Japan Inbound Tax & Legal Newsletter

Japan-US Tax Treaty 2013 Protocol: Entry into Force

August 2019, No. 42

In Brief

In an effort to strengthen the bilateral economic relationship and promote cross-border investment, Japan and the US signed a protocol to amend the 2003 income tax treaty between the two countries on 25 January 2013. The 2013 protocol introduces a number of changes to the treaty, such as a general withholding tax exemption for interest, a broader withholding tax exemption for certain dividends, mandatory binding arbitration under the mutual agreement procedure (MAP) and measures to facilitate tax administration.

The protocol entered into force on 30 August 2019, the date Japan and the US exchanged instruments of ratification, and applies to withholding taxes on dividends and interest paid or credited on or after 1 November 2019. For other taxes, the protocol will apply to taxable years beginning on or after 1 January 2020. The mandatory arbitration procedures apply for cases under consideration by the competent authorities on the date the protocol entered into force (30 August 2019) or that come under consideration after that date.

Changes made by the protocol

The protocol introduces the following key changes to the Japan-US tax treaty:

Dividends

Before protocol applies	After protocol applies
Ownership threshold for exemption from source country taxation is "**more than** 50%."	Ownership threshold for exemption from source country taxation is "**at least** 50%."
Holding period threshold for exemption from source country taxation is **12** months.	Holding period threshold for exemption from source country taxation is **six** months.

The relaxation of the dividend exemption thresholds will help align the Japan-US treaty with Japan's tax treaties with countries such as the Netherlands, Switzerland and the UK, which contain similar provisions.

Interest

Before protocol applies	After protocol applies
Source country taxation of interest is **10%** (**0%** if paid to specified persons (e.g., government bodies, financial institutions)).	Source country taxation of interest is **0%,** except for certain types of interest (e.g., **contingent interest,** which may be subject to source country taxation).

Contingent interest is interest that is determined by reference to, among other things, receipts, sales, income, changes in the value of property or dividend payments made by the debtor or a related person. Under the protocol, contingent interest may be taxed in the source country (the country in which the interest arises); however, if the beneficial owner of the interest is a resident of the other contracting country, the tax imposed by the source country may not exceed 10%.

Capital gains from real property

Before protocol applies	After protocol applies
Source country taxation applies to capital gains from the alienation of: • Real property located in the source country; • Shares or comparable rights in **a company resident in the source country** that derives at least 50% of its value directly or indirectly from real property located in the source country; and • Interests in a partnership, trust or estate to the extent of its real property located in the source country.	Source country taxation applies to capital gain from the alienation of: • Real property located in the source country; • Where the source country is Japan, shares or interests in **any company, partnership or trust** deriving the value of its property **directly or indirectly principally** from real property referred to in Article 6 and situated in Japan; and • Where the source country is the US, a "US real property interest" as defined under US tax law.

The protocol expands Japan's ability to tax capital gains derived from an indirect ownership of real property and more closely aligns the treaty language with Japanese and US domestic tax laws.

It should be noted that recent amendments to Japanese domestic law changed the timing for determining whether a company is real estate rich. Under the prior rules, the determination was made based on the company's value on the date of sale. However, the current rules provide that a company is considered real estate rich if it meets the "at least 50%" threshold at any point during the 365 days prior to the date of sale. Since neither the tax treaty nor the protocol provides language that overrides the domestic law provision, a company must follow the domestic rules when analyzing whether it is real estate rich.

Mutual agreement procedure (MAP)

Before protocol enters into force	After protocol enters into force
Mandatory arbitration is **not required**.	Mandatory arbitration is **required** if the competent authorities of Japan and the US cannot resolve the matter after negotiating for a reasonable amount of time (typically two years from the presentation of the case to the competent authority of the other contracting country).

Directors' fees

The Japanese version of the protocol clarifies the treaty language regarding the taxation of remuneration received by directors and other employees who are residents of a contracting country from a company resident in the other contracting country. The protocol states that such fees are outside the scope of the relevant article of the treaty (Article 15) unless the person serves on the board of directors of the company, thus reducing the potential risk of double taxation resulting from a broad interpretation of the term "director" and the broader scope of taxable income applicable to directors under Japanese tax law. Further, to the extent a board member has other functions (i.e. consultant, employee, etc.), Article 15 will not apply to remuneration paid on account of the other functions. Note that the protocol changed the Japanese language of Article 15 and made no changes to the English language version of Article 15.

Exchange of information

The protocol includes new exchange of information and administrative assistance articles that allow for full exchange of information between the competent authorities of Japan and the US to aid in the administration of each country's tax laws and assist in the collection of taxes. Covered taxes in Japan are expanded to include the national consumption tax, inheritance tax and gift tax.

Deloitte's View

The updates to the Japan-US tax treaty included in the 2013 protocol should provide taxpayers with potential benefits, including relaxation of the requirements to qualify for the dividend withholding tax exemption and the introduction of a general withholding tax exemption for interest payments. However, changes to the rules regarding the alienation of shares may have adverse impacts for some taxpayers, as indirect transfers (including foreign-to-foreign transfers) of Japanese real estate rich companies potentially may fall within the scope of the protocol and be subject to tax in Japan. Further, taxpayers should note that applicable treaty forms will need to be resubmitted to claim the new interest withholding exemption provided in the protocol. Taxpayers should consider the potential impact of the protocol's provisions before the rules take effect to avoid any unexpected consequences.

Newsletter Archives

To see past newsletters, please visit our website. www.deloitte.com/jp/inboundtaxnewsletter

Subscribe to Japan: Inbound Tax Alert and tax@hand

To automatically receive future newsletters, please email deloitte-tokyo.newsletter@tohmatsu.co.jp and register by providing your name, company, position, and email address.
Click here to download our tax@hand app to view inbound tax alerts and other content on your mobile device.

Contacts

Deloitte Tohmatsu Tax & Legal Inbound Group

Not all facts and circumstances are covered in this alert. If you have any questions regarding your specific situation, please contact one of the tax professionals at our Deloitte office in Tokyo as follows:

Jun Sawada, Inbound Group Leader		jun.sawada@tohmatsu.co.jp
Business Tax Services	Sunie Oue, Partner	sunie.oue@tohmatsu.co.jp
	David Bickle, Partner	david.bickle@tohmatsu.co.jp
Indirect Tax Services	Fumiko Mizoguchi, Partner	fumiko.mizoguchi@tohmatsu.co.jp
Global Employer Services	Russell Bird, Partner	russell.bird@tohmatsu.co.jp
Transfer Pricing	Timothy O'Brien, Partner	timothy.obrien@tohmatsu.co.jp
	Samuel Gordon, Partner	samuel.gordon@tohmatsu.co.jp
Tax Management Consulting	Sam Reeves, Director	sam.reeves@tohmatsu.co.jp
Global Tax Services	Koichi Hattori, Partner	koichi.hattori@tohmatsu.co.jp
Financial Service Industry	Yang Ho Kim, Partner	yangho.kim@tohmatsu.co.jp
	Kai Hielscher, Partner	kai.hielscher@tohmatsu.co.jp
Tax Controversy	Yutaka Kitamura, Director	yutaka.kitamura@tohmatsu.co.jp
Legal	Kaori Oka, Partner	kaori.oka@tohmatsu.co.jp
Immigration	Yoshito Kijima, Partner	yoshito.kijima@tohmatsu.co.jp

Issued by

Deloitte Tohmatsu Tax Co.
Tokyo Office
Marunouchi-Nijubashi Building, 3-2-3 Marunouchi, Chiyoda-ku, Tokyo 100-8362, Japan
Tel: +81 3 6213 3800
email: tax.cs@tohmatsu.co.jp
Corporate Info: www.deloitte.com/jp/en/tax

Deloitte Tohmatsu Group (Deloitte Japan) is a collective term that refers to Deloitte Tohmatsu LLC, which is the Japan member firm of Deloitte Touche Tohmatsu Limited (DTTL), a UK private company limited by guarantee, and firms affiliated with Deloitte Tohmatsu LLC that include Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and Deloitte Tohmatsu Corporate Solutions LLC. Deloitte Tohmatsu Group is known as one of the largest professional services groups in Japan. Through the firms in the Group, Deloitte Tohmatsu Group provides audit & assurance, risk advisory, consulting, financial advisory, tax, legal and related services in accordance with applicable laws and regulations. With about 11,000 professionals in nearly 40 cities throughout Japan, Deloitte Tohmatsu Group serves a number of clients including multinational enterprises and major Japanese businesses. For more information, please visit the Deloitte Tohmatsu Group (Deloitte Japan)'s website at www.deloitte.com/jp/en.

Deloitte provides audit & assurance, consulting, financial advisory, risk advisory, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 245,000 professionals make an impact that matters, please connect with us on Facebook, LinkedIn, or Twitter.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

All of the contents of these materials are copyrighted by Deloitte Touche Tohmatsu Limited, its member firms, or their related entities including, but not limited to, Deloitte Tohmatsu Tax Co. (collectively, the "Deloitte Network") and may not be reprinted, duplicated, etc., without the prior written permission of the Deloitte Network under relevant copyright laws.

These materials describe only our general and current observations about a sample case in accordance with relevant tax laws and other effective authorities, and none of Deloitte Network is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. The opinions expressed in the materials represent the personal views of individual writers and do not represent the official views of Deloitte Network. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

Member of
Deloitte Touche Tohmatsu Limited

© 2019. For information, contact Deloitte Tohmatsu Tax Co., DT Legal Japan, Deloitte Tohmatsu Immigration Co.

IS 669126 / ISO 27001