January 2015

HR and tax alert

Japan

"Exit tax" on unrealized capital gains may apply from July 2015

Summary

The Government's 2015 tax reform plan includes a proposal for an "exit tax", which has been submitted to the Japanese parliament for debate.

The exit tax proposal will introduce measures to tax wealthy individuals on unrealized capital gains at the time of their departure from Japan. The target of the exit tax are those individuals whose financial assets at the time of departure have an assessed value of JPY 100 million (approx.US$850,000) or greater, and who meet certain residency requirements.

If enacted, the exit tax is expected to be effective from 1 July 2015.

Background

When Japanese permanent residents sell certain financial assets, any gain is subject to a capital gain tax. However, if they move abroad and sell the assets while they are a resident of another country and no longer resident of Japan, no such tax is imposed. Further, Japanese tax treaties allocate sole taxing rights to the country where the person resides. For example, if an individual who owns company shares with large unrealized gains moves to a country, such as Singapore or Hong Kong, where capital gains are not taxed, and then sells their shares, the individual would not pay any capital gain tax at all. Because of a growing number of Japanese citizens and permanent residents moving to countries that do not impose tax on capital gains, the Japanese Government plans to start the exit tax scheme in the 2015 tax reform plan.

Exit tax scheme – key points

- The exit tax scheme will potentially impact individuals who have been resident of Japan for 5 or more of the 10 years immediately prior to the date of departure and who, at the time of departure, own financial assets that have an assessed value of JPY 100 million or greater (approx.US$850,000).
- For the purpose of determining the five year residency period above, the duration of stay in Japan under certain visa categories, like Investor/Business Manager, Intra Company Transferee, Specialist in Humanities/International Services, will not be counted (more specifically, visa categories under Table 1 of the Immigration Control and Refugee Recognition Act will not be counted).
- For these purposes, financial assets include company shares, government bonds, corporate bonds, equity of tokumei kumiai (anonymous partnerships) and unsettled derivatives.

- Individuals temporarily relocating from Japan with no intention of selling such financial assets while they are abroad can elect to defer the tax payment for five years (an additional extension of up to five years is possible). However, appointment of a tax representative in Japan and a collateral deposit to cover such tax would be required. If the individual returns to Japan within five years, having not sold their financial assets, the tax that would have otherwise applied under the exit tax scheme will be exempt and the collateral deposit will be refundable by filing an amended tax return for the year of departure.
- On the other hand, if the individual does not return to Japan within five years (or a further extended period) or does sell their assets, then the deferral period will immediately end and the individual will be required to pay the tax that was deferred under the exit tax scheme. Further, interest accrued during the deferral period would also be payable.
- If an individual plans to leave Japan without appointing a tax representative, then a tax return needs to be filed and tax, including any "exit tax", needs to be paid prior to departure. In such a case, the tax on unrealized gains will be assessed on the value of such financial assets three months prior to departure less the cost basis.
- Provisions for foreign tax credits and stepped up cost basis may be provided to eliminate potential double taxation

Next steps

- Individuals who leave Japan purely for business reasons can minimize the impact of the exit tax by appointing a tax representative and electing the tax deferral. Claiming a refund of the collateral deposit would be possible if the actual realized gain is lower than the unrealized gain at the time of departure.
- Employers should consider the potential impact on their mobility programs involving assignees in Japan, including equalization policies and communications with impacted employees. Visa types should also be considered to reduce any potential impact.

Harish Shrivastava
Tel: + 81 3 3506 2017
Email: harish.k.shrivastava@jp.ey.com

Noriko Satomi
Tel: + 81 3 3506 4163
Email: noriko.satomi@jp.ey.com

Takayo Iwata
Tel: + 81 3 3506 2015
Email: takayo.iwata@jp.ey.com