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Japan Tax & Legal Inbound Newsletter

Can Japan attract international financial firms and their high-earning executives?

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Background

The Japanese government is considering implementing business and tax measures aimed at attracting foreign financial firms (and other professional firms that service the sector) and their high-earning employees to boost Japan's standing as a global financial center. In November 2016 the Tokyo metropolitan government established an advisory panel for "Global Financial City Tokyo," consisting of corporate executives and experts from Japan and abroad, to discuss challenges to revitalizing Japan's financial sector and obstacles to overseas businesses' entering the Japanese market in an attempt to regain its status as one of the world's leading financial centers and overcome competition from rising financial centers in Asia. On 31 August 2020, Japan's Financial Service Agency (JFSA) released its annual policy guidance for the year, and among the goals is the desire to make Japan's financial and capital markets more sophisticated to enhance its role in Asia and the rest of the world.

Proposals to attract foreign banks and financial executives

To promote foreign financial institutions' and experts' entry into the Japanese market, Japan's central government has proposed to introduce visa support and a streamlined approval process for investment management licenses. In addition, the JFSA has indicated its desire to see other measures introduced, such as the introduction of English administrative services and a faster registration process, acceleration of market structure reform on exchanges, and measures to improve the business environment including tax benefits such as treating unlisted companies' executive compensation as deductible (which is common in other developed countries). Other measures under consideration include improvements to payment infrastructure, further deregulation to improve the Corporate Governance Code in areas such as digital transformation, and the removal of Japan-specific obsolete industrial practices that banks operating in Japan have to follow to function, such as the use of paper documents, seals, and in-person communication.

Suggested tax reform to attract foreign financial executives

Attracting financial firms to Japan also could lead to an inflow of foreign high and ultra-high net worth executives. However, Japan's tax code is seen as a deterrent to many wealthy individuals relocating to Japan on a permanent basis. For example, Japan has the highest inheritance tax rate in the world at 55%.

To remove this potential barrier, the JFSA has suggested Japan reduce inheritance tax by granting exemptions for nonpermanent foreign residents in senior positions, such as for overseas assets owned by the executives before moving to Japan. Some government officials also are keen to see a reduction in the income tax rate on those who earn more than JPY10 million annually (approximately USD 90,000), to make Japan more competitive with other Asian countries with well-developed financial centers. Japan also taxes capital gains (at 15%), whereas many countries that are able to attract foreign financial firms do not.

However, the reduction of tax rates has received strong pushback from some government officials and politicians as it is perceived to favor those who are wealthy and to specifically benefit the financial services sector.

Barriers to entry

Despite the government's willingness to make changes to attract financial firms to Japan, there are additional factors that may act as deterrents to relocating for companies and their employees. The first is the unequal treatment of foreign residents relative to Japanese nationals, as highlighted by the recent reentry ban for foreign residents traveling to Japan from a country infected by COVID-19. Under the ban, Japanese nationals traveling from the same COVID-19 country as a foreign resident of Japan will be permitted to enter Japan whereas the foreign resident will not. From August 2020, some foreign residents have been permitted to enter Japan and, from 1 September, the reentry ban was lifted under stringent conditions. Although the ban may only be temporary as a result of COVID-19, Japanese nationals are not subject to the same policy and this has caused concern for international businesses and various countries' chambers of commerce, which have issued a joint statement indicating that the inconsistency is likely to deter foreign nationals and companies that may wish to invest in Japan.

In addition, under the Japanese immigration rules, foreign finance industry employees are limited to bringing just one dependent into Japan in addition to their families, which could be viewed as a downside to relocation, for example, if a high net worth executive is accustomed to having more than one personal employee (housekeeper, childcare provider, etc.).

Another potential barrier to entry for foreign financial firms is gaining a foothold in Japan's domestic market, which is heavily dominated by large Japanese banks. Japanese retail banks have branch networks across the country and provide excellent coverage. In addition, a good deal of banking in Japan is done through ATMs, and establishing an ATM network could be an extremely costly undertaking for a foreign firm because ATMs in Japan typically are housed in separate real estate. Further, Japanese wholesale banks already have given decades-long service to small and medium-sized enterprises. Therefore, the Japanese domestic market, along with its language and culture barriers, could be viewed as a difficult environment by some foreign banks.

Deloitte's View

Despite the current barriers to foreign financial firms' entering the Japanese market, any efforts taken by the JFSA and the government today to cut red tape and improve market entry would be a medium-term structural benefit to the Japanese economy. In addition, introducing English administrative services would make Japan more attractive and help bring much needed skilled labor and knowledge into the country. Further, despite Japan's ageing population, which could be viewed as impeding any upside to potential economic growth, Japan is expected to remain one of the world's largest consumer markets as well as a relevant investment destination. There is a real chance that foreign direct investment flows will increase into Japan as the market becomes more accessible to foreign firms and their employees.

Although the current emphasis on deregulation and possible modifications to the tax code is focused on financial markets and those that work for financial firms, other measures being taken by the government across the entire economy through the Japan Revitalization Strategy are designed to make operating in Japan easier in the short-term and to make Japan a more attractive location for foreign businesses. Companies interested in investing in Japan, or those already operating in Japan but looking to expand, should continue to keep an eye out for additional deregulation in their relevant markets and for changes to tax rules and regulations aimed at boosting competitiveness.

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