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Navigating United States–Japan Estate Planning

How to help your clients avoid unpleasant surprises

Dealing with Japanese legal and tax issues can be difficult; the Japanese legal system differs greatly from that of the United States. Japanese tax rates are high and the language barrier can make communication challenging. Add to those obstacles Japanese cultural reticence to talk about death, and things get even more difficult. But, letting your client bury his head in the sand isn't an option. In this unique collaboration by a Japanese lawyer, two Japanese tax advisors and a U.S. lawyer, we give you an overview of the Japanese legal and tax rules that arise following someone's death and some tips to assist you in advising your clients. We focus on planning for Japanese citizens living in the United States and U.S. citizens who own assets in Japan.

The Basics

Let's start by reviewing the key elements of Japanese inheritance law.

No probate. The Japanese Civil Code[1] follows the concept of universal succession, whereby title vests immediately in the heirs or devisees on a decedent's death. Thus, there's no need for probate to transfer title. While this is convenient in many cases, there can be surprises for a U.S. advisor. For example, if the decedent had more debt than assets, the heirs will inherit the net liability, unless they renounce the inheritance within three months of learning about the death.

Governing law. Under Japanese law, the law of the decedent's citizenship at the time of the execution of a will governs the will's validity.[2] Similarly, for Japanese citizens, Japanese law governs other inheritance-related matters, such as intestacy distribution and any restrictions on the testator's testamentary freedom.[3] Thus, if you're dealing with a Japanese citizen client, you need to consider the application of Japanese law, regardless of the client's residence at the time of death.

Will vs. intestacy. Compared to the United States, fewer people in Japan make wills. Instead, many Japanese rely on intestacy distribution. See "Intestacy Distribution," p. 66. But, when there are multiple heirs, an intestacy distribution can take longer because the heirs must agree on how to divide the specific assets among themselves. This situation can also result in disputes, which may require resolution by mediation or even court order. Therefore, a will is preferable if the testator wishes to deviate from the intestacy scheme, has multiple heirs or wants to allocate certain assets to certain heirs (even if the value distributed to the heirs ultimately reflects the intestacy distribution).

U.S. will vs. Japanese will. Japan ratified the Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions (Convention No. 9, effective June 19, 1964) and enacted domestic law to conform to the Convention.[4] Under these rules, Japan will recognize a will that's validly executed under the law of the place of the testator's residency, even if it's not Japan. In other words, a Japanese citizen living in the United States can make a valid will under the law of his home state.

As a practical matter, however, it's usually better to

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execute a separate Japanese will. Getting a U.S. will recognized in Japan requires both U.S. and Japanese attorneys to explain to the relevant authorities why the will should be accepted. Obtaining accurate translations and appropriate certifications can be costly. Because of these hurdles, it may take additional time and money to effectuate the change of title. There are two major forms of Japanese wills under the Japanese Civil Code: (1) a handwritten (holographic) will,[5] and (2) a notarial will.[6] Generally, notarial wills are better because they're less likely to be challenged.[7]

But, a significant stumbling block to creating a notarial will is that, in most cases,[8] the client will need to visit Japan to do so. This requirement may be difficult in some circumstances. The client may have no choice but to use a U.S. will, despite the anticipated additional cost and time to have the will recognized in Japan.

Forced heirship. Japan protects forced heirship rights, otherwise known as the "legally secured portion."[9] In essence, one-third to one-half of the decedent's assets are reserved for the eligible heirs (spouse, children and parents, but not siblings). See "Forced Heirship," this page. For example, if the decedent had a spouse and one child, the legally secured portion for each is one-quarter. Note that the eligible heir must assert this right; if a will infringes on forced heirship rights, but the eligible heir fails to claim his right within the prescribed period of time, the will stands. This rule applies even to Japanese citizens living in the United States, at least in theory. One method to avoid forced heirship is to renounce Japanese citizenship, but it's not an appealing option for many Japanese clients for personal and cultural reasons.

Trusts in Japan. Despite its civil law tradition, Japanese law allows the creation of trusts as an estate-planning device. Whether trusts created under foreign laws have effect with regard to Japanese assets, however, is less clear. Japanese statutes don't directly address this issue. According to influential academics,[10] Japanese courts are likely to follow U.S. law on the validity and effect of a trust if the trust instrument designated U.S. law. Thus, a U.S. trust should, in theory, be recognized in Japan.

As a practical matter, it will be easier for the beneficiaries if the assets in Japan are held in Japanese trusts. Courts, government officials handling real property title registration and bank officials are less likely to view Japanese trusts with confusion and suspicion, causing fewer problems.

That said, trusts aren't widely used in Japan for estate-planning purposes. Since succession doesn't require probate, there's no need to create trusts to avoid it. A trustee is required to be licensed by the government, and there are only a small number of such licensed trustees. Japanese people tend to use wills to dispose of their assets instead.

Inheritance and Gift Tax System

Tax on the beneficiary. Unlike the U.S. transfer tax

Intestacy Distribution

Spouses get at least one-half of the estate

Priority	Blood relatives	Spouse	Relative portions	
			Blood relatives	Spouse
First	Direct descendants	Spouse	1/2	1/2
Second	Direct ascendants	Spouse	1/3	2/3
Third	Siblings (or their children, if deceased)	Spouse	1/4	3/4

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Forced Heirship

One-third to one-half of all assets are reserved for eligible relatives

Priority	Legally reserved portion (relative to the whole)	Allocation	
		Spouse	Blood relatives
Spouse and descendants	1/2	1/4	1/4
Spouse and ascendants	1/2	1/3	1/6
Spouse and siblings	1/2	1/2	Zero
Descendants only	1/2	None	1/2
Ascendants only	1/3	None	1/3

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A Wide Scope

To which assets do Japanese inheritance tax and gift tax apply?

Decedent/Donor \ Beneficiary	Resides in Japan at death/gift	Does not reside in Japan at death/gift: Japanese citizen: Resided in Japan during 5 years prior to death/gift	Does not reside in Japan at death/gift: Japanese citizen: Did not reside in Japan during 5 years prior to death/gift	Does not reside in Japan at death/gift: Non-Japanese citizen
Resides in Japan at death/gift	Worldwide asset taxation	Worldwide asset taxation	Worldwide asset taxation	New as of April 2013: Worldwide asset taxation
Does not reside in Japan at death/gift: Resided in Japan during 5 years prior to death/gift	Worldwide asset taxation	Worldwide asset taxation	Tax Japanese assets only	Tax Japanese assets only
Does not reside in Japan at death/gift: Did not reside in Japan during 5 years prior to death/gift	Worldwide asset taxation	Tax Japanese assets only	Tax Japanese assets only	Tax Japanese assets only

To find the applicability of the tax, find the resident status of the decedent/donor on the left, and then find the box corresponding to the beneficiary's status from the top.

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system, the Japanese inheritance and gift tax system taxes the beneficiary, rather than the decedent's estate or the donor (collectively, the transferor). The beneficiary must file a tax return and pay the tax. The tax is imposed on a worldwide basis, but foreign assets may be excluded, depending on the respective residences[11] of the transferor and beneficiary.[12] See "A Wide Scope," this page.

Of particular note is the recent change in the scope of taxation (shown as "new" in "A Wide Scope"). Starting in April 2013, if the transferor resides in Japan, then the transferor's worldwide assets are subject to tax, even if the beneficiary isn't a Japanese citizen. For example, imagine a U.S. citizen living in Japan, perhaps working for a Japanese subsidiary of a U.S. corporation. When he dies, Japan taxes his U.S. assets passing to his U.S. citizen children, who may never have set foot in Japan! Those children are required to file tax returns with the Japanese government and pay the tax.

The Japanese inheritance tax and gift tax are imposed independently of each other. But, if the beneficiary of a gift who meets certain eligibility requirements chooses the unified tax reporting method at the time of the gift, the beneficiary can calculate the gift tax and inheritance tax under a unified system,[13] similar to that of the United States, at the time of the donor's death.

Gift tax. In the United States, general wisdom dictates that inter vivos gifting is more advantageous than transfers at death. In contrast, the Japanese gift tax is more onerous than the inheritance tax because the rate brackets are more compressed. See "Gift Tax Rates," p. 68. There's an annual exclusion from the gift tax of ¥1,100,000 per donee (one yen equals about .01 U.S. dollar).[14] Note that there's only one exclusion

Gift Tax Rates

These amounts are more onerous than those for inheritance

Up to ¥ 2,000,000	10%
¥ 2,000,001 – ¥ 3,000,000	15%
¥ 3,000,001 – ¥ 4,000,000	20%
¥ 4,000,001 – ¥ 6,000,000	30%
¥ 6,000,001 – ¥ 10,000,000	40%
¥ 10,000,001 or more	50%

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per donee. No matter how many donors there are, the most that a person can receive under the exclusion is ¥1,100,000. The gift tax return is due March 15 of the year following the year of the gift.

Inheritance tax. The inheritance tax is calculated on the assumption that the assets are passing under intestacy. Then, the tax is allocated to each beneficiary based on the amount actually received. Lifetime gifts made by the decedent within three years of death are added back to the taxable amount. The basic exclusion is ¥50,000,000 plus ¥10,000,000, multiplied by the number of legal heirs (¥50,000,000 + (¥10,000,000 x # of legal heirs)). The tax rates range from 10 percent to 50 percent.[15] See "Inheritance Tax Rates," this page. If the beneficiary isn't the decedent's child, parent or spouse, the gross tax amount before deductions is increased by 20 percent.[16] The filing deadline is 10 months from the date of death.

Note that in 2015, there will be some changes. The inheritance tax will become more burdensome. The basic exclusion will be reduced (¥30,000,000 + (¥6,000,000 x # of legal heirs)), and the top marginal rate will be increased to 55 percent for assets worth more than ¥600,000,000. In contrast, the gift tax burden will be less in some cases because of the changes to the rate structure. This shift may encourage lifetime gifting in the future.

Taxation of trusts. Trusts don't create any tax advantages under the Japanese inheritance and gift tax laws. The trust is essentially ignored for tax purposes, and the trust beneficiary is taxed as if he received the assets outright, even if he never gains unfettered access to the principal. If the trust has multiple discretionary beneficiaries, the situation is problematic because the tax laws aren't clear on how the tax will be allocated. There's no "sheltering" of the decedent's inheritance tax exemption (as in the typical spousal trust planning in the United States) because when the income beneficiary dies, the trust assets are treated as passing from the income beneficiary to the remainder beneficiary. Thus, the trust assets received by the remainder beneficiary are, once again, subject to the inheritance tax.

In fact, in a blended family situation, the trust can actually increase the tax burden because of the 20 percent surcharge mentioned above. Suppose Harry leaves everything in trust for his wife Wendy's lifetime, with the remainder to pass to Harry's child from a prior marriage. When Wendy dies, the trust assets are considered to pass from Wendy to the stepchild. Because there's no blood relationship between Wendy and the stepchild, the 20 percent surcharge applies. In contrast, if the assets pass directly from Harry to his child, the surcharge doesn't apply.

Common technique using life insurance. A commonly used estate-planning technique for those individuals subject to Japanese inheritance tax involves life insurance. The proceeds of a life insurance policy funded

Inheritance Tax Rates

These are calculated assuming assets are passing under intestacy and then allocated to each beneficiary based on the amount actually received

Up to ¥ 10,000,000	10%
¥ 10,000,001 – ¥ 30,000,000	15%
¥ 30,000,001 – ¥ 50,000,000	20%
¥ 50,000,001 – ¥ 100,000,000	30%
¥ 100,000,001 – ¥ 300,000,000	40%
¥ 300,000,001 or more	50%

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by the decedent are subject to the inheritance tax, in principle. However, if the decedent's legal heirs receive the proceeds, a special exemption equal to ¥5,000,000 multiplied by the number of legal heirs applies.[17] Therefore, the decedent can leave more to his heirs if the inheritance is in the form of life insurance proceeds.

United States–Japan Treaty

Given the broad reach of both Japanese and U.S. transfer taxes, double taxation is a real possibility. The 1955 United States–Japan Estate, Inheritance and Gift Tax Treaty is intended to alleviate the impact of such treatment.

The treaty specifies the situs of certain classes of assets.[18] It also provides a treaty exemption when one country taxes solely based on an asset's situs.[19] For example, if a Japanese person who's a non-resident of the United States dies with a U.S. situs asset (such as U.S. real estate) and the beneficiary is a domiciliary of Japan, the United States would tax the transfer solely based on the situs of the asset (the real property in the United States). In that case, the United States must provide a pro rata estate tax exemption that reflects the value of the U.S. assets over the decedent's worldwide assets. Thus, if the U.S. assets represent 10 percent of the non-resident alien decedent's total assets, the exemption is 10 percent of $5.25 million. Correspondingly, if Japan is taxing solely based on the situs of the property (for example, a U.S. citizen residing in the United States, but owning real property in Japan), it must allow a treaty exemption against the inheritance tax. This exemption also applies in the gift tax context. To claim the treaty exemption, the donor or the estate must disclose the worldwide assets and the treaty position.[20] Deductions are also allowed on the same prorated basis. If there's still double taxation after these relief provisions, the treaty provides a death tax credit as well.[21] Treaty credits must be claimed within five years of the due date of the tax.[22]

Non-Legal Considerations

Practical planning can make the post-death transition go more smoothly. Encourage your client to make a list of all the relevant information—for example, the names and contact information of family members or the location of Japanese assets—in English. Unless the fiduciary is also bilingual, it can take time and money to translate this basic information. Keep in mind that being able to speak Japanese isn't necessarily the same as being able to read Japanese; U.S.-born children of Japanese descent often speak fluent Japanese, but have a hard time reading or writing Japanese text. The client should keep copies of birth, marriage and death certificates of family members. The Japanese government maintains an official registry of each Japanese citizen's family history. Thus, third parties routinely ask for copies of the registry to prove kinship. Unless your client and all his heirs are Japanese citizens, they'll need other methods of proving kinship. Finally, identifying the appropriate Japanese professionals before the client passes away is extremely helpful. Japanese lawyers generally don't handle tax matters. Instead, licensed tax advisors ("zeirishi") handle tax advice and compliance.

Tips for Practitioners

Is your head spinning yet? We've put together some practical tips to help you navigate these issues:

- Encourage your client to plan. Making a will is better, and more predictable, than relying on default rules.
- A separate Japanese will is often advisable. A notarial will made in Japan is best, but if that's not possible, consult a Japanese lawyer about using a U.S. will.
- Be mindful of the forced heirship rules if you have a Japanese citizen client. If this is a concern, consult local counsel.
- Be careful about using trusts. Putting Japanese assets in trust may create practical problems, and it may not achieve the best tax result.
- Inter vivos gifting can be quite costly if the transfer is subject to the Japanese gift tax. Consult a Japanese tax advisor.
- Consider the timing of estate and inheritance tax returns. Because the U.S. estate tax return is due one month earlier than the Japanese inheritance tax return, you'll need to ask the Japanese side to work on an expedited schedule to establish the values of Japanese assets.
- If you have a U.S. citizen client living in Japan who wants to leave U.S. assets to U.S. beneficiaries, the client may want to move his residency out of Japan before death.
- If your client tells you that his Japanese parent passed away, encourage the client to seek advice in Japan. You don't want him to unwittingly inherit debt or miss the opportunity to assert forced heirship rights.
- Seek the assistance of local advisors and coordinate!

Endnotes

1. Modeled after the civil codes of France and Germany.
2. Hono tekiyo ni kansuru tsusokuho (Act on general rules for application of laws of Japan), art. 37.
3. *Ibid.*, art. 36.
4. Igon no housiki no junkyoho ni kansuru houritsu (Act on the law applicable to the forms of wills), art. 2.
5. Minpo (Civil Code), art. 968.
6. *Ibid.*, art. 969.
7. A Japanese citizen can validly execute a handwritten will pursuant to the Japanese Civil Code, even if he resides outside of Japan. Non-Japanese citizens may do so in certain limited circumstances. But, unless the client consults a Japanese attorney in crafting the will, a handwritten will has the same potential problems as any do-it-yourself will.
8. Technically speaking, Japanese citizens can go to the Japanese consulate to make a notarial will. Minpo, *supra* note 5, art. 984. However, the consuls are often unwilling to perform this service, due to lack of experience.
9. Minpo, *supra* note 5, art. 1028.
10. *See, e.g.*, Makoto Shimada, Kokusai sintaku no seiritsu oyobi kouryoku no junkyoho (1)(2) (Laws governing validity and effects of international trust), Keio hogaku, No. 10 (2008) and No. 13 (2009), Kokusai sintaku ni kakawaru houritsu mondai no junkyoho kettei kijun (Laws applicable to legal issues concerning international trusts), Keio hogaku No. 11 (2008).
11. "Residence" under the Japanese tax laws means the place where one's life is based. It's a concept somewhat similar to "domicile" under U.S. transfer taxes.
12. Sozokuzeiho (Inheritance Tax Code), art. 1-3.
13. *Ibid.*, art. 21-9.
14. Sozei tokubetsu sochiho (Special taxation measures code), art. 70-2-3.
15. Sozokuzeiho, *supra* note 12., art. 15 and 16.
16. *Ibid.*, art. 18.
17. *Ibid.*, art. 12.
18. United States–Japan Estate, Inheritance and Gift Tax Treaty, April 16, 1954, art. III.
19. *Ibid.*, art. IV.
20. Internal Revenue Code Section 6114.
21. *Supra* note 18, art. V.
22. *Ibid.*