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Japan tax alert

Ernst & Young Shinnihon Tax

Amendment of the Japan-US tax treaty

Content

On 25 January, Japan and the United States of America signed a protocol (Protocol Amending the Convention between the Government of Japan and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, or the "Protocol") amending the current tax treaty between the two nations that was ratified in 2004 (the "Current Treaty"). The key amendments in the Protocol are as follows:

- Reduction of the ownership percentage threshold and holding period for withholding tax ("WHT") exemption on dividends
- Elimination of source country taxation on interest (i.e., elimination of WHT on interest payment)
- Introduction of arbitration procedures for mutual agreement procedures
- Change to information exchange provision
- Expansion of mutual assistance in the collection of taxes

Before going into effect, the Protocol first needs to be ratified - a process in which the Japanese Diet and the United States Senate pass the Protocol and then instruments of ratification are exchanged. It will have effect on taxes withheld at source for amounts paid or credited on or after the first day of the third month following the exchange of instruments of ratification and with respect to other taxes, for tax years beginning on or after the first of January following the exchange of instruments of ratification.

Reduction of the ownership percentage threshold and holding period for WHT exemption on dividends (Article 10)

Under the Current Treaty, dividends are exempt from WHT if the US parent company meets the limitation on benefits conditions and owns more than 50% of the shares in the Japanese subsidiary for at least 12 months.

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Under the Protocol however, the ownership requirements will be relaxed so that a US parent company owning 50% or more of the shares in the Japanese subsidiary for at least 6 months will be exempt from WHT on dividends.

	Current Treaty	Amended Treaty
Dividends (exemption)	Owning more than 50% of shares for at least 12 months	Owning 50% or more of shares for at least 6 months

Elimination of source country taxation on interest (i.e., elimination of WHT on interest payment) (Article 11)

Under the Current Treaty, interest paid by Japanese companies to US parent companies or related companies is generally subject to 10% WHT. As an exception, if recipients are certain governments or financial institutions including banks or insurance companies, interest is exempt from WHT. When the Protocol takes effect, interest will generally be exempt from WHT. However, if interest is determined by reference to sales, income, profits or other cash flow of the debtor, such interest will still be subject to 10% WHT.

	Current Treaty	Amended Treaty
Interest	General: 10% Financial institutions: exemption	General: exemption

Introduction of arbitration procedures for mutual agreement procedures (Article 25)

The Protocol introduces arbitration procedures in which independent arbitrators resolve cases that competent authorities are unable to reach an agreement on or to resolve, within two years of the date the case was presented for review, pursuant to the mutual agreement procedures. The arbitration procedures will apply to cases that are under consideration by the competent authorities as of the date of the exchange of instruments of ratification and to cases that come under consideration after that date.

Change to information exchange provision (Article 26)

An information exchange provision is included in the Current Treaty, but will be renewed under the Protocol. The Protocol states that the information exchange provision is not intended as an obligation to obtain or provide information that would reveal confidential communication between an attorney and their client.

Expansion of mutual assistance in the collection of taxes (Article 27)

Previously, mutual assistance in the collection of taxes was applicable only in cases of abuse of treaty benefits. Under the Protocol, it will be expanded to revenue claims with respect to individual income tax, corporate income tax, consumption tax, inheritance tax and gift tax.

Comments or general inquiries regarding this tax alert may be directed to our Corporate Communications team at tax.marketing@jp.ey.com.

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