

The FY2021 Tax Reform and Request Items for the FY2022 Tax Reform

With a view to establishing Tokyo as a global financial center and attracting businesses, human resources, and funds from overseas, the Outline for the FY2021 Tax Reform includes tax measures for corporate taxation, asset taxation, and personal income taxation. In addition, the Tax Reform Request for FY2022 has been compiled to create an investment-friendly environment and promote further digitalization. This report outlines both the FY2021 Tax Reform and the Tax Reform Request for FY2022.

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1. FY2021 Tax Reform

1-a. Tax measures for the development of a Global Financial Center

With a view to attracting businesses, human resources, and funds from overseas to establish Tokyo as a global financial center, the Outline for the FY2021 Tax Reform includes the following tax measures for corporate taxation, asset taxation, and personal income taxation as part of efforts to resolve various issues.

Corporate taxation (Corporate tax: Imposed on investment management companies)

Previously, with respect to the corporate tax imposed on investment management companies, performance-linked remuneration for executives of unlisted companies was not deductible.

The FY2021 Tax Reform has allowed performance-based remuneration for executives of unlisted non-family companies, etc., whose main business is investment management, treated as a deductible

expense, provided that they disclose the calculation method and the performance, etc., on the Financial Services Agency's website, etc., in light of the circumstances where such compensation is generally subject to the scrutiny of stakeholders such as investors.

Asset taxation (Inheritance tax: Imposed on heirs such as fund managers)

Conventionally, foreign property of foreign nationals who have resided in Japan for more than 10 years was subject to inheritance tax. If the period of residence was less than 10 years, property in Japan only was subject to taxation.

With the FY2021 Tax Reform, in the interest of facilitating the employment, etc. of highly-skilled foreign personnel in Japan, foreign property of foreign nationals residing in Japan for work, etc. is no longer subject to inheritance tax, etc. provided that the property is inherited by foreign nationals residing outside Japan or staying in Japan for a short period of time, etc. regardless of their period of residence.

Personal income taxation (Income tax: Imposed on individual fund managers)

Under the previous tax system, it was unclear whether profits distributed from a fund in excess of equity interest in accordance with the fund manager's investment performance constituted financial income.

The FY2021 Tax Reform has clarified that distributions of partnership profits

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(carried interest) received by fund managers from funds in which they hold equity interest (partnerships whose business is the transfer of shares, etc.) in excess of equity interest are subject to separate taxation (a flat rate of 20%) as profit from the transfer of shares, etc., instead of being subject to comprehensive taxation (progressive tax rate up to 55%) as considerations for services, provided that the distribution ratio is economically reasonable. The FSA will establish necessary measures to ensure the

convenience and accuracy of tax returns filed by fund managers in such circumstances.

Exemption from filing for investments in Japanese funds through overseas funds

In addition, when investing in a Japanese fund through a foreign fund, etc., foreign investors are exempted from filing a tax return in Japan even if the ownership interest in the foreign fund, etc. is 25% or more but the ownership interest per investor is less than 25%.

Outline of the FY2021 Tax Reform Items and the impact on asset managers

	(Tax rate)	(Before the reform)	(Tax rate)	(Content of the reform)
Outline	30%	<ul style="list-style-type: none"> Performance-based compensation for executives of unlisted companies <u>could not be expensed</u>. 	0%	<ul style="list-style-type: none"> Performance-based remuneration for executives of unlisted companies, etc., primarily engaged in the Investment Management Business, can be recorded as a necessary expense if certain requirements are met.
	0~55%	<ul style="list-style-type: none"> Overseas assets owned by foreign nationals who have resided in Japan for more than 10 years were <u>subject to Inheritance Tax</u>. 	0%	<ul style="list-style-type: none"> In the event of the death of a foreign national who resided in Japan for employment, etc., regardless of the period of residence in Japan, overseas assets acquired by his/her family members, etc., residing abroad through inheritance are exempted from Inheritance Tax.
	0~55%	<ul style="list-style-type: none"> <u>Unclear</u> what is taxable on profits distributed in excess of equity interest 	20%	<ul style="list-style-type: none"> Clarified that "profit distributed in excess of equity interest" is subject to separate taxation (a flat rate of 20%) as profit from the sale of the equity share price in certain cases.
Impact on asset managers	<ul style="list-style-type: none"> (Corporation Tax) A 30% tax on executive compensation of asset management companies will be exempted, enabling asset managers to provide their executives with full compensation. (Inheritance Tax) Foreign nationals who have resided in Japan for more than 10 years will be exempted from taxation on their overseas assets. (Income Tax) The amount of taxation on "profits distributed in excess of equity interest" will be reduced to a flat rate of 20%. 			

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2. Tax Reform Request for FY2022 : Creation of an investment-friendly environment and promotion of further digitalization

In Japan, each ministry in the government will submit the “Tax Reform Request” for next Fiscal Year, usually during August to September. This will be screened and aggregated into “Tax Reform Proposals”, which will be determined by the cabinet. This will finally go through the discussion at the national diet (parliament), and finally go into legislation if the bill has passed the diet.

Here, we summarized the Tax Reform Request, announced by the JFSA (Japanese Financial Services Agency), the regulatory body in Japan. As mentioned above, these requests are yet to be fixed at current status (and uncertain whether it will be realized), but we would like to introduce the government’s efforts on reformation, and how it may affect the asset management industry.

2-a. Unification of taxation on financial income

Expansion of the scope of aggregation of profits and losses related to financial instruments

- Expansion of the scope of aggregation of profits and losses for financial instruments to include derivatives transactions, deposits and savings, etc.
 - Currently, aggregation of profits and losses is not available for derivatives transactions, deposits, and savings, etc.
 - This may provide more benefits to the investors, leading to the expansion of the business opportunities for asset managers.

2-b. Revision of inheritance tax on listed shares, etc.

- Review the inheritance tax assessment method for listed shares, etc.
 - Currently, listed shares, etc. that have become inherited property are (in principle) valued at their market value at the time of inheritance, though the moment of inheritance tax payment is later than that, conveying the risk of price fluctuations (=decline in stock prices).
 - This may prevent the citizens from selling stocks in anticipation of a decline in prices after inheritance.

2-c. Enhancement of convenience of NISA accounts, further digitalization of tax procedures

Use of My Number Card when opening a NISA account

- Necessary improvements be made so that investors can immediately confirm whether or not they have a NISA account by using their My Number Card
 - NISA (Nippon individual savings account) is the system granting tax-exempt benefits for investors. Each investor can open only one account.
 - Currently, if applicants are not sure whether they already have a NISA account, there is no system to immediately confirm eligibility.
 - By using “My Number Card”, a government-issued card (which could be used for identity verification as well as to receive a wide range of governmental services), this confirmation could be done immediately, leading to the easiness of the individual investors to start investments by utilizing NISA.

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Promotion of further digitalization of tax procedures, etc.

- Necessary measures be taken to enable procedures between financial institutions and tax authorities to be transmitted in a data format that can be immediately utilized by tax authorities.
 - Currently, only PDF or hardcopy documents are used for transactions between financial institutions and tax authorities, limiting data utilization by tax authorities. Furthermore, financial institutions still need to convert electronic data received from customers into document format such as PDF, also preventing improvements in efficiency through digitalization.
 - This may improve the efficiency on both government (tax authority) side and financial institutions side for operations related to taxations.

*Please note that we are covering only major items of the Tax Reform Request, and also summarized the outline. If you want to learn more exhaustive menu, or details of each contents, please visit the government website, or feel free to ask the secretariat. (fincitytokyo@jp.ey.com)

Sources and full text:

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