

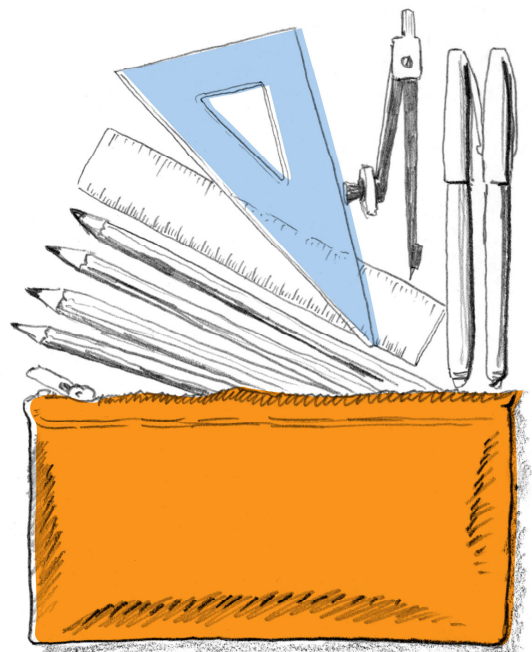
Japan tax bulletin

Quarterly newsletter on important tax and business developments in Japan
January 2009

In this issue

2009 Japan Tax Reforms Proposals

In December of 2008, Japan's liberal democratic party presented the outline for tax reforms expected to be passed in March 2009. The proposal was in line with the report issued in August 2008 by the Ministry of Economy, Trade, and Industry. Highlights of the 2009 reform proposals follow.



Foreign dividend exemption to be introduced

For fiscal years beginning on or after April 1, 2009, foreign dividend exemption will replace the current indirect foreign tax credit with respect to certain dividends paid to a Japanese parent corporation from a foreign subsidiary.

Currently, dividends received from foreign subsidiaries are included in the taxable income of the recipient parent. Relief from double taxation for the tax paid in the foreign jurisdiction is provided through a tax credit. Because Japan's corporate rate is one of the highest in the world, Japan tax on the dividend typically exceeds the available credit, resulting in a net global tax increase if income is repatriated. The general effect is to discourage the repatriation of foreign profits.

Under the proposed reform, 95% of dividends paid from the business income of foreign subsidiaries is

exempt and credit for foreign taxes imposed on the dividends will no longer be available.

The recipient parent corporation must hold 25% of the foreign affiliate for at least a 6-month period preceding the date the affiliate's payment obligation arises for dividend exemption to apply. If a lower holding ratio for the purpose of obtaining a foreign tax credit exists under an applicable tax treaty, the lower ratio will be used as the threshold.

Corresponding changes to Japan's CFC rules.

With the adoption of the foreign dividend exemption method, corresponding changes to the CFC rules will be implemented to ensure that dividends received from subsidiaries located in tax haven jurisdictions continue to be subject to Japan tax.

Comparison of Japan's current and proposed methods

	FTC system (current)	FDE system (proposed)
Dividend From Subsidiary	100	100
Foreign Tax (20%)	20	20
Taxable Income of Parent (before dividend)	300	300
Net taxable Income of Parent	400	300
Domestic Tax (30%) Before Credit	120	90
Less Foreign Tax Credit	20	NA
Final Domestic Tax	100	90
Total Domestic and Foreign Tax	120	110

(For example purposes, figures assume 100% of dividend is excluded).

Investment Limited Partnerships

Changes affecting PE determination. Under the current rules for investment limited partnerships (*toushi jigyou yugen sekinin kumiai*), a non-resident partner is deemed to have a permanent establishment (PE) in Japan if the general partner of the partnership is located in Japan and carrying out the operation of the partnership, with the result that certain income of the non-resident partner will be subject to taxation in Japan. Under the proposed reforms, for PE determinations made on or after April 1, 2009, a non-resident partner satisfying the following conditions (and others not yet specified) will be treated as a **specified foreign partner** (*tokutei gaikoku kumiai in*) and as a result be deemed to not have a PE in Japan:

1. The partner is a limited partner of the partnership;
2. The partner does not carry out the operation of the partnership;
3. The partner has less than a 25% interest in the partnership assets;
4. The partner does not have a special relationship with a general partner of the partnership; and
5. The partner has no PE in Japan with respect to another business.

Capital Gains Exemption. Under the current '25/5' rule, a non-resident investor is subject to Japan tax on capital gains from the sale of shares in

a Japanese company if the investor (a) owned 25% or more of the company's shares at any time during the preceding 3 years; and (b) sells 5% or more of the company's shares during any one fiscal year. Since reforms introduced in 2005, the holdings of a non-resident investor making an investment through a partnership are aggregated with holdings of the other partners when determining if the non-resident investor meets these thresholds.

Under the reforms, with respect to sales of shares made on or after April 1st, 2009 by investment limited partnerships (or foreign equivalent), the holdings of a non-resident investor making an investment through a partnership will not be aggregated with the holdings of the investor's partners for purposes of determining the 25/5 thresholds if the non-resident investor satisfies either the **specified foreign partner** conditions (noted above) or the following conditions:

6. The partnership has no PE in Japan;
7. The non-resident partner is a limited partner that does not carry out the operation of the partnership; and
8. Each non-resident partner of the partnership owns less than 25% of the shares in question.

Sales of shares held for less than a year or sales of shares in certain distressed financial institutions will not be covered.



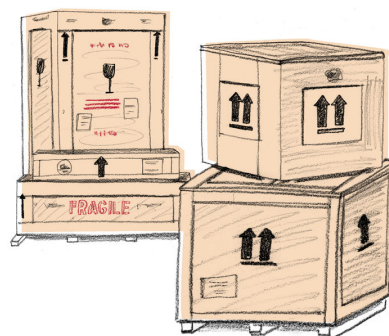
Tax measures for small and medium enterprises (SMEs)

Reduced rate. For fiscal years ending 1 April 2009 through 31 March 2011, the lowest corporate tax rate will be reduced from the current 22% to 18% for annual income up to JPY 8,000,000 for small and medium-sized enterprises (SMEs). A corporation with paid-in capital not exceeding JPY 100,000,000 and which is not a subsidiary of large corporation is considered an SME.

Tax loss carry back. The tax loss carry back (*kessonkin no kurimodoshi kanpu*) is currently available to SMEs for 5 years from the date of inception. Under the reforms, it will be available to SMEs for all fiscal years for tax losses incurred in fiscal years ending on or after February 1, 2009.

Changes in inventory accounting methods

Elimination of LIFO. After an as yet unspecified transitional period, LIFO (last in, first out) and the straight line average cost method will no longer be an allowable inventory accounting methods. The changes are part of the Accounting Standards Board of Japan's accelerated convergence of Japan GAAP with IFRS.



Land tax reforms

Extension of land capital gain surtax suspension. The suspension of the special surtax on capital gains on sales of land was set to expire on 31 December 2008, but will be extended for 5 years under the proposed reforms. The suspension will apply to short term and long term capital gains for corporate taxpayers, and short term capital gains for individuals.

Long-term capital gains deduction. The first JPY 10 million of long term capital gains from real estate (gains from real estate held for 5 years or longer) acquired between January 1st, 2009 and December 31st, 2010 will not be subject to capital gains tax for both corporate and individual taxpayers.

Land registration tax. The proposed reforms include postponing the incremental raising of the land registration with respect to land sales until April 1st, 2011 as follows:

Proposed land registration tax rates

Period property purchased	Current rate	Proposed rate
Through March 31 st , 2009	1.00%	1.00%
April 1 st , 2009 – March 31 st , 2010	1.30%	1.00%
April 1 st , 2010 – March 31 st , 2011	1.50%	1.00%
April 1 st , 2011 – March 31 st , 2012	-	1.30%
April 1 st , 2012 – March 31 st , 2013	-	1.50%

Deductions for loans for home purchases, access renovations, and eco-renovations

The following deductions are available for loans or renovations for residential purposes made between January 1st, 2009 through the end of the specified applicability period.

Standard home loans. For loans made from January 1st, 2009 through December 31st, 2013, an annual deduction of 1% of the loan balance is available up to a maximum of JPY 5,000,000 over 10 years from the date of the loan.

Long-term conforming mortgage. For mortgages made between January 1st, 2009 through December 31st, 2013, an annual deduction of 1.2% of the loan balance up to JPY 6,000,000 over a 10-year period from the date of the mortgage.

Long-term confirming mortgage for a new building. For mortgages made between January 1st, 2009 through December 31st, 2011, a single deduction of 10% of performance-enhancing expenses up to JPY 1,000,000.

Eco-renovations. For eco-renovations made

between April 1st, 2009 through December 31st, 2010, a single deduction of 10% of the renovation expense up to JPY 200,000 (or JPY300,000 for solar power renovation).

Access renovations. For access renovations made between April 1st, 2009 through December 31st, 2010, a single deduction of 10% of the renovation expense up to JPY 200,000.



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