

JAPAN

Law and Practice

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Contents

1. Tax p.4

- 1.1 Tax Regimes p.4
- 1.2 Exemptions p.5
- 1.3 Income Tax Planning p.5
- 1.4 Taxation of Real Estate Owned by Non-residents p.5
- 1.5 Stability of Tax Laws p.6
- 1.6 Transparency and Increased Global Reporting p.6

2. Succession p.6

- 2.1 Cultural Considerations in Succession Planning p.6
- 2.2 International Planning p.6
- 2.3 Forced Heirship Laws p.7
- 2.4 Marital Property p.7
- 2.5 Transfer of Property p.8
- 2.6 Transfer of Assets: Vehicle and Planning Mechanisms p.8
- 2.7 Transfer of Assets: Digital Assets p.8

3. Trusts, Foundations and Similar Entities p.8

- 3.1 Types of Trusts, Foundations or Similar Entities p.8
- 3.2 Recognition of Trusts p.9
- 3.3 Tax Considerations: Fiduciary or Beneficiary Designation p.9
- 3.4 Exercising Control Over Irrevocable Planning Vehicles p.9

4. Family Business Planning p.9

- 4.1 Asset Protection p.9
- 4.2 Succession Planning p.9
- 4.3 Transfer of Partial Interest p.10

5. Wealth Disputes p.10

- 5.1 Trends Driving Disputes p.10
- 5.2 Mechanism for Compensation p.10

6. Roles and Responsibilities of Fiduciaries p.10

- 6.1 Prevalence of Corporate Fiduciaries p.10
- 6.2 Fiduciary Liabilities p.11
- 6.3 Fiduciary Regulation p.11
- 6.4 Fiduciary Investment p.11

7. Citizenship and Residency p.11

7.1 Requirements for Domicile, Residency and Citizenship p.11

7.2 Expeditious Citizenship p.11

8. Planning for Minors, Adults with Disabilities and Elders p.12

8.1 Special Planning Mechanisms p.12

8.2 Appointment of a Guardian p.12

8.3 Elder Law p.12

9. Planning for Non-traditional Families p.12

9.1 Children p.12

9.2 Same-Sex Marriage p.12

10. Charitable Planning p.12

10.1 Charitable Giving p.12

10.2 Common Charitable Structures p.12

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offers tailor-made solutions that address the diverse needs of high net worth clients, including private business owners, founders and major shareholders of listed companies and private investors. It brings together attorneys and tax accountants with rich knowledge and experience in not only dispute resolution, but also fields as diverse as domestic and cross-border corporate reorganisation, trusts, international taxation and more, to provide services as part of the firm's wealth management practice group.

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1. Tax

1.1 Tax Regimes

Income Tax

The annual tax rate is based on taxable income, ranging from 5% for income of JPY1.95 million or less to 45% for income over JPY40 million. In addition, an income surtax will be applied on income earned through 31 December 2037 at the rate of 2.1% of the base income tax liability, to secure the financial resources for recovery from the Tohoku Earthquake in 2011. Municipal income and prefectural income taxes are also imposed on taxable income, at a combined rate of 10%.

Certain types of capital gains are treated separately from other types of income. For example, capital gains from the sale of real estate owned for more than five years or from the sale of stock in a corporation will generally be subject to a flat rate of 20.315% (national tax and local tax combined). For capital gains from the sale of real estate owned for five years or less, a flat rate of 39.63% (national tax and local tax combined) will apply.

Starting in 2025, a minimum tax will be applied to ultra-wealthy individuals. Specifically, taxpayers with annual income exceeding JPY330 mil-

lion will be subject to additional income tax on the excess amount, ensuring that the overall tax rate on their income is at least 22.5%.

For Japanese income tax purposes, all individuals are classified as residents (including non-permanent residents) or non-residents. Residents will generally be subject to Japanese income tax on their worldwide income. However, non-permanent residents who do not have Japanese citizenship and who have spent a total of five years or less within the past ten years as residents in Japan are taxed on their Japan-sourced income and on their non-Japan-sourced income to the extent that it is remitted to Japan. Non-residents are persons who are not treated as residents. Japanese income tax on non-residents is assessed on Japan-sourced income only.

Rental income and capital gains from real estate located in Japan are always treated as Japan-sourced income. To reduce the tax burdens arising from real estate, certain special tax structures (eg, TMK or TK-GK schemes) are commonly used by non-resident investors.

Inheritance Tax

Inheritance tax is imposed on an individual who acquires property by inheritance or bequest upon the death of the decedent. It is imposed on the

aggregate value of all the properties acquired. The taxable base of property for inheritance tax purposes is the fair value at the time of death of the decedent.

If the aggregate value does not exceed the basic deduction, no inheritance tax will be levied. Currently, the basic deduction is equal to JPY6 million multiplied by the number of statutory heirs, plus JPY30 million.

The total inheritance tax is calculated based on the entire estate, regardless of how the assets are transferred to each heir and legatee, at progressive tax rates ranging from 10% for JPY10 million or less to 55% for more than JPY600 million. The total amount of tax is then allocated among those who will actually receive the estate assets in accordance with the decedent's will or the agreement among the heirs. Since there is a special exemption for spouses, in many cases they do not have to pay inheritance tax.

Gift Tax

Gift tax is imposed on an individual who acquires properties as a gift during the lifetime of the donor. The gift tax is calculated based on the fair value of all gifts at the time of transfer during a calendar year, after deducting an annual basic exemption of JPY1.1 million, at progressive tax rates ranging from 10% for JPY2 million or less to 55% for more than JPY45 million, in the case of gifts received by a person aged 18 years or older from a lineal ascendant.

Who is Subject to Inheritance and Gift Taxes?

For Japanese inheritance tax and gift tax purposes, all individuals are classified as either residents or non-residents, depending on their place of domicile. Their nationality and the length of the residency also matter.

1.2 Exemptions

Any gift or inheritance of shares in a private company that is effective between 2018 and 2027 as part of a business succession plan may be exempt from gift or inheritance tax if certain requirements are met.

As stated in **2.6 Transfer of Assets: Vehicle and Planning Mechanisms**, the transfer of assets to a spouse would usually be exempt from inheritance tax. With respect to gift tax, there are special tax treatments for transferring assets to younger generations for education, residence acquisition and other purposes.

1.3 Income Tax Planning

In Japan, purchasing real estate to be depreciated is the most common form of planning to create tax losses, which reduces the amount of income tax.

1.4 Taxation of Real Estate Owned by Non-residents

As stated in **1.1 Tax Regimes**, rental income and capital gains from real estate owned by non-residents and located in Japan are always treated as Japan-sourced income. To reduce the tax burdens arising from real estate, certain special tax structures (eg, TMK or TK-GK schemes) are commonly used by non-resident investors.

1.5 Stability of Tax Laws

Japan amends its tax laws every year. The following recent amendments have had a significant impact on high net worth individuals.

Scope of Inheritance and Gift Taxes

There have been changes to the scope of inheritance and gift taxes, depending on the status of the heir/donee and the deceased/donor. For instance, before 2017, to avoid inheritance and

gift taxes, a family generally needed to emigrate from Japan to a foreign country and stay there for more than five years and also change the location of their assets from Japan to a foreign country. However, after 2017, the term of five years was extended to ten years.

Introduction of Exit Tax

The Japanese government introduced an exit tax effective from 1 July 2015, which is applicable to certain expatriating Japanese individual residents; see **2.2 International Planning**.

COVID-19

To simplify the tax filing procedures, Japanese tax authorities have started to accept tax returns and other tax documents that are not sealed by the taxpayers. They are also promoting the electronic filing system, the so-called “e-tax”.

1.6 Transparency and Increased Global Reporting

Tax Treaties

Japan has concluded many tax treaties, most of which include an exchange of information clause. Japan is also a signatory to the Convention on Mutual Administrative Assistance.

Common Reporting Standard (CRS)

For the purposes of implementing an exchange of information based on the CRS, Japan adopted a system for financial institutions to report relevant information to the competent tax offices in its 2015 tax reforms.

Reporting System

In an effort to improve compliance and enforcement with respect to the reporting of income from overseas assets, the foreign asset report requirement was introduced on 1 January 2014 for permanent individual residents who own overseas assets of more than JPY50 million in

aggregate. A permanent individual resident is an individual resident who has Japanese nationality or who has been in Japan in excess of five years out of the preceding ten years.

2. Succession

2.1 Cultural Considerations in Succession Planning

It is a tradition in Japan for older generations to pass on their wealth to younger generations. Donations to charity funds have recently become popular among founders because the donated assets are not subject to inheritance tax upon their death, as stated in **3.1 Types of Trusts, Foundations or Similar Entities**.

2.2 International Planning

As seen in **1.1 Tax Regimes**, the rates of inheritance tax and gift tax are very high in Japan, so international planning is essential for high net worth families. To avoid inheritance and gift taxes, a family generally needs to emigrate from Japan to a foreign country and stay there for more than ten years, and also change the location of their assets from Japan to a foreign country.

In connection with this, the exit tax regime introduced in 2015 is critical for the emigrating family. Under this tax regime, a Japanese resident will be subject to an individual income tax on unrealised gain from certain securities upon the resident’s emigration from Japan if certain conditions are met. The exit tax is applicable to a person who:

- is a Japanese resident whose place of domicile (*kyusho*) or residence (*kyusho*) has been Japan for more than five years out of the ten years prior to the emigration; and

- has taxable assets with a combined value of JPY100 million or more – ie, certain securities, interests in a silent partnership (*tokumei kumiai*), unsettled credit transactions and unsettled derivatives.

As a result of the introduction of the exit tax regime, it has become difficult for families who have securities (such as shares in their own businesses) with a significant amount of unrealised gains to emigrate from Japan. However, other families who only have assets with no unrealised gains are still in a good position to consider international planning.

2.3 Forced Heirship Laws

Under Japanese law, the rules of inheritance are governed by the law of the nationality of the decedent. Therefore, if a decedent's nationality at the time of their death is Japanese, then Japanese law governs the rules of inheritance.

Under the Japanese Civil Code, all rights and obligations (except those that are purely personal) of the deceased transfer to the heirs automatically and comprehensively at the time of the decedent's death.

As Japan ratified the 1961 Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions in 1964, the formality of a will made in a form that satisfies relevant foreign law requirements may be admitted. However, the contents of a will are governed by the law of the nationality of the decedent.

As is the case in other civil law jurisdictions, statutory reserved portions of certain statutory heirs are provided for in the Civil Code. A statutory reserved portion enables certain persons to claim a share of an estate if they are excluded from succession by the decedent's

will. Although the decedent may determine the allocation of their estate property by will, their spouse, children and lineal ascendants as heirs will have a right to receive their statutory shares of the estate under forced heirship rules.

As a result of the amendments to the Civil Code regarding the succession system, which became effective on 1 July 2019, certain rules regarding forced heirship rules were changed (eg, gifts made ten years or more before the decedent's death are generally not counted in the calculation of the statutory reserved portion of the estate for certain heirs).

2.4 Marital Property Common Property

Assets obtained during marriage are deemed common property, even when they are obtained under the name of only one spouse, and are therefore divided equally, even if one spouse did not earn any income. By contrast, assets obtained by a spouse prior to marriage belong to that spouse only. Assets that a spouse inherited from their own family are also excluded from the division of assets upon divorce.

Preuptial and Postnuptial Agreements

Preuptial and postnuptial agreements are permitted in Japan. Postnuptial agreements may be cancelled at any time during the marital term, unless any third-party rights are impaired. However, such cancellations will not be permitted once the amendments to the Civil Code of Japan take effect by 2026. Preuptial agreements may be asserted against third parties if they are registered with the Legal Affairs Bureau.

2.5 Transfer of Property

The cost basis of a property transferred by inheritance or gift will not change for income tax purposes.

2.6 Transfer of Assets: Vehicle and Planning Mechanisms

The transfer of assets to a spouse would usually be exempt from inheritance tax (not gift tax).

If certain requirements are met, a transferor can fix the fair value of the transferred assets for inheritance tax purposes by gifting the same assets to the transferee before their death and paying 20% of the fair value (after certain deductions) as gift tax at the time of the gift. In this case, the transferee must pay the inheritance tax (after deduction of the gift tax already paid) at the time of inheritance, but the amount of the inheritance tax is calculated by using the fair value at the time of the gift.

With respect to gift tax (not inheritance tax), there are special tax treatments for transferring assets to younger generations for education, residence acquisition and other purposes.

2.7 Transfer of Assets: Digital Assets

Cryptocurrency is subject to inheritance tax and gift tax in Japan. The fair value of cryptocurrency is determined by its market price. If the market price is not clear, other valuation methods may be used, such as the sales price used by other parties.

3. Trusts, Foundations and Similar Entities

3.1 Types of Trusts, Foundations or Similar Entities

Trusts and foundations are usually used in Japan for tax and estate planning purposes.

Trusts

For Japanese income tax purposes and depending on its legal character, a trust is treated as:

- transparent;
- not transparent but not a taxable entity; or
- a deemed corporation.

Trusts that are used for wealth management purposes are mostly categorised as transparent trusts. When an individual acquires a trust beneficiary interest upon the death of the decedent, inheritance tax would be imposed on the individual.

If the trust is a deemed a corporation, it is subject to corporation tax, at a rate of approximately 30%. In this case, when a settlor entrusts property to a trustee, any unrealised gains in the property are subject to capital gains tax.

Foundations

As there is no ownership interest in a foundation, the assets acquired by the foundation would not be included in the estate of the decedent, and thus would not generally be subject to inheritance tax upon the death of the founder. Although these entities are generally subject to corporation income tax on gains by donation, the income could be exempt from corporation income tax if certain conditions are met. When a founder makes a certain donation (other than cash) to a foundation, there could be capital gains taxation, although there are some exceptions if certain conditions are met.

3.2 Recognition of Trusts

Trusts are recognised and respected by the Trust Law of Japan, where the term “trust” typically refers to a settlor entrusting property to a trustee based on confidence in that trustee,

who administers and disposes of the property in its own name in accordance with the trust agreement between the settlor and the trustee for the benefit of the beneficiaries. With respect to the tax treatment of trusts, see **3.1 Types of Trusts, Foundations or Similar Entities**.

3.3 Tax Considerations: Fiduciary or Beneficiary Designation

Trusts

A beneficiary of a trust (including a foreign trust) who is a Japanese resident is subject to Japanese individual income tax on the income of the trustee, as long as the trust is treated as transparent for tax purposes. If the trust is treated as a deemed corporation for tax purposes, the beneficiary is generally not subject to Japanese individual income tax on the income of the trustee (unless Japanese CFC rules apply to a foreign trustee).

Foundations

A donor to a foundation (including a foreign foundation) who is a Japanese resident is not subject to Japanese individual income tax on the income of the foreign foundation. However, if the donated assets have unrealised gains, they will be subject to Japanese capital gains tax at the time of donation. Such capital gains taxation may be avoided if the foundation is established under Japanese law, but not if the foundation is established under foreign laws.

3.4 Exercising Control Over Irrevocable Planning Vehicles

Trusts

In Japan, whether a trust is revocable or irrevocable should not affect tax treatments, if it is transparent for tax purposes. Therefore, even if the settlors retain extensive power to revoke the trust, it should not be problematic from a tax perspective.

Foundations

If the founder wants to avoid corporation income tax on the foundation and capital gains tax on them, the donation must be irrevocable.

4. Family Business Planning

4.1 Asset Protection

Several popular methods and tools are used for asset protection under Japanese laws.

Foundations

The foundation is the most popular tool to avoid inheritance tax; see **3.1 Types of Trusts, Foundations or Similar Entities**.

Wills

Many Japanese high net worth individuals make wills to protect their intentions after their death. However, the assets transferred to the heirs are generally subject to inheritance tax.

Trusts

A trust is sometimes used in the same way as a will. The value of the underlying assets transferred to the heirs through beneficiary rights is generally subject to inheritance tax.

4.2 Succession Planning

Popular family business succession planning strategies include the following:

- ownership and management of the family business are passed on within the family – ie, the family continues to own and manage the business upon succession;
- the family withdraws from the operation and management of the business but continues to own the business, leaving the management to professional managers outside of the family; and

- the family sells the business and quits the management and ownership of the business.

The first two options generally require certain tax planning to reduce the fair value of the family business so that the family can afford to pay inheritance tax or gift tax. However, if the family chooses the first option and obtains a special approval from the Japanese tax office, those taxes may be completely waived.

4.3 Transfer of Partial Interest

Transfers by individuals to other related parties must be conducted at a fair value for tax purposes. The fair value is calculated in accordance with tax circulars and notices issued by the Japanese government, but is usually lower than the real fair market value.

In particular, as the fair value of real properties for tax purposes is usually much lower than the fair market value, wealthy individuals buy real properties for tax planning purposes. However, the tax authorities sometimes challenge the value of those properties; see **5.1 Trends Driving Disputes**.

5. Wealth Disputes

5.1 Trends Driving Disputes

Tax authorities have been quite active of late in auditing inheritance tax and gift tax on wealthy individuals, leading to an increasing number of disputes being brought by taxpayers in the National Tax Tribunal or courts to ask for the cancellation of the decisions of tax authorities. For example, many people purchase real estate at market value immediately before their deaths, and the heirs thereof use a fair value for tax purposes, which is less than the market value, when they declare the inheritance tax. Such fair

value is sometimes denied by the tax authorities. In this regard, on 19 April 2022 the Supreme Court of Japan supported the tax authorities' decision not to acknowledge the appraised value of real estate in an inheritance tax case based on roadside land prices set by the authorities, which were significantly lower than market prices.

Disputes concerning trusts have also been increasing as the use of trusts has become more common among wealthy individuals. In a recent court precedent, a trust was deemed to be void as it infringed the statutory reserved portion of an heir.

5.2 Mechanism for Compensation

An heir may allege that a trust set up by another heir infringes their statutory reserved portion and that such reserved portion should be returned to them. For more details about the statutory reserved portion, see **2.3 Forced Heirship Laws**.

6. Roles and Responsibilities of Fiduciaries

6.1 Prevalence of Corporate Fiduciaries

Although both individual fiduciaries and corporate professional fiduciaries bear fiduciary duties to beneficiaries, the level of conduct required for professional fiduciaries is typically higher.

6.2 Fiduciary Liabilities

It is not typical for courts to pierce the veil of a trust or foundation. However, if an individual director of a trustee corporation is grossly negligent when conducting their duties, it is possible for a beneficiary of the trust to ask for compensation or damages as a result of the breach of fiduciary duties.

It is possible to provide for a lower level of fiduciary duty in the trust deed, but it is not possible to provide for an exemption from fiduciary duty.

6.3 Fiduciary Regulation

In the context of a trust that is privately and specifically set up by wealthy individuals for estate planning purposes, trust assets are not typically and practically actively invested. The trustees are subject to fiduciary duties, as explained in **6.2 Fiduciary Liabilities**.

6.4 Fiduciary Investment

It is possible for a trust or foundation to have an active business by establishing a subsidiary within the scope of fiduciary duties, unless otherwise provided in the trust deed.

7. Citizenship and Residency

7.1 Requirements for Domicile, Residency and Citizenship Domicile/Residency

Persons having a domicile (*iyusho*) in Japan and persons having a residence (*kyosho*) in Japan for one year or more are treated as residents for income tax purposes, and persons having a domicile (*iyusho*) in Japan are treated as residents for inheritance/gift tax purposes. The Income Tax Law and Inheritance Tax Law interpret “domicile” to mean the “principal base and centre of one’s life”, while residence refers to a location in which an individual continually resides for a certain time, but which does not qualify as a base and centre of one’s life.

However, there is no clear-cut definition of domicile in Japanese tax laws; therefore, whether a person is a resident or a non-resident cannot be simply decided based on specific and clear

numbers under domestic laws in Japan (eg, days spent in Japan), unlike countries that have a 183-day rule.

Generally speaking, whether an individual has a domicile in Japan would be decided by taking into account many factors, including time spent in Japan, place of living, place of domicile of their family, place of occupation and location of assets.

Citizenship

If either the father or the mother is a Japanese citizen when their child is born, the child obtains Japanese nationality. A person who is not a Japanese citizen may acquire Japanese nationality through naturalisation, which is under the jurisdiction of the Minister of Justice.

7.2 Expeditious Citizenship

If a person’s father or mother is a Japanese citizen when they apply for Japanese citizenship with the Minister of Justice, that person may acquire citizenship without the need to satisfy the requirement of continuous residence for at least five years. Even in that case, the applicant must be residing in Japan during the process of naturalisation.

8. Planning for Minors, Adults with Disabilities and Elders

8.1 Special Planning Mechanisms

There are mechanisms for minors and adults with disabilities. Typically, a special needs trust is used in these cases.

8.2 Appointment of a Guardian

A statutory guardian must be appointed with court approval. In addition, a voluntary guardian may be appointed before a notary public.

Creating a special needs trust has recently become more popular among wealthy families, as it is more flexible than appointing a guardian.

8.3 Elder Law

There is a national pension system in Japan. However, as pension payment under the national pension system is limited to a minimum standard, people are expected to have a separate personal fund for future financial stability.

9. Planning for Non-traditional Families

9.1 Children

A child born out of wedlock can inherit the estate of a deceased parent if the parent acknowledges the child; this also applies to adopted children. These children will be treated in the same manner as other children.

Surrogate pregnancy arrangements and posthumous conceptions are not permitted in Japan.

9.2 Same-Sex Marriage

Same-sex marriage is not currently permitted under the Civil Code, although there are a number of cases in which the validity of the current system is disputed. There are practical arrangements through which a same-sex married couple achieves basically the same rights as a couple in a statutory marriage. A number of local governments issue a certificate of same-sex “partnership” for same-sex couples.

10. Charitable Planning

10.1 Charitable Giving

A person making a charitable donation gets certain tax benefits, such as deducting the amount from their income or crediting against the tax amount.

Moreover, certain exemptions from capital gains taxation are automatically triggered upon the donation of assets with accumulated capital gains to charities. For details, please see **3.1 Types of Trusts, Foundations or Similar Entities**, **3.3 Tax Considerations: Fiduciary or Beneficiary Designation** and **3.4 Exercising Control Over Irrevocable Planning Vehicles**.

10.2 Common Charitable Structures

Foundations are typically used for charitable planning. For more details, please see **3.1 Types of Trusts, Foundations or Similar Entities**, **3.3 Tax Considerations: Fiduciary or Beneficiary Designation** and **3.4 Exercising Control Over Irrevocable Planning Vehicles**.