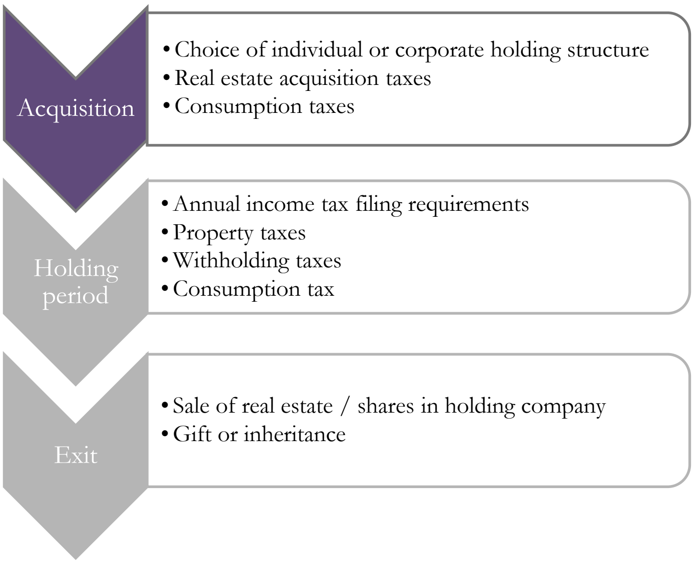
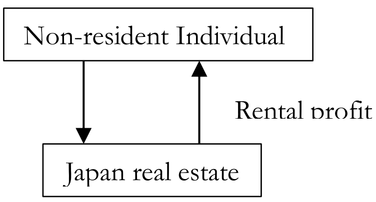
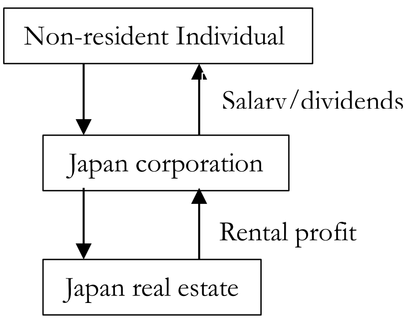
Diversifying into Japan real estate for a non-resident – a comparison the tax implications of individual and domestic corporate holding structures

Foreign investors looking to invest in Japan real estate have various options on how to hold the investment. Generally speaking, the taxation aspects over the lifetime of the investment are as follows:



One of the first considerations is whether to hold the investment individually or through a corporate vehicle. The first in our series of newsletters is a high-level comparison of the Japan income tax aspects of holding real estate individually or through a Japan corporation as shown in the diagram below:

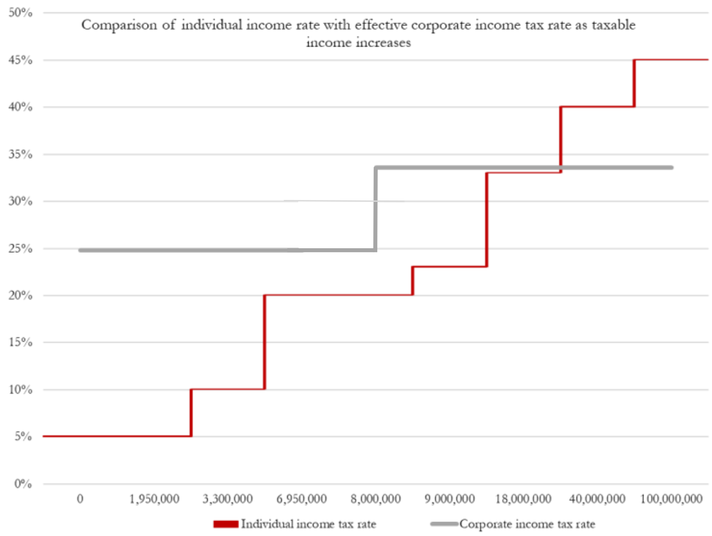




Scope of taxation and rates

A non-resident individual is subject to Japan income tax, either through withholding or tax return filing, on their Japan source income at progressive rates ranging from 0% to 45%. For real estate investments, the investor is subject withholding at the time of receipt of the income and also tax return filing in Spring of each year. A domestic corporation is subject to corporate income tax on worldwide profits at 23.2%. Certain small sized enterprises benefit from a reduced rate of 15% on the first JPY8 million of income. Once local and enterprise taxes are factored in the effective tax rates are approximately 24.8% for the reduced rate portion and 32% to 34% for the balance, depending on the corporation's share capital and location of its head office. Of course, various deductions are available under Japan tax law from gross income when calculating the taxable income.

As can be seen from the graph below, when taxable income reaches JPY18 million, the tax rate for a corporation becomes lower than the tax rate for a non-resident individual so real estate investments with this level of income are held more tax-efficiently in through a corporate vehicle.



Although the income tax rate is a factor in deciding how to structure a Japan holding, there are other taxes on acquisition and throughout the holding period that need to be considered. Stay tuned for the next newsletter in our series, which will cover these stages in more detail.