a tax filing requirement) if a bequest or gift of property located outside of Japan is made to them by a person whose domicile is in Japan.

This change expands the scope of Japan's inheritance and gift tax law to limit the effectiveness of planning involving the recipient or heir leaving and becoming a non-resident of Japan. In addition, changes to the inheritance basic exemption effective on 1 January 2015 and increases to the inheritance/gift tax rates could increase the potential inheritance and gift tax exposure.

For purposes of the Inheritance and Gift Tax Law, a domicile generally is defined as the base of one's living, which is determined based on the objective facts (a person generally cannot have more than one domicile). Facts that may play a role in determining whether a domicile exists for these purposes include: (1) whether permanent residency has been granted, (2) whether the person is residing in Japan, (3) the presence of family in Japan, (4) the presence of property in Japan, (5) employment in Japan, etc. Therefore, a foreign national residing in Japan or being employed in Japan for even a short period of time could inadvertently create a domicile and subject their heirs to the tax if a bequest or gift is made.

In addition to the expanded scope of the inheritance and gift taxes, there has also been an extension in the reporting requirements of overseas assets (which also became effective in January 2014), and further changes effective from January 2015, which apply additional penalties for income underreported on foreign assets not disclosed. The Japanese tax authorities may use these foreign asset disclosures to identify bequests or gifts that should be subject to tax in Japan. Table 1 below summarizes the relevant recent changes.

Table 1: Primary changes to the inheritance and gift taxes under the 2013 tax reform

Changes	Status
1. Revision of the definition of taxpayers of the inheritance / gift taxes	Current (effective from 1 April 2013)
2. Revision of the scope of reporting of overseas assets	Current (effective from 1 January 2014)
3. Reduction in the basic exemption of the inheritance tax	Current (effective from 1 January 2015)
4. Adjustment of the tax rate schedule of the inheritance / gift taxes	Current (effective from 1 January 2015)

Change in the definition of inheritance / gift taxpayers

Broadly, Japan's inheritance and gift tax laws seek to tax the person receiving the inheritance or gift, rather than the person or estate making the bequest or gift. Prior to the April 2013 changes, recipients with no connection to Japan (i.e., non-Japanese nationals with domicile outside of Japan) receiving assets with a situs outside of Japan were not within the scope of the Japanese rules.

Following the April 2013 changes, such recipients could potentially be subject to Japanese gift or inheritance tax on the receipt of property located outside of Japan if it was received from a person with a domicile in Japan. That is, after the changes, foreign nationals coming to Japan could potentially subject their non-Japanese beneficiaries to Japanese inheritance tax on not only Japanese assets in their estate, but all other assets as well.

Table 2 shows the current scope of taxation of property covered by the rules with the new scope of property subject to tax shown in green.

Table 2: Scope of inheritance and gift taxes in Japan after 1 April 2013

Person receiving inheritance / gift		Domicile in Japan	Domicile outside Japan		
			Japanese nationality		No Japanese nationality
			Domicile in Japan within five years	No domicile in Japan within five years	
Domicile in Japan					April 2013 Changes
No domicile in Japan	Domicile in Japan within five years	<ul style="list-style-type: none"> Property inside Japan Property outside Japan 			
	No domicile in Japan within five years			<ul style="list-style-type: none"> Property inside Japan only 	

Tax Rate Increase and Basic Exemption Decrease

In addition to expanding the scope of taxpayers subject to Japan's inheritance and gift tax, the marginal inheritance tax rates have increased with the top rate increasing from 50% to 55%. The fixed and variable basic exemptions for inheritance tax (an inheritance tax credit) have also been reduced effective 1 January 2015. As a result, the threshold for being subject to Japan's inheritance tax has been lowered from an inheritance tax of JPY50M plus JPY10M per legal heir to JPY30M plus JPY6M per legal heir.

Implementation of Exit Tax (under 2015 tax reform)

If an individual who satisfies the following conditions transfers securities or investments to his or her foreign resident children or grandchildren through inheritance or gift, unrealized capital gains on these securities and investments will be taxed at 15.315% (exit tax) while inheritance tax or gift tax is also levied; (i) the individual has held an address or domicile in Japan for more than five years (excluding the period during which the individual has certain residency status) within the past ten years preceding the date of inheritance or gift on or after 1 July 2015 and (ii) the individual holds securities and investments **worth JPY100M or more**.



Deloitte's View

The expansion of the rules described above can give rise to various negative scenarios, including:

- The foreign beneficiary would likely have a Japanese tax return filing requirement and a requirement (if a taxable transfer) to pay Japanese tax, from potentially illiquid assets.
- To claim relief from double taxation (e.g., through a foreign tax credit in Japan or a foreign country), the foreign beneficiary may need to undertake complicated and lengthy procedures for relief, and tax may be assessed up-front, leaving little of the bequest or gift remaining to fund such procedure.

Given these potentially costly outcomes, combined with an increase in inheritance tax rates and a reduction in inheritance tax exemption amounts, we recommend that foreign nationals contemplating an assignment in Japan carefully consider with a view to possible inheritance or gift taking place during the stay in Japan whether they will establish a domicile prior to coming to Japan and foreign nationals already in Japan consider whether their current foreign estate tax planning sufficiently addresses the added risks of the application of this new rule.

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