Japan: Gift and inheritance taxation reforms affecting mobile employees – relief and more exposure

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In brief

The Ruling Party's 2017 Japan Tax Reform Proposal (known in Japanese as *Zeisei Kaisei Taiko*) was released on December 8, 2016. The proposed amendments provide Japan gift and inheritance tax relief on non-Japan situs assets to foreign nationals residing in Japan for ten years or less out of the last fifteen years and who hold a 'table 1' visa that generally does not allow them to stay indefinitely in Japan, such as a work-related visa.

However, no relief is provided to foreign nationals who hold a 'table 2' visa such as a spouse of a Japanese national or permanent resident visa or foreign nationals who have resided in Japan for more than ten years out of the last fifteen years. (For ease of reference in this *Insight*, we refer to these taxpayers as 'longer-term foreigners'.) Their worldwide assets remain subject to Japanese gift and inheritance tax.

In addition, for the first time, the receipt or transfer of worldwide assets by longer-term foreigners will remain subject to Japan inheritance and gift tax after they depart Japan until they have no longer had a *jusho* in Japan for ten out of the last fifteen years. Therefore, a receipt or transfer of worldwide assets by longer-term foreigners could remain subject to Japan inheritance and gift tax for up to five more years after permanent departure from Japan.

Finally, the five year lookback rule for Japanese nationals will be increased to ten years after permanently moving out of Japan.

If these amendments are passed into law by March 2017, they will become effective starting April 1, 2017.

In detail

Overview of gift and inheritance tax

Japanese gift and inheritance tax is imposed on the recipients of the property, rather than the person transferring the property. This means that even if a recipient who is not a resident in Japan may still be subject to Japan gift/inheritance taxation.

A recipient's or the decedent's *jusho* is critical in determining the scope of Japan gift and inheritance taxes which can be limited to assets located in Japan (so-called '*limited taxpayer*') or for worldwide assets (so-called '*unlimited taxpayer*').

Definition of jusho

There is no definition under the Japan tax laws for what constitutes as a *jusho* however, it is understood to refer to the definition under Japan Civil Law, which is described as a person's 'principal place of living' as determined based on an individual's 'objective facts and circumstances'.

Please note that *jusho* is not the same as the concept of permanent home as defined in other locations.

Some of the main factors that are considered in determining one's *jusho* include, but are not limited to, the following:

- Location of where one resides
- Location of the person's spouse and other family members
- Location of the person's occupation
- Location of the person's assets/property.

Current law – who is subject to tax – limited versus unlimited taxpayers

If the recipient's *jusho* is outside of Japan, the recipient is considered to be a 'limited taxpayer' and gift and inheritance tax is only levied on those assets situated in Japan at the time of the transfer.

If an individual inherits/receives assets while his/her *jusho* is in Japan, then he/she is considered an 'unlimited taxpayer' and inheritance/gift tax may be levied on the value of worldwide assets inherited/received, regardless of whether the donor/decedent's *jusho* was in Japan or overseas at the time of the asset transfer.

In addition, where the donor/decedent had a *Jusho* in Japan, even if the recipient did not have a *jusho* in Japan, the recipient is also classified as an unlimited taxpayer and subject to gift and inheritance tax on worldwide assets.

Beneficiaries who are Japanese nationals may be considered 'unlimited taxpayers' even if residing outside of Japan, if they or the decedent had a *jusho* in Japan within the past five years of the inheritance or gift.

The current law is summarized in the table below:

Donee/Heir / Donor/Decedent		Jusho of Donee/Heir: Jusho in Japan	Jusho of Donee/Heir: No Jusho in Japan
Jusho of Donor/Decedent	Jusho in Japan	Unlimited taxpayer - the donee/heir has Jusho in Japan, worldwide assets regardless of situs will be taxable.	Unlimited taxpayer - Even though the donee/heir does not have Jusho in Japan, the donor/decedent's Jusho in Japan will make worldwide assets taxable regardless of its situs. *
Jusho of Donor/Decedent	No Jusho in Japan	Unlimited taxpayer - the donee/heir has Jusho in Japan, worldwide assets regardless of situs will be taxable.	Limited taxpayer - both the donee/heir & donor/decedent do not have Jusho in Japan, only Japan situs assets will be taxable**

* With the tax reform effective April 1, 2013, if the donor/decedent has Jusho in Japan, the Non-Japanese beneficiary will be classified as an unlimited taxpayer taxed on worldwide assets.
** If the Donee/Heir is a Japanese National, both the Donor/Decedent and the Donee/Heir have to break Jusho for at least 5 years.

Current law – impact on expatriates

Practically, expatriates on an assignment in Japan for one year or longer would have potential Japanese inheritance tax exposure on any worldwide amounts inherited and a Japan gift tax exposure for any worldwide gifts received while residing in Japan. In addition, any assets they transfer while in Japan through gift or inheritance would potentially be subject to Japan gift or inheritance tax for the recipient.

This tax exposure is regardless of their status as non-permanent residents or permanent residents (living in Japan for more than five years within the past ten years) for income tax purposes. Therefore, currently for foreigners it is possible to be taxed on Japan source income only for income tax purposes but be subject to Japan inheritance and gift tax on worldwide inheritances and gifts.

For more background and detailed information on the current law, please see our previous alert located here:

http://www.pwc.com/jp/en/taxnews-international-assignment/assets/japan-gift-and-inheritance-tax-reform-update.pdf

Details of the proposed tax reforms

Exclusion from Japan inheritance and gift tax for foreigners 'staying temporarily' in Japan

Under the proposed tax reform, the transfer of overseas assets regarding a foreigner could be excluded from Japan gift or inheritance tax if the foreigner is 'staying temporarily' in Japan with a visa issued under table 1 of the Immigration Act.

Taxpayers who have resided in Japan for a period of not more than ten years out of the previous fifteen years are considered as 'staying temporarily' in Japan. The transfer of overseas assets between these taxpayers and other taxpayers who are 'staying temporarily' in Japan with a visa issued under table 1 of the Immigration Act or with foreigners outside of Japan who have not resided in Japan before would not be subject to gift and inheritance tax. However, please note the transfer of overseas assets with Japanese nationals who are subject to gift and inheritance tax would not be excluded. Also, the transfer of Japanese assets would continue to be subject to Japan gift or inheritance tax.

Foreign nationals holding a spouse of a Japanese national visa or permanent resident visa (or other visa under 'table 2') or foreign nationals who have maintained a *jusho* in Japan for more than ten years out of the last fifteen years will be considered as unlimited taxpayers and subject to gift and inheritance tax on worldwide assets transferred.

Foreigners subject to Japan inheritance and gift tax after departing Japan

As an anti-tax avoidance measure, the proposed reforms also include a 'lookback' rule for foreign nationals. Foreign nationals will continue to be subject to Japan inheritance and gift tax on the transfer of worldwide assets after they depart Japan until they have no longer had a *jusho* in Japan for ten out of the last fifteen years.

To clarify, this means that the transfer of assets involving foreign nationals who had a *jusho* in Japan for ten years or more could be subject to Japan gift or inheritance tax as well as potentially transfer tax in another country for up to five years after permanently moving out of Japan. Even if the foreign national no longer holds a Japanese visa or if the assets are located overseas or if the transferor/recipient has never resided in Japan before, the transfer of assets involving the foreign national would be subject to Japan gift or inheritance tax.

In addition, no transition measures were announced in the proposed tax reform. If the law does not contain any transition measures then this would mean that individuals who previously moved out of Japan **prior** to April 1, 2017 could be subject to Japan inheritance and gift tax. One would need to count back fifteen years from the transfer date of the asset to determine if the individual had *jusho* in Japan for ten years during this period. Therefore, if a gift takes place on April 1, 2017 then theoretically, someone who permanently moved out of Japan as far back as April 2, 2012 could be subject to Japan gift tax.

Increased scope of gift and inheritance tax for Japanese nationals

Historically, beneficiaries who are Japanese nationals may be considered 'unlimited taxpayers' even if residing outside of Japan if they or the donor/decedent had a *jusho* in Japan within five years of the inheritance or gift. The proposed tax reforms would increase this time period from five years to ten years.

The takeaway

Issues to consider for your expatriate employees

Impact for shorter-term foreigners

These changes provide welcome relief for shorter-term foreigners, relieving them of the burden of potentially being subject to Japanese gift/inheritance on overseas assets. This change should reduce the trepidation that some assignees may have had about seeking and accepting an assignment in Japan. We believe that this change should positively impact the number of employees considering accepting a Japanese assignment.

Impact for longer-term foreigners

However, the impact for longer-term foreigners is they will be exposed to Japanese gift and inheritance tax for up to five years after they permanently depart Japan. Companies will need to consider possible methods of helping their longer-term foreigners manage the potential additional gift/inheritance tax exposure.

Potential approaches

- Communication to expatriates – Educating current expatriates residing in Japan of their potential gift/inheritance tax exposure is also important to potentially avoid any inadvertent and unexpected tax liabilities (for example, seminars to educate employees and employers to make them aware of these issues).
- Considering visa arrangements for expatriates - Given the fact that the type of Japan visa held by foreign nationals now has a direct impact on whether foreign nationals can be excluded from Japan gift and inheritance tax on overseas assets, impacted individuals and

companies should review their visa status.

- Pre-assignment and during assignment planning – In many cases, gift and inheritance tax implications may be managed through appropriate planning prior to and during the Japan assignment. For instance, the acceleration of gifts to the pre-assignment period (or before an expatriate has resided in Japan for ten years) could possibly avoid the Japan gift taxation and decrease the expatriate's net worth for Japan inheritance tax exposure. In addition, proper titling of properties could also reduce inheritance tax exposure. Of course, the gift and estate tax implications in the home country would also need to be considered.
- Estate tax planning – Companies can also consider providing professional personal financial planning assistance to senior executives and those shorter-term expatriates approaching the ten year threshold. Often executives fail to consider the effect of a long-term assignment on their estate planning, not realizing their home country planning may no longer be fully effective.
- Tax protection/tax equalization – Obtaining a better understanding of the exposure of gift and inheritance taxes for your expatriates in Japan should be on the agenda of all company HR and mobility professionals. We recommend that companies take a moment to review their current tax equalization policies to see if any clarification is needed on gift and/or inheritance tax matters. Similarly, companies may want to review their tax protection policies and the applicable tax ceiling coverage limits.

In summary, these amendments are currently just proposals and not yet law and there are still many important details to be clarified. Hopefully, these details will be known when the bill is introduced in the Japan parliament in January 2017. However, should they pass and become effective April 1, 2017, the relief from gift and inheritance tax for short-term expatriates will be a positive change. On the other hand, the increased exposure for longer-term foreigners and Japanese national employees would mean that Global Mobility professionals would need to consider ways to address their potential additional gift and inheritance tax burden.

Let's talk

For further information and assistance on these matters, please contact your Global Mobility Services engagement team or one of the following professionals from PwC Tax Japan:

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