

Tax Reform in FY 2017

- Key FSA-related Items in
the Outline for the FY 2017 Tax Reform -

December 2016
Financial Services Agency



1. Toward Vigorous Capital Markets and Stable Household Asset Building

◆ Improvement of NISA to Promote Diversified Installment Investment of Small Amounts

[Background and Issues]

- NISA (Nippon Individual Savings Account) has been steadily gaining popularity. As of March 31, 2016, the account openings have reached about 10 million, and the purchase amounts have reached about 7.8 trillion yen.
- For the FY 2017 Tax Reform, with a view to further promoting NISA, we have proposed the establishment of “Dollar-Cost Averaging NISA” suitable for diversified installment investment of small amounts, encouraging younger generations with insufficient cash on hand to start investment.

[Outline for the FY 2017 Tax Reform]

(1) Establishment of “Dollar-Cost Averaging NISA” (See the Next page)

(2) Measures to be taken after the tax-exempt period (five years) is over:

- Users can continue investment using the tax-exempt allowance, which is called ‘rollover’, after the nontaxable period of NISA is over (five years from the initial purchase). If users choose the rollover, the price of the listed stock in the tax-exempt period can exceed the tax-exempt allowance available for annual account of each year. The upper limit on the price of the listed stocks (the price at the time of delivery) to be transferred to a tax-exempt management account shall be abolished, so that all of the listed stocks can be transferred.

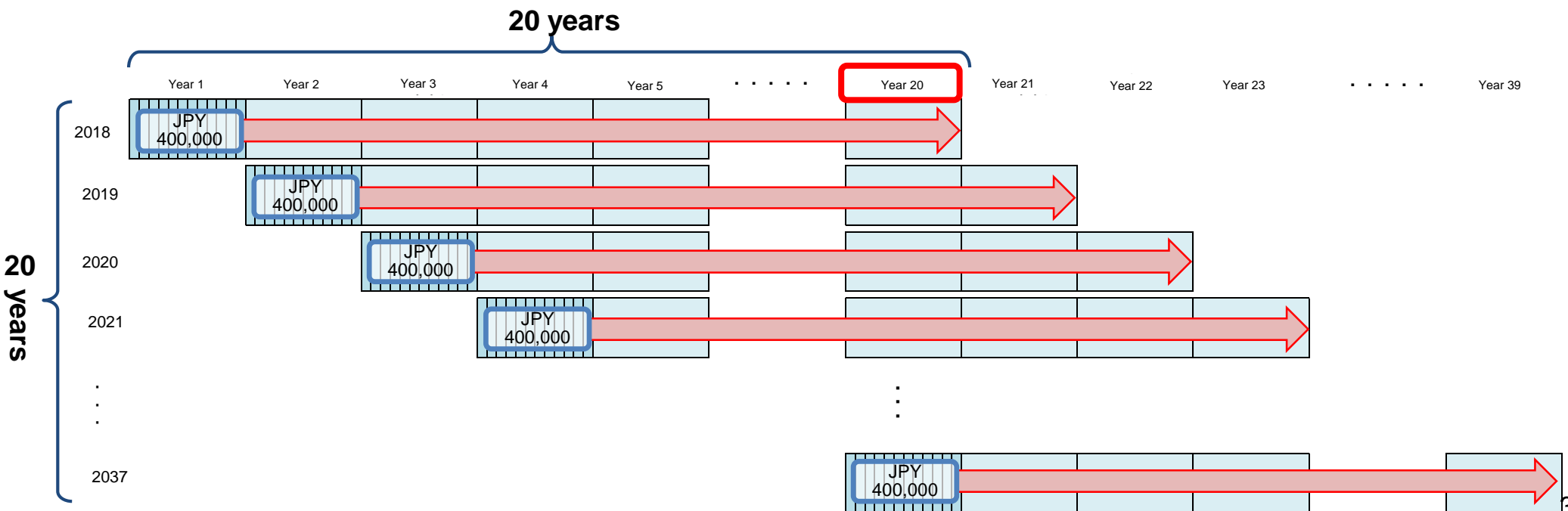
Chapter 1 of the FY 2017 Tax Reform (compiled by the ruling parties): “Basic Concept of the FY 2017 Tax Reform” (Excerpt)

“Considering that the current NISA is not convenient for installment investment, “Dollar-Cost Averaging NISA” shall be established to promote diversified installment investment of small amounts in view of supporting stable household asset building. As to “Dollar-Cost Averaging NISA”, for beginner investors, it is important to limit assets eligible for tax exemption to investment trusts that meet the requirements such as diversified investment in several securities in order to avoid the concentration of risks arising from specific securities, and it is also important to promote practical investment education. Furthermore, this system shall be established on the condition that periodic review will be conducted to ensure appropriate use of the new NISA considering that the tax-exempt period continues for a long time.

In addition, NISA as a whole will be reorganized in the aforementioned personal income tax reform, in line with the setting up of fair systems to support self-help efforts preparing for various risks in life after retirement. Based on this policy, for the purpose of clarifying the targets to politically support through simplification of the system and improvement of taxation systems, the unification of the NISA structure in which multiple systems co-exist currently into one system suitable for diversified installment investment of small amounts shall be considered.”

Overview of “Dollar-Cost Averaging NISA” (To be introduced in January 2018)

Tax-exempt annual investment limit, etc.	Upper limit on annual investment: JPY 400,000 ; Tax-exempt holding period: 20 years ; Investment period: 2018-2037 (20 years)
Assets eligible for tax exemption	Certain investment trusts suitable for long-term diversified regular investment *Requirements to be reviewed <div><div>General outline of tax reform states: (1) Trust period is indefinite or at least 20 years, and (2) the investment trusts do not pay dividends monthly</div></div>
Investment method	Regular and continuous purchases based on contract
Relationship to ordinary NISA	Select either Ordinary NISA or “Dollar-Cost Averaging NISA”



◆ Unification of Financial Income Taxation (Expansion of Scope of Profit/loss Offset for Financial Instruments)

[Background and Issues]

- The scope of profit/loss offset between financial instruments was expanded in the revision of the FY 2013 Tax Reform to specified government or company bonds, etc. in addition to listed stocks and publicly offered investment trusts(to be implemented in January 2016).
- The scope is yet to be expanded to derivatives transactions and deposits.

[Outline for the FY 2017 Tax Reform]

- Further unification of taxation on financial income including income from derivatives transactions should be considered on the viewpoint that it will contribute to establish a “Comprehensive Exchange” that handles all instruments including securities, derivatives, and commodities as well as that it will create an environment that facilitates investment in various financial instruments. Also, the necessity for effective measures to prevent intended tax avoidance activities by using diversified schemes should be taken into account.

Taxation Methods for Financial Instruments

	Income gains	Capital gains/losses
Listed stocks and publicly offered investment trusts	Separate self-assessment taxation	Separate self-assessment taxation
Specified government or company bonds, and publicly offered bond investment trusts	From January 2016 Separate withholding taxation ⇒ Separate self-assessment taxation	From January 2016 Tax exempt ⇒ Separate self-assessment taxation
Derivatives transactions	Separate self-assessment taxation	
Bank deposits, etc.	Separate withholding taxation	—

The scope in which profit/loss can be offset.

◆ Revising the Assessment of Inheritance Tax on Listed Stocks, etc.

[Background and Issues]

- In principle, listed stocks, etc. as inherited property are evaluated at the market value as of the date of inheritance^(*).
(*) Under the current system, the lowest value is applied among the fair value as of the time it was inherited, and the respective average closing prices in each of the three months prior to inheritance (the month in which it was inherited, the previous month and the month before last).
- On the other hand, listed stocks, etc. post high risks of price fluctuations. Property cannot be transferred until the division of property is agreed upon among the heirs, but high risks of price fluctuations in listed stocks, etc. are not considered in evaluating the inheritance tax on listed stocks, etc..
- For the above-mentioned reason, it is pointed out that listed stocks, etc. are more disadvantageous than other assets including deposits and bonds that post low risks of price fluctuations, and that investors tend to avoid investing in stocks.
⇒ As to listed stocks, etc., the following measures shall be taken.
 - (1) The assessed value of the inheritance tax on listed stocks, etc. shall be determined by considering the risks of price fluctuations during the period from the inheritance to the deadline of the tax payment.
 - (2) As to listed stocks, etc., the price of which fell significantly after inheritance, exceptional measures for the evaluation shall be provided.
 - (3) The priority rank of listed stocks, etc. for payment of inheritance tax in kind shall be revised so that listed stocks, etc. will be treated as in the same rank as the first priority-ranked assets (government and municipal bonds, real estate, and ships).



[Outline for the FY 2017 Tax Reform]

As to the priority ranks of property qualified for payment of inheritance tax in kind, the securities listed on a financial instruments exchange among stocks, bonds and beneficiary certificates of securities investment trusts shall be treated in the same rank (first priority rank) as government bonds and real estate. Investment securities listed on a financial instruments exchange shall be included in the scope of property qualified for payment of inheritance tax in kind, and their priority rank shall also be the first priority rank.

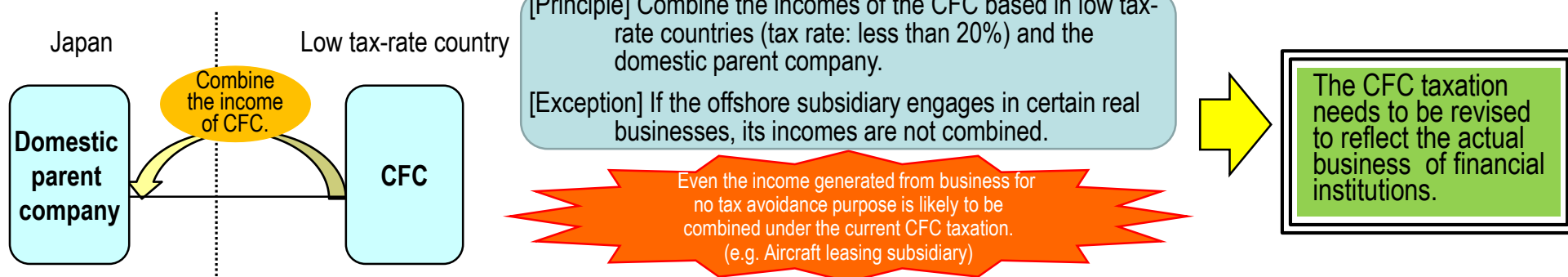
2. Responses to Financial Globalization

◆ Fundamental Revisions of Controlled Foreign Company (CFC) Taxation

[Background and Issues]

- CFC taxation is designed to address tax avoidance using controlled foreign companies (“CFC”) based in low tax-rate countries by combining the incomes of the CFC and the domestic parent company.
- Under the current CFC taxation, it is pointed out that, for example, the income of CFC engaging in aircraft leasing business which has no tax avoidance purpose is likely to be combined with the income of the parent company.
- The FY 2016 Tax Reform suggested that the CFC taxation be revised taking the discussions of the OECD BEPS project into consideration.

Outline of the current CFC taxation



[Outline for the FY 2017 Tax Reform]

(1) Consideration required for financial subsidiaries that actually conduct substantial business

A certain type of financial income gained by financial institutions that meet certain requirements shall be excluded from the income subject to combination.

(2) Consideration required for a paper company (SPC) established for a reasonable purpose

In the case where a certain licensed foreign affiliated company engaged in insurance business (“Insurance Consignor”) entrusts insurance business to an insurance consignee which meets the substantive standards and the administrative and controlling standards, the Insurance Consignor shall also meet these standards.

(3) Measures that consider economic activities by companies engaged in actual businesses

A company independently engaged in aircraft leasing business shall be considered as qualified for the business standards.

◆ Revisions of the Taxation System Concerning Cross-border Repurchase Agreement of Bonds (Repo Transactions)

[Background and Issues]

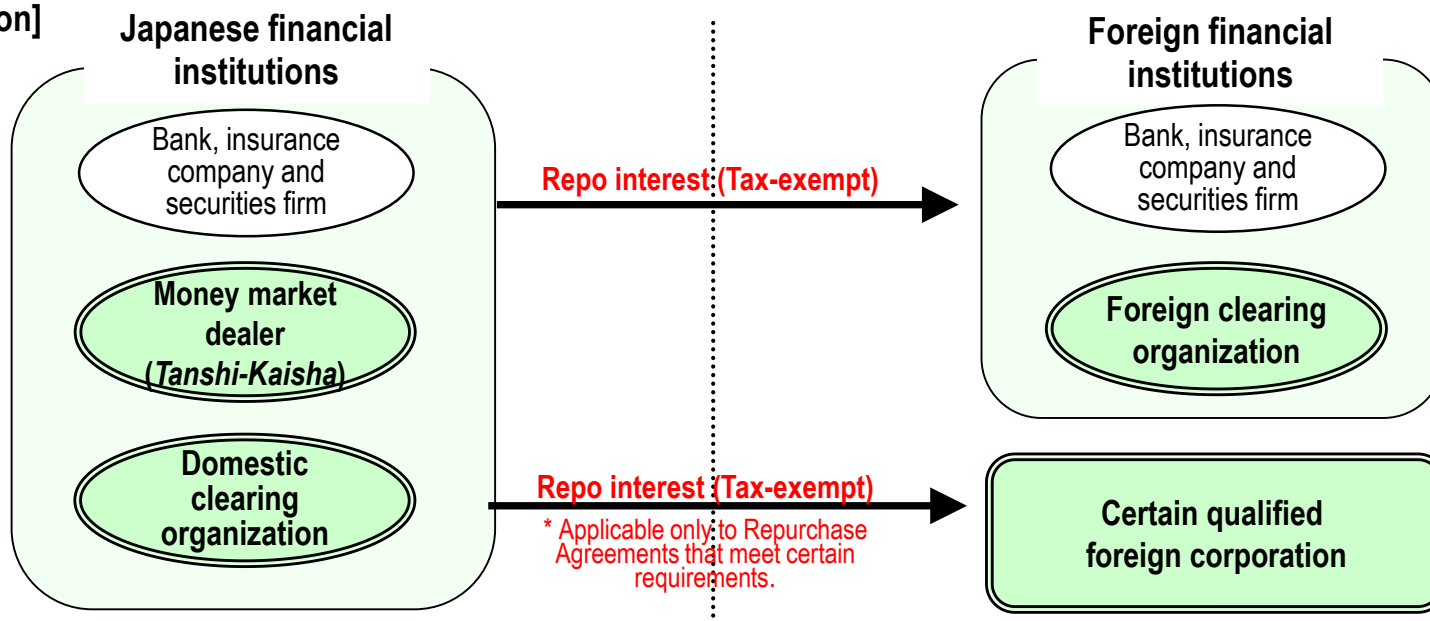
- With respect to cross-border repurchase agreement of bonds (“Repo Transactions”), the Repo interest that a foreign financial institution receives from a Japanese financial institution is tax-exempt from the viewpoint of enhancing smooth short-term funding by financial institutions. (Special measures for Repo Transactions)
- It is, however, pointed out that cross-border Repo Transactions are inhibited under the current system, because the special measures for Repo Transactions are applied only to the Repo transactions between Japanese financial institutions and foreign financial institutions and not to the Repo Transactions conducted by a money market dealer (*Tanshi-Kaisha*) or a clearing organization.



[Outline for the FY 2017 Tax Reform]

- (1) Money market dealers and clearing organizations in Japan and abroad shall be included in the scope of financial institutions qualified for the special measures for Repo Transactions.
- (2) Interest received by certain qualified foreign corporations arising from Repo Transactions conducted with Japanese financial institutions shall be tax-exempt. (a temporary measure for two years)

[After the revision]



3. Other Key Items

◆ Abolishing Special Corporate Tax on the Reserve Funds of Corporate Pensions or Extending the Suspension of Special Corporate Tax

[Background and Issues]

- Special corporate tax refers to the corporate tax imposed on the reserve funds of corporate pensions. (1.173%)
Note: Special corporate tax was introduced in 1962 based on the principle that tax shall be imposed on the deferred interest accumulated during the period up to the time of benefit payment although the tax should be imposed as wage income when contributed.
- In light of the low interest rates environment and the financial situations of corporate pensions, special corporate tax has been suspended since FY 1999, but the relevant measures will expire on March 31, 2017.
- For the purpose of maintaining and stabilizing the pension assets that support the post-retirement life of workers, it is necessary to abolish the special corporate tax or extend the suspension of special corporate tax.

[Outline for the FY 2017 Tax Reform]

The suspension of special corporate tax on the reserve funds of corporate pensions shall be extended for three more years.

(Overview of corporate pension taxation of major countries)

	Japan	United States	United Kingdom	Germany	France
When contributed (by employers)	Tax-exempt	Tax-exempt	Tax-exempt	Taxable	Tax-exempt
While managed	Taxable (Special corporate tax) (*) Suspended up to March 31, 2017.	Tax-exempt	Tax-exempt	Tax-exempt	Tax-exempt
When a benefit is paid	Taxable (Deductible)	Taxable	Taxable	Taxable (Only on revenue)	Taxable

4. Other Requests

◆ Extension of the Tax Measure Regarding Investment Corporations

[Background and Issues]

Under the FY 2016 Tax Reform, the period for treating Renewable Energy Power Generation Facilities (hereinafter, “Renewable Energy Facilities”) held by an investment corporation as pass-through assets for tax purposes was extended from 10 years to 20 years. Following the FY2016 Tax Reform, the first infrastructure fund was listed on the Infrastructure Fund Market of the Tokyo Stock Exchange in June 2016. In addition, several infrastructure funds are in preparation for listing.

In order to achieve sustainable growth of the Infrastructure Fund Market as stated in the growth strategies, etc., continued efforts for active participation by private sector investment is necessary while meeting the short-term listing needs.

[Reference] An excerpt from “Japan Revitalization Strategy 2016”

Section 2. Specific measures

2. Regulatory and system reforms to realize revolution in productivity

2-2. Revitalization of vital financial and capital markets

(5) Improvement of the convenience of financial and capital markets and their revitalization

- The Government will develop an environment necessary for sustainable growth of the Infrastructure Fund Market so that investors may easily invest in infrastructure assets.

[Outline for the FY 2017 Tax Reform]

The special measures on the pass-through treatment for tax purposes granted to an investment corporations(Infrastructure Fund) shall be extended for three more years from March 31, 2017. This measure is applicable to the acquisition of Renewable Energy Facilities and investments mainly in Renewable Energy Facilities under a silent partnership contract.

◆ Consumption Tax on “Virtual Currency”

[Background]

- The transfer of “virtual currency” is not stipulated as tax exempt under the Consumption Tax Act.
Meanwhile, the transfer of “the means of payment” under the Foreign Exchange Act and “Prepaid Payment Instruments” under the Payment Services Act, both of which are used merely as the means of settlement of the consideration for the transactions, are treated as nontaxable transactions.
- Given the fact that “virtual currency” has actual functions as measures of payment and settlement, the Payment Services Act has been amended, and the new regulatory framework has been put in place to ensure AML/CFT compliance by virtual currency exchanges and consumer protection.

[Outline for the FY 2017 Tax Reform]

The transfer of virtual currency stipulated in the Payment Services Act shall be exempted from consumption taxation.

Examples of tax exempt treatments of virtual currency in foreign countries

Country/Region	Tax treatment	Remarks
Europe (EU)	Tax-exempt	<p>The Court of Justice of the EU judged that the transfer of virtual currency falls under tax-exempt transactions as prescribed in the Council Directive on the Common System of Value Added Tax.</p> <p>* The judgement indicated that virtual currency is also included in the tax-exempt category of “Currency, bank notes and coins” under the Council Directive. (October 2015)</p>
United States (New York State)	Tax-exempt	<p>The New York State tax authority announced its view that virtual currency is tax exempt.</p> <p>* In New York State, intangible property is treated as nontaxable, under which virtual currency falls. (December 2014)</p>

Note: The Australian Department of Finance announced in March 2016 that with respect to the current tax law stipulating that virtual currency is subject to consumption taxes, it will consider appropriate legislative measures in cooperation with the industry community for the amendment to the Consumption Tax Act.