Deloitte.

September 2017

ICEbreakers: Unlocking Japan

Hot topics

2017 tax reform: The National Diet enacted the 2017 tax reform proposals on 27 March 2017, which include the following major corporate tax changes:

- The R&D tax credit regime is revised to increase competitiveness.
- The deductibility of director compensation is amended, including revisions to increase flexibility for companies to use profit-linked compensation.
- The provisions related to corporate reorganizations are revised, including the expansion of the definition of a tax-qualified horizontal-type corporate division to include certain horizontal-type corporate divisions via incorporation. The scope of tax relief for small and medium-sized enterprises will be limited for fiscal years beginning on or after April 1, 2019.
- The controlled foreign corporation rules are fundamentally revised in accordance with the basic concepts of the OECD's BEPS project. The new rules will become effective for accounting years beginning on or after April 1, 2018 of the foreign related company.

Other developments

- **US limited partnerships:** On February 9, 2017, the National Tax Agency (NTA) clarified the Japanese tax treatment of US limited partnerships, including the following:
  - The NTA treats US limited partnerships as fiscally transparent entities for Japanese tax purposes, provided they have not made an election to be classified as a corporation for US federal tax purposes; and
  - For the purposes of applying the Japan-US tax treaty, a Japanese resident that derives an item of income through a US limited partnership and that meets all other requirements under the treaty would be eligible to claim tax treaty benefits.
- **Consumption tax:** On November 18, 2016, the National Diet enacted a bill to delay the second planned increase of the consumption rate from 8% to 10%. The delay pushes back the planned rate increase from April 1, 2017 to October 1, 2019, and also postpones the introduction of the new invoice method.

Treaty update

OECD multilateral instrument (MLI): Japan was one of the countries that signed the MLI on June 7, 2017.

- As signatory and party to the MLI, Japan has declared its position with regards to items included in the MLI and this will have impacts on the interpretation and application of a number of Japan's major bilateral tax treaties (e.g. treaties with China, Germany, Hong Kong, Ireland, Singapore and the UK) going forward. However, the US is not a signatory to the MLI, so the US-Japan tax treaty is not a covered tax agreement (CTA), and none of the MLI provisions are applicable.
- For the above-mentioned CTAs, many of the MLI provisions related to permanent establishment (PE) will not apply despite Japan not reserving (i.e. the other jurisdiction opted out). Nevertheless, it should be noted that there is at least one example where the courts in Japan have interpreted an existing treaty in a way broadly in line with the expanded PE definition under MLI provision article 13(2).
- The inclusion of the principal purpose test (PPT) should have a significant impact on Japan's treaties, especially for those treaties that do not currently include comprehensive anti-tax avoidance provisions.
- For certain CTAs, a one-year lookback period to determine whether a company is real estate rich, such that gains on the disposal of its shares, etc. would be taxable, will be added, meaning that companies must examine whether the company was real estate rich at any time during the 365-day period prior to disposal.

Contacts

Linda Ng
Managing Director
Tel: +1 212 436 2764
ling@deloitte.com

Tomotaka Kuwata
Senior Manager
Tel:+1.212.492 4225
tokuwata@deloitte.com

International Core of Excellence (ICE)

ICE Delivers:
Insight: Professionals with deep knowledge of key foreign tax jurisdictions.
Convenience: A community of 27 tax professionals representing 16 major tax jurisdictions all sitting in New York
Experience: In-depth local knowledge combined with a firm grasp of how local tax issues mesh with a company's US tax considerations.

For more information on the Japanese tax system, please visit Deloitte International Tax Source (www.dits.deloitte.com) and/or Deloitte tax@hand (www.taxathand.com).