

Japan: Application of exit tax to foreigners delayed for five years

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In brief

On March 31, 2015, the Diet passed the 2015 Tax Reform Proposal into law, which included the 'exit tax' provisions that would require the mark-to-market of certain financial assets and the imposition of capital gains tax on any resulting gains for certain residents in Japan moving abroad.

One significant development that is different from the government's announcement of the proposal in late December 2014 is that foreigners will not be subject to the exit tax until five years after the effective date of the law (from June 30, 2020) regardless of the visa type that they hold or the amount of their financial asset holdings.

The exit tax laws are complicated and the expectation is additional guidance and clarification will be needed from lawmakers and Japan tax authorities. For example, vested employee stock options are not specifically excluded from the exit tax regime. As such, a later exercise of the options which have been subjected to exit tax could potentially result in double-taxation.

This Tax Insight updates our initial [article](#) published in January 2015.

In detail

Outline of the 'exit tax'

In an effort to prevent wealthy individuals from possibly escaping tax on unrealized capital gains, the Diet has passed laws to tax these gains for certain residents moving overseas with certain financial assets of JPY 100 million or more in aggregate value.

For this purpose, an 'exit' means when an individual no longer has maintained *jusho* (principle place of residence) or *kyosho* (temporary place of abode) in

Japan. At the time of the exit, the individual will be subject to tax on the gain on securities and derivative transactions as if the individual sold or settled the transaction at fair market value.

The new tax rule will be applicable to exits, as well as certain gifts and inheritances of property, made by a Japan resident on or after July 1, 2015. However, see [UPDATE](#) comments below for the delayed application for foreign nationals.

Individuals subject to the 'exit tax'

Japan residents who satisfy both of the following conditions are subject to 'exit tax':

- a) Individuals who hold certain financial assets with total value of JPY 100 million or more upon departure from Japan
- b) Individuals who had maintained *jusho* or *kyosho* in Japan* for five years or more during the 10-year period immediately prior to the Japan departure.

* Time residing in Japan under a visa status shown on 'Table 1' of the Immigration Control and Refugee Recognition Act is not included. Note: Table 1 would include visa types, such as, specialists in the humanities/international services, intra-company transferee, and temporary visitor, which are commonly used for expatriate assignees.

UPDATE: The accompanying enforcement orders to the exit tax laws indicate that for foreign nationals, the five out of the last ten years 'clock' would not start until July 1, 2015. Therefore, foreign nationals, regardless of the visa that they hold, will not be subject to the exit tax until June 30, 2020 at the earliest.

In addition, it should be clarified that foreign nationals married to Japan nationals are not required or deemed to carry a spouse of Japan national visa. Therefore, foreign nationals married to Japan nationals will not be subject to the exit tax if they carry a visa under 'Table 1'.

Assets subject to the exit tax

The following financial assets are subject to the exit tax:

- securities defined in the Income Tax Law (Article 2(17))
- ownership of *tokumei-kumiai* contracts
- unsettled derivative transactions
- unsettled credit transactions
- unsettled hedging transactions for stock risks trading.

Cash or cash deposits are not part of the securities defined in the above. Also, non-financial assets such as real estate properties are not subject to the exit tax. It is important to note that the 100 million yen threshold for the exit tax rule applies to the aggregate value, rather than applying to each asset separately.

UPDATE: Vested employee stock options are not excluded from the exit tax. However, there has been no specific guidance issued on how the gain for exit tax purposes would be calculated or the calculation of the compensation income amount that would be subject to tax upon exercise of the options. Further clarification is needed in this regard.

Taxation of financial assets

Financial assets will be taxed as if capital gains were realized at the time of departure from Japan (deemed realization), if a Tax Administrator is appointed prior to the departure date.

If a Tax Administrator is not appointed before departing from Japan, the exit tax will have to be settled by the departure date using the asset valuation date 3 months prior to the expected departure date.

The tax treatment on deemed realization will be the same as regular taxation (i.e., deemed capital gains and losses can be offset).

Exemption of exit tax

If an individual does not sell his/her financial assets while living abroad and returns to live in Japan within five years, the deemed capital gain tax liability will be exempted. Accordingly, if taxes were paid upon exit, recovery is permitted.

Extension of time for the tax payment

By appointing a Tax Administrator and providing 'collateral' upon Japan departure, an individual can be allowed an extension of the tax payment for up to five years. Furthermore, under certain conditions, such as a business reason, an additional five-year extension can be granted (i.e., maximum of 10 years

in total). An interest charge will apply for deferred tax payments.

If the extension of exit tax payment is in effect, Japan national individuals will be considered having *jusho* in Japan within five years prior to the gift/inheritance for the purpose of gift and inheritance taxes during this period. If the individuals are subject to gift and/or inheritance taxes, it would be assessed on all assets worldwide (not only on assets subject to the exit tax). Such gift/inheritance taxes would be assessed in addition to the exit tax, which is part of income tax.

Moreover, during the extension period, individuals are required to submit an annual report of financial assets related to the exit tax that is being deferred.

The extension of the exit tax will be terminated when the individual sells an asset subject to the tax while staying abroad or he/she does not return to Japan within the extension period (five or ten years). Please note, however, that when partial assets are disposed of, only the extension of the tax payment related to such assets will be terminated.

Treatment on declined value of financial assets on the actual disposition date

In the situation where the individual terminates the extension by either: 1) selling an asset while staying abroad or 2) if the extension is expired, the fair value of the asset at the time of the extension expiration may be lower than the value used for exit taxation. In such case, taxpayers can file a downward assessment request to adjust the gain amount. Such downward assessment request must be made within four months after the event (sale of the asset or the expiry date).

Adjustment for double taxation resulting from exit tax

When capital gains are taxed in the foreign country upon actual disposition of an asset, the individual would be doubled taxed because of the Japan exit tax. For individuals whose exit tax payment is deferred, if the foreign country does not adjust for the double taxation, a foreign tax credit based on the tax in the foreign country may be allowed as a credit against Japanese exit tax by filing a downward assessment request within four months of such foreign tax payment.

Exit tax on inheritance and gift to non-residents

Where individuals meeting the conditions for the exit tax (see *Individuals subject to the exit tax* above) transfer certain financial assets (see *Assets subject to the exit tax* above) to a non-resident individual by inheritance or gift, the exit tax will also be applied as if the unrealized capital gains on those assets were realized at the time of inheritance or gift, even if the donor/decedent does not leave Japan.

The takeaway

The new exit tax laws have the potential to both accelerate and increase taxes on unrealized capital gains on wealthy individuals (Japanese nationals and from June 30, 2020, foreign nationals with certain types of visa, such as, permanent resident, spouse or child of Japanese national, and spouse or child of permanent resident) who meet the five out of ten year residence criteria and are moving abroad. Although the legislation attempts to mitigate the impact on Japanese outbound assignees who will return to Japan upon repatriation within a certain period (up to 10 years), some administrative procedures and costs (such as providing collateral upon Japan departure and annual asset reporting during the assignment period) are required.

Furthermore, the 'exit tax' will be imposed when Japanese residents (who meet the conditions for the exit tax) transfer an asset to a non-resident (via gift or bequest), even if they are not moving abroad.

Long-term expatriates who have significant financial assets and are subject to this new tax because of their visa type, should certainly consider the effect to their situation when planning their overseas relocation. There are many considerations, such as, timing of future dispositions of the assets, foreign country tax relief, foreign currency fluctuation and effect on the gains, possible recovery of the 'exit tax' before the expiration period, and deciding to extend the payment period which also affects *jusho* (principle place of residence) for gift/inheritance taxation. Foreign nationals who would be subject to the exit tax starting from June 30, 2020 should take advantage of the five year window to see if they can avoid the exit tax or minimize its impacts.

Also, for expatriates under company tax equalization programs, companies may need to review their policies to determine whether such an exit tax is within the scope of their policy coverage, and if so, how to apply the tax settlement.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your regular PwC Global Mobility Services professional or one of the following professionals from PwC Japan:

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