



## COMMITTEE REPORT: INTERNATIONAL PRACTICE

By **Tomoko Nakada**

# Japanese Inheritance and Gift Tax Reform

Increasing the taxes on the wealthy with worldwide assets

In April 2017, a new tax law took effect (the 2017 Reform) in Japan making it more difficult to avoid Japanese inheritance and gift tax by moving overseas. Before the 2017 Reform, wealthy Japanese individuals were able to avoid inheritance tax and gift tax by changing the residency of both the decedent/donor and the heir/devisee/donee more than five years before a lifetime gift or death. The government has now made that tax avoidance more difficult by extending the 5-year period to 10 years. Some Japanese senior business owners had moved to Singapore, where there's no gift or death tax. They brought their children with them, and all have been counting to five on their fingers. But, the wealthy father and his son now need to live outside of Japan for more than 10 years. The 2017 Reform was a part of the series of Japanese legislation to expand the scope of taxation on worldwide assets. Let's review the ramifications of the 2017 Reform on inheritance and gift taxation involving Japanese citizens and foreign citizens having a connection with Japan.

### Inheritance Tax in General

Japan imposes inheritance and gift tax on an heir/devisee/donee who receives the assets (collectively, the beneficiary). Neither the estate itself nor the executor is a taxpayer.

**Basic exclusion.** The basic exclusion amount (which is deducted from the amount of the total taxable<sup>1</sup> assets held by the decedent to calculate the tax base) for inheritance tax is: (1) 30 million<sup>2</sup> Japanese yen (JPY), plus (2) the amount obtained by multiplying JPY 6 million<sup>3</sup>

by the number of legal heirs (= JPY 30 million + (JPY 6 million × number of legal heirs)). For example, if a husband dies leaving a wife and two children (three heirs), the basic exclusion is JPY 48 million.<sup>4</sup> Some adopt their grandchildren to increase the number of legal heirs to reduce the inheritance tax.<sup>5</sup>

**Inheritance tax rate.** The calculation of the total inheritance tax amount is complicated. One doesn't multiply the value of the estate as a whole (after deducting the basic exclusion amount) by the tax rate to determine the total inheritance tax.<sup>6</sup>

**Spousal credit.** Unlike the unlimited marital deduction in the United States, the spousal credit for the Japanese inheritance tax is limited. That is, no Japanese inheritance tax will be imposed on amounts that the spouse receives up to the greater of: (1) the spouse's statutory share of the total taxable assets, and (2) JPY 160 million.<sup>7</sup> The statutory share of the spouse will be one-half<sup>8</sup> if the decedent is also survived by children. A wealthy U.S. husband with a Japanese wife told me, "My U.S. attorney made a perfect plan. No U.S. estate tax will be due when I die. I didn't expect that my wife would have to pay the tax on my U.S. assets to Japan!" He didn't know this limitation.

**Gift tax.** One can't avoid the inheritance tax by making a gift during the donor's lifetime. To deter such tax avoidance, the graduated gift tax rate structure imposes a higher tax rate at a lower threshold than in the inheritance tax.

### Narrowing the Loopholes

Wealthy Japanese individuals have tried to avoid taxes by transferring their assets overseas. In response, the Japanese tax agency has been expanding the scope of the taxes on overseas assets under the 2000, 2013 and 2017 Reforms.

**Before the 2000 Reform.** Only the residency<sup>9</sup> of



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the beneficiary mattered. So, a wealthy Japanese father used to tell his son, “Move out of Japan. I will give you my overseas assets. Then, you won’t have to pay any Japanese gift tax.” The son of a billionaire, the founder of a large consumer finance company in Japan, successfully escaped gift tax of JPY 133 billion<sup>10</sup> by moving to Hong Kong and receiving a gift of Dutch assets. The son won a case<sup>11</sup> filed against the tax agency. The tax agency refunded JPY 200 billion,<sup>12</sup> including interest, to the son.

**Before the 2013 Reform.** The citizenship of the beneficiary mattered. So, a wealthy Japanese grandfather was able to use a loophole by telling his son and his pregnant wife, “Why don’t you have the baby born in the United States?<sup>13</sup> I will give my grandchild, a U.S. citizen, my overseas assets. Then, he won’t have to pay Japanese gift tax.”

These loopholes are no longer available after the tax reforms in 2000 and 2013.

**After the 2013 Reform.**<sup>14</sup> There was, however, still a loophole. That is, when both the father and the son resided outside Japan for more than five years, no Japanese inheritance or gift tax would apply to overseas assets.

Imagine a wealthy retired Japanese owner of a big company. He lives alone in a luxury condo in Singapore. He has few friends. He’s just killing time. He always says, “I have to stay alive more than five years. Just a little more patience!” His son lives in the United States. If the owner resided in Singapore for more than five years after leaving Japan, no gift or death tax from any country would apply to his overseas assets.

### The 2017 Reform

A nightmare for this owner has occurred. The Japanese tax agency has extended the 5-year period to 10 years this year. He’s beginning to think about returning to Japan.

The 2017 Reform is also relevant to foreign citizens with worldwide assets. Relief is provided only to foreign residents temporarily working and living in Japan. In contrast, no relief is provided to other foreign residents. The 2017 Reform introduced a harsher rule, making the transfer of worldwide assets by foreigners who were long-term residents subject to Japanese inheritance and gift tax even after they leave Japan.

**Worldwide taxation.** Because of the beneficia-

ry-based tax in Japan, a beneficiary who’s a resident of Japan is subject to Japanese taxation on worldwide assets. A beneficiary who’s a non-resident in Japan can also be subject to the same worldwide taxation (excluding the case where the decedent/donor falls within certain exceptions), to prevent tax avoidance.<sup>15</sup> See “Scope of Japanese Inheritance and Gift Taxation,” p. 46. Note that this new rule will apply to a death or gift on and after April 1, 2017.

When can your client avoid Japanese inheritance tax on his U.S.-situs assets? Here’s the outline of the new rule from the standpoint of a decedent.

## The 2017 Reform targets wealthy Japanese citizens to prevent the outflow of wealth from Japan.

- 1. Japanese citizen.** Suppose your client is a Japanese citizen. Your advice to him is to stay alive more than 10 years after he leaves Japan. Count 10 years from the date of his departure. The beneficiary, who’s a Japanese citizen, also needs to meet that requirement.
- 2. Temporary resident.** Suppose your client is a U.S. citizen temporarily living and working in Japan. There are two requirements to be a temporary resident: (1) to reside in Japan with a “Table 1” visa<sup>16</sup> under the Immigration Control and Refugee Recognition Act (the Act), such as a work visa, and (2) having resided in Japan for not more than 10 years. Because the Table 1 visa includes work visas such as intra-company transferee and dependent visas, many foreign citizens and their family members are likely to satisfy these two requirements. Then, Japanese worldwide taxation won’t apply.
- 3. Not temporary resident.** In contrast, if your client is a U.S. citizen who: (1) resides in Japan with a “Table 2” visa<sup>17</sup> under the Act, such as a spouse visa, or (2) has resided in Japan for more than 10 years, your client won’t be a temporary resident, and Japanese worldwide taxation will apply.
- 4. Foreigners who left Japan.** Suppose your client is a U.S. citizen who’s resided in Japan for more than



## Scope of Japanese Inheritance and Gift Taxation

What it will be like after the 2017 Reform

Heir/Devisee/Donee (Taxpayer)		Decedent/Donor		Residence in Japan		No residence in Japan		
				Non-Japanese citizen	Temporary resident *A	Japanese citizen		Non-Japanese citizen
						Had residence in Japan within past 10 years	No residence in Japan within past 10 years	
Residence in Japan								
		Non-Japanese citizen	Temporary resident *A					
No residence in Japan	Had residence in Japan within past 10 years	Japanese citizen		*1	*1 *3	*1	*1 New	
		Non-Japanese citizen		<b>Tax on worldwide assets</b>			*2 New	
	Exception *B			*2	*2 *3	*2		
No residence in Japan within past 10 years						*3	Tax on Japanese-situs assets only	

To find the taxable assets, find the resident status of the beneficiary at the time of death or gift from the top and then find the resident status of the decedent/donor at the time of death or gift on the left.

\*A Temporary resident: Any resident (1) who had a status of residence listed in Table 1 of the Immigration Control and Refugee Recognition Act, such as a work visa, at the time of death or gift, and (2) whose total period of having residence in Japan is 10 years or less within the past 15 years prior to death or gift.

\*B Exception: Any decedent/donor (non-Japanese citizen) (1) who had no residence in Japan at the time of death or gift, (2) who had a residence in Japan at a point in time within the past 10 years prior to death or gift, and (3) whose total period

of having residence in Japan is 10 years or less within the past 15 years prior to death or gift.

\*1 All of the decedent/donor's worldwide assets are subject to inheritance/gift tax for 10 years after leaving Japan.

\*2 All of the decedent/donor's worldwide assets are subject to inheritance/gift tax for 5 years after leaving Japan.

\*3 Among the decedent/donor's worldwide assets, assets received by a Japanese heir/devisee/donee (collectively, the beneficiary) are subject to inheritance/gift tax for 10 years after the beneficiary leaves Japan.

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10 years and decides to return to the United States in the near future. Surprisingly, all your client's worldwide assets will remain subject to Japanese inheritance and gift tax for five years even after leaving Japan. A 10-year residency in Japan makes your client subject to Japanese worldwide taxation, but the 10-year period (from departure) for Japanese citizens

is shortened to five years for foreign citizens.<sup>18</sup>

In that case, the advice to your client is: Don't die within five years after leaving Japan. If he does, all his worldwide assets will be subject to Japanese taxes. Your client must stay alive more than five years after leaving Japan. Then, he'll fall within Exception B in the




chart. After that, among your client's worldwide assets, only assets inherited by a beneficiary who's subject to Japanese taxes (for example, your client's Japanese wife) will remain subject to Japanese inheritance tax for 10 years after your client's wife leaves Japan.

This new rule will affect in particular U.S. citizens with U.S. assets worth below the U.S. estate and gift tax exclusion amount (\$5.49 million in 2017) and above the Japanese basic exclusion amount. Because no U.S. estate tax is paid, there's no foreign tax credit against Japanese inheritance tax. Your client may have only U.S. assets, but your client's U.S. children who've never visited Japan will have to pay inheritance tax to Japan. On the other hand, suppose your client is a very wealthy U.S. citizen with U.S. assets worth above the U.S. exclusion amount. Here, double taxation will occur. The foreign tax credit under the U.S.-Japan Estate, Inheritance and Gift Tax Treaty and the Japanese Inheritance Tax Act<sup>19</sup> may provide some relief. But, the United States is the only country with an inheritance tax treaty with Japan. There will be more cases with no relief to avoid double taxation.

### Where Will Japan Go?

The 2017 Reform targets wealthy Japanese citizens to prevent the outflow of wealth from Japan. It won't let anybody go. But, the 2017 Reform has widened the scope of worldwide taxation too much by taxing foreigners who left Japan with respect to their foreign assets inherited by foreigners who are non-residents of Japan.

The policy reason of preventing tax avoidance isn't well grounded. Some U.S. citizens accumulated their U.S. assets before they came to Japan. Their heirs may be only U.S. children or U.S. siblings who've never visited Japan. A question about the basis of Japanese taxation on these beneficiaries exists.<sup>20</sup> It will also be difficult from a practical standpoint to enforce the taxes on foreign assets.<sup>21</sup>

Rather, we should consider the adverse impact of the 2017 Reform from broader economic and social perspectives. Many countries have abolished the death tax.<sup>22</sup> We shouldn't discourage foreigners from making long-term commitments to Japan. Otherwise, we won't be able to transition to a truly global community. 

### Endnotes

1. Taxable assets can be only Japanese-situs assets.

2. JPY 30 million = about \$278,220 (JPY 1 million = \$9,274, as of Sept. 8. The same conversion rate applies throughout this article.)
3. JPY 6 million = about \$55,644.
4. JPY 48 million = about \$445,152.
5. Only up to two adopted children (only one for a decedent with one or more biological children) can be counted as legal heirs for this purpose. Inheritance Tax Act, Article 15, Paragraph 2.
6. For the inheritance and gift tax rate, see Kenichi Sadaka, Kei Sasaki and Akira Tanaka, "Japan," *Private Client* 2017 (November 2016), at p. 69.
7. JPY 160 million = about \$1,483,840. Inheritance Tax Act, Article 19-2.
8. Civil Code, Article 900.
9. The legal residency for inheritance and gift tax purposes is the "principal place of living" under the Civil Code, Article 22. It's determined by objective factors such as the length of the person's stay, the person's occupation, the location of the person's spouse and other family members and the person's assets/property.
10. JPY 133 billion = about \$1,233,442,000.
11. Japan Supreme Court decision, in the case of Takefuji Corp. (Feb. 18, 2011).
12. JPY 200 billion = about \$1,854,800,000.
13. The son and his wife didn't reserve Japanese citizenship for the baby; thus, the baby held only U.S. citizenship status. This is because an individual with dual citizenship is deemed to be a Japanese citizen under the Inheritance Tax Act. Inheritance Tax Act Basic Circular (Directive), 1 no 3-1 no 4 kyo-7.
14. For the scope of the Japanese inheritance and gift tax before the 2017 Reform, see Akane R. Suzuki, Tomoko Nakada, Shigehisa Miyake and Hidehito Ogaki, "Navigating United States-Japan Estate Planning," *Trusts & Estates* (November 2013), at p. 67.
15. Inheritance Tax Act, Article 1-3 and Article 1-4.
16. Table 1 Visa: For example, highly skilled professional, business manager, legal/accounting services, medical services, engineer/specialist in humanities/international services, intra-company transferee, temporary visitor or dependent.
17. Table 2 Visa: permanent resident, spouse or child of Japanese citizen, spouse or child of permanent, long-term resident.
18. As a transition measure from April 1, 2017 to March 31, 2022, the 5-year rule (from departure) won't apply to foreigners who haven't resided in Japan from April 1, 2017 to the date of death or gift.
19. Inheritance Tax Act, Article 20-2.
20. See Masahiro Shibuya, "Implication of the Japanese Inheritance and Gift Tax Reform," 1455 *Jurist* (June 2013), at p. 46.
21. Enforceability on foreign assets is also a question. No information will be available to the Japanese tax agency about: (1) deaths of foreign citizens living outside Japan, and (2) their foreign assets. The tax agency needs to ask the United States for assistance under the Convention on Mutual Administrative Assistance in Tax Matters as well.
22. Barbara R. Hauser, "Death Taxes Around the World in 2013," *Trusts & Estates* (November 2013), at p. 56.