The Private Wealth & Private Client Review

Fourth Edition

Editor
John Riches

Law Business Research

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EDITOR'S PREFACE

There is no doubt that the twin recurring themes for 2015 at a global level in private wealth planning are those of transparency and regulation. The zeal of policy makers in imposing ever more complex and potentially confusing sets of rules on disclosure of beneficial ownership information seems unabated.

i Common reporting standard (CRS)

The centrepiece of cross-border automatic information exchange is CRS. This FATCA equivalent for the rest of the developed world is set to come into effect from 1 January 2016. At the last count just over 90 countries had committed to CRS. Its principal effects will be felt in two waves – among the so-called early adopters group the rules will take effect from 1 January 2016 and first information exchanges will apply in September 2017. For the second wave, there will be a year's delay.

What is interesting about CRS is that the OECD has taken a central role in producing coordinated guidance on its interpretation. The draft guidance initially published in July 2014 was somewhat sketchy in nature and we can expect, as we move towards the beginning of next year, revised and more detailed guidance on a number of key issues.

Deep concerns exist about the extent to which information exchange between tax authorities under CRS will remain secure in the hands of the 'home' countries of beneficial owners. While the 'normal' way of signing up to CRS is via the multilateral convention that provides for exchange with other signatory nations, there are indications that some jurisdictions (at this stage the Bahamas, Hong Kong and possibly Switzerland) may seek to adopt a more 'bilateral' approach implementing CRS. If this approach becomes more widespread, then the practical implementation of CRS could be significantly delayed by jurisdictions who negotiate treaties on a one-by-one basis with 90 other countries.

While CRS is often compared to FATCA, there are some material differences that emerge from closer scrutiny. Whatever the shortcomings of FATCA, the ability to issue a global intermediary identification number and to sponsor entities on a cross-border basis somewhat lessens the bureaucratic excesses of its impact. What is distinctly unclear about CRS at this point is whether equivalent mechanics will emerge. As CRS is currently written as a series of bilateral treaties between jurisdictions with no domestic law 'anchor' (as is the case with FATCA) concerns are being expressed about the potential duplication for complex cross-border structures of reporting. In this context, the July 2014 introduction to CRS notes that the rules as to where a financial institution (FI) will be deemed resident differs between jurisdictions – in some cases this will be based on the place of incorporation whilst in others it may be based on the place of effective management.

There are concerns as to how non-financial entities (NFEs) will be dealt with under CRS. There is anecdotal evidence emerging already in the context of FATCA that financial institutions, driven by concerns about fines from regulators for NFEs and the related ownership structure are subjecting bank account applications for NFEs to additional enquiries that generate very significant costs and delay.

It is noteworthy that there has been a significant crossover from the anti-money laundering (AML) or terrorist financing regime coordinated by the Financial Action Task Force (FATF). This is expressly provided in the CRS model treaty that imports into CRS the FATF concept of beneficial ownership. In the CRS world, this is known as 'controlling persons'. By expressly linking the definition of controlling persons to that of beneficial ownership employed for FATF purposes, there is the prospect of the beneficial ownership definition evolving over time in accordance with principles adopted in that domain. It is noteworthy that, as well as looking to ultimate legal and beneficial ownership of an entity, these definitions also look to the capacity to exert influence and control in the absence of any formal legal entitlement. Thus the expanded definition is as follows.

Beneficial owner refers to the natural person who ultimately owns or controls a customer or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.[1]

It is completely appreciated that, in a law enforcement context, criminals and terrorists do not typically advertise their involvement in ownership structures where they are liable to be detected by the appropriate agencies. Transporting this definition wholesale, however, into the world of tax information exchange where domestic tax authorities may draw unfair and adverse implications from an attribution of being a 'controlling person' is more questionable. It is not a complete response to this concern to say, in the final analysis, if someone has no ability to enjoy the benefit of assets held within a particular structure that they can demonstrate this – the potential costs and bureaucracy of an unwarranted tax audit that may arise from such a misunderstanding will be more difficult to quantify.

Another area of concern is the capacity for banks who have, in the past, misclassified or misunderstood information about ownership structures. If this information is simply

1 http://www.fatf-gafi.org/pages/glossary/a-c/ – The Recommendations were adopted by FATF on 16 February 2012. (emphasis added).

'copied over' from AML records for CRS purposes then there is scope for false and misleading information to be exchanged in circumstances where the 'beneficial owners' may be completely unaware of such mistakes or misclassifications.

What follows from this is an increased importance for professional advisers to actively engage with clients to discuss the implications of these changes. Taken together, the combined impact of these changes is likely to be seen in years to come as a 'paradigm shift' in international wealth structuring. It is therefore critically important that the advisory community equips itself fully to be able to assist in a pro-active manner.

ii Public registers of beneficial ownership

On 20 May 2015, the EU published the final version of its fourth anti-money laundering directive (4AMLD). This commits the EU Member States to providing a public register of beneficial ownership within the next two years. What is noteworthy about the terms of the regulation is the fundamental distinction that has been drawn between ownership information about 'legal persons' (including companies and foundations) on the one hand, and 'legal arrangements' (including trusts) on the other. There is an obligation for information on legal persons to be placed in the public domain while information relating to trusts and equivalent arrangements will be restricted so that it is only made available to competent authorities.

The acceptance in the drafting of these regulations that there is a legitimate distinction to be drawn between commercial entities that interact with third parties, primarily in the context of business arrangements, and private asset ownership structures that are primarily designed to hold wealth for families is an encouraging one.

It should not, however, be assumed that the emphasis on privacy that underpinned this particular distinction will necessarily be a permanent one. There is a very strong constituency within the EU that still argues that a public register of trusts should be introduced at some stage in the future.

Turning to the UK, 2016 will see the introduction of a public register of beneficial ownership for companies in the UK. This legislation, to a large extent, anticipates the impact of 4AMLD although it is not completely symmetrical. The centrepiece of UK domestic legislation is the public identification of persons with influence over UK companies, known as 'persons exercising significant control' (PSCs). There are significant penalties for non-compliance. In particular, in circumstances where a PSC does not respond to the request for information from a company, not only can that refusal generate potentially criminal sanctions, it can also result in any economic benefits deriving from the shares as well as the ability to vote being suspended.

While it is appreciated that there are reasons why sanctions need to be applied to encourage people to comply, the harsh economic penalties may be seen as totally disproportionate to non-compliance. It is interesting to note that the PSC concept analogous to that of the 'controlling persons' in the context of CRS. As with CRS, the most complex area here is the extent to which those being seen to exert 'influence' without formal legal entitlement may be classified as PSCs.

One further interesting issue that needs to be considered as matters move forward is whether the impact of the EU public register for corporate entities will result in a 'back door' trust register in many cases. One of the categories for disclosure of PSCs in the UK register is 'ownership or influence via a trust'. In circumstances therefore where a trust holds a material interest in a company, this can result in not only the trustees and protectors of the trust, but also family members with important powers (such as hire and fire powers) being classified as PSCs and having their information placed on a public register. While this register will not give direct information about beneficiaries as such, in many cases it will provide a significant degree of transparency about family involvement. It seems likely that, over time, the EU will also look to 'export' a requirement for beneficial ownership information on public registered companies to be incorporated in many of the international finance centres. While IFCs have indicated that they are sceptical about the adoption of such registers in circumstances where there is not a common standard applied to all jurisdictions, it remains to be seen how long this stance can be maintained once 4AMLD is in full force.

iii Position of the United States

The United States stands out as having secured a position for itself in the context of cross-border disclosure that many feel is hypocritical. Specifically there is a carve out from CRS on the basis that the US has implemented FATCA. The constitutional position in the US where measures of this nature would tend to be introduced at a state rather than federal level also complicates the picture. In the absence of any comprehensive regime to regulate trustee and corporate service providers, the US appears to have achieved a competitive advantage in administering 'offshore' structures because it has exempted itself, in practical terms, from reciprocation on automatic information exchange. This is already leading to many considering the US as an alternative base from which to administer family structures in a more 'private' setting than is possible in IFCs once CRS take effect.

iv Global legal entity identifier system (GLEIs)[2]

A development flowing from the 2008 financial crisis is the introduction of GLEIs. In December 2014 a regulatory oversight committee relating to GLEIs introduced a task force to develop a proposal for collecting GLEIs information on the direct and ultimate parents of legal entities. The policy is to ensure financial intermediaries can track who they are dealing with as counterparties in investment transactions. The underlying policy that drives the creation of the GLEIs is to create transparency in financial markets. In the current phase 1 of the project, the information required to be collected is limited to 'business card information' about the entities concerned and will therefore be limited to a name, address and contact number. However, the 'level 2' data that is likely to be required will extend the reference data to relationships between entities. This could result in beneficial ownership information being required in due course. This proposal is likely to see some development in the course of the next six months but is yet another illustration of overlapping regimes for collecting beneficial ownership information that are likely to have a substantial effect on the operation of family wealth holding structures in the years ahead.

2 http://www.leiroc.org/.

v Conclusion

The challenges of keeping abreast of changes in the regulatory and transparency arena are significant. These issues look set to be a significant driver in wealth strategy in the next three to five years. Navigating these issues will increasingly become a required skill set for professional advisers.

John Riches
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London
September 2015

Chapter 25

JAPAN

Atsushi Oishi and Makoto Sakai[1]

I INTRODUCTION

Japan is known as a country with high rates of both inheritance and income tax. Indeed, the high level of these tax rates have resulted in an increasing movement of wealthy Japanese individuals and their assets to low-tax jurisdictions with a view to minimising their tax burden.

A number of recent developments in Japan have actually made matters worse for wealthy families and their advisers. From an estate taxation perspective, tax reforms in 2013 (the 2013 Tax Reforms) had a significant impact on wealthy individuals and wealth management planning. The 2013 Tax Reforms were mainly intended to close the gap between wealthy individuals and the poor.

With regard to inheritance tax, the 2013 Tax Reforms made the following changes, among other things:

a reduced the basic deduction (effective from 1 January 2015);

b adjusted tax rates structure for inheritance and gift taxes (effective from 1 January 2015); and

c broadened the scope of assets subject to inheritance and gift taxes (effective from 1 April 2013).

Previously, the heirs of only about 4 per cent of all estates were subject to a filing or payment requirement for inheritance taxes.[2] However, as a result of these reforms, many more estates have become subject to inheritance taxes. As could have been expected, the

1 Atsushi Oishi and Makoto Sakai are partners at Mori Hamada & Matsumoto.

2 Source: Ministry of Finance website; https://www.mof.go.jp/tax_policy/summary/property/137.htm

movement of wealthy people and their assets to low-tax jurisdictions has only accelerated as a result of these changes.

The Japanese government introduced a new exit tax as a part of tax reforms in 2015 in an effort to prevent high net worth individuals holding securities with unrealised gain from avoiding Japanese capital gains taxation by moving to countries with no capital gains tax. This tax became effective from 1 July 2015, and is applicable to certain expatriating Japanese residents.

II TAX

i Income tax

For Japanese income tax purposes, all individuals are classified as either residents or non-residents, regardless of their nationality.

Persons having a 'domicile' (*jyusho*) in Japan and persons having a 'residence' (*kyosho*) in Japan for one year or more are treated as residents (*kyojyusha*). These residents will be subject to Japanese income tax on their worldwide income. Persons not treated as residents are non-residents. Japanese income tax for non-residents is assessed on Japan-sourced income only.

Therefore, the concepts of 'domicile' and 'residence' are very important to determine the types of income that would be included in an individual's taxable income in Japan (see Section II.iv, *infra*).

The annual tax rate is based on taxable income, ranging from 5 per cent (for income of ¥1.95 million or less) to a recently increased 45 per cent (for income over ¥40 million).[3] Prior to 1 January 2015, the highest tax rate was 40 per cent (for income over ¥18 million). There are also municipal income and prefectural income taxes imposed on taxable income, and the combined rate for these taxes is 10 per cent.

ii Gift and inheritance tax

The Japanese Inheritance Tax Law covers inheritance tax and gift tax. Inheritance tax is imposed on an individual who acquires property by inheritance or bequest upon the death of the decedent.

Unlike in the United States, the individuals who acquire assets by inheritance or bequest, not the estate, are subject to the inheritance tax. Inheritance tax is imposed on the aggregate value of all properties acquired. The taxable base of property for inheritance or gift tax purposes is the fair market value at the time of the transfer. However, since there is no uniform method of assessing the fair market value of each asset, the NTA has published a Basic Valuation Circular to determine the method when determining the fair market value of each asset for inheritance or gift tax purposes. For instance, the value of land is generally determined based on the roadside value per square metre of land that the NTA publishes annually.

3 In addition, an income surtax will be applied for a 25-year period for income earned through 31 December 2037 at a rate of 2.1 per cent of the base income tax liability to secure the financial resources to implement the restoration from the Tohoku Earthquake in 2011.

If the aggregate value does not exceed a basic deduction, no inheritance tax will be levied. Effective from 1 January 2015, the basic deduction has been reduced to ¥6 million multiplied by the number of statutory heirs, plus ¥30 million, whereas the basic deduction was previously ¥10 million multiplied by the number of statutory heirs, plus ¥50 million. As a result of this reform, the heirs of many more estates have become subject to the filing or payment requirement in respect of inheritance taxes.

The total inheritance tax is calculated separately for each statutory heir and legatee based on the statutory shares described below, regardless of how the assets are transferred, using the progressive tax rates as shown in the table below (which also shows the tax rates that were in effect until 31 December 2014). Then, the total amount of tax is allocated among those who will actually receive the estate assets in accordance with the decedent's will or the agreement among the heirs. A 20 per cent surtax will be imposed on any heir or legatee who is not the spouse, the decedent's parents or the decedent's children. Also, for inheritance tax to be paid by a spouse, the portion of tax due attributed to the spouse pursuant to the statutory share (the greater of the amount of the spouse's statutory share or ¥160 million) is creditable against the spouse's actual inheritance tax due. Therefore, in many cases, spouses do not have to pay inheritance tax.

≤ ¥10 million	10%	≤ ¥10 million	10%
≤ ¥30 million	15%	≤ ¥30 million	15%
≤ ¥50 million	20%	≤ ¥50 million	20%
≤ ¥100 million	30%	≤ ¥100 million	30%
≤ ¥300 million	40%	≤ ¥200 million	40%
-		≤ ¥300 million	45%
> ¥300 million	50%	≤ ¥600 million	50%
-		> ¥600 million	55%

Gift tax is imposed on an individual who acquires properties by gift during the lifetime of the donor. Gift tax is imposed as a supplement to inheritance tax. The amount of gift tax is calculated based on the value of properties obtained by a gift (or by a deemed gift) during each calendar year, after deducting an annual basic exemption of ¥1.1 million, using the progressive tax rates as shown in the table below (which also shows the tax rates until 31 December 2014).

Former rates (until 31 December 2014)					
≤ ¥ 2 million	10%	≤ ¥2 million	10%	≤ ¥2 million	10%
≤ ¥3 million	15%	≤ ¥4 million	15%	≤ ¥3 million	15%
≤ ¥4 million	20%	≤ ¥6 million	20%	≤ ¥4 million	20%
≤ ¥6 million	30%	≤ ¥10 million	30%	≤ ¥6 million	30%
≤ ¥10 million	40%	≤ ¥15 million	40%	≤ ¥10 million	40%
-		≤ ¥30 million	45%	≤ ¥15 million	45%
> ¥10 million	50%	≤ ¥45 million	50%	≤ ¥30 million	50%
-		> ¥45 million	55%	> ¥30 million	55%

Heirs or donees subject to Japanese inheritance or gift tax may be summarised as shown in the following table:

<table>
<tr><th colspan="2" rowspan="3">Heir or donee
Deceased or donor</th><th rowspan="3">Japanese resident</th><th colspan="3">Non-Japanese resident</th></tr>
<tr><th colspan="2">Japanese nationality</th><th rowspan="2">No Japanese nationality</th></tr>
<tr><th>Japanese resident any time in the past five years</th><th>Non-Japanese resident any time in the past five years</th></tr>
<tr><td colspan="2">Japanese resident</td><td colspan="3" rowspan="2">Unlimited liability: worldwide assets are taxable</td><td>2013 Tax Reforms</td></tr>
<tr><td rowspan="2">Non-Japanese resident</td><td>Japanese resident any time in the past five years</td><td></td></tr>
<tr><td>Non-Japanese resident any time in the past five years</td><td></td><td colspan="3">Limited liability: domestic assets are taxable</td></tr>
</table>

For instance, an heir or donee who is domiciled in Japan when acquiring property upon the death of the deceased or by gift has unlimited liability for inheritance tax or gift tax, regardless of his or her nationality. Unlimited liability taxpayers are subject to inheritance tax or gift tax on all of the properties acquired regardless of whether the assets are located in or outside Japan. On the other hand, limited liability taxpayers are subject to inheritance tax or gift tax only on the assets situated in Japan. Whether the property is situated in Japan is determined based on the location rules promulgated in the Inheritance Tax Law. For instance, real property is deemed a Japan-based asset if it is located in Japan. Also, corporate shares, bonds and debentures are deemed Japan-based assets if the issuing company has its head office or its principal office in Japan.

As mentioned above, the 2013 Tax Reforms broadened the scope of assets subject to inheritance and gift taxes, which has had an impact on international estate planning. The upper right section in the table reflects revisions that became effective on 1 April 2013. Under the new rules, when an heir receives an asset located outside Japan from a deceased who had a domicile in Japan, the heir would be subject to Japanese inheritance tax even when the heir has no domicile in Japan or no Japanese nationality at the time of the inheritance. This reform was to respond to a certain type of tax avoidance scheme by a Japanese-resident donor, which was to avoid inheritance or gift tax by giving the offshore assets to an heir who does not have Japanese nationality.

Japan has signed only one tax treaty in relation to estate, inheritance and gift tax, which is the one with the United States.

iii Newly introduced exit tax

As indicated above, the Japanese government introduced the new exit tax in 2015, which is applicable to certain expatriating Japanese individual residents effective from 1 July 2015. Under the new rule, a Japanese resident who is subject to the exit tax will be subject to individual income tax on unrealised gain from certain securities upon the resident's emigration from Japan. The exit tax is applicable to a person who:

a is a Japanese resident whose place of domicile or residence has been Japan in excess of five years out of ten years prior to the emigration; and

b has taxable assets (certain securities, interests in a silent partnership, unsettled credit transactions and unsettled derivatives) with a combined value of ¥100 million or more.

It is notable that the exit tax is generally applicable not only to a Japanese national but also to a non-Japanese national, although the period of time spent in Japan by non-Japanese nationals under certain types of visa status (including intra-company transferee visas or business investor/manager visas) does not count toward the five-year threshold.

Those who are subject to the exit tax are deemed to have transferred certain taxable assets at the fair market value at the time of either (1) the date of emigration from Japan (in the case generally where the taxpayer appoints a tax manager in Japan by the time taxpayer files an individual tax return) or (2) the date three months before emigration from Japan (in the case other than (1)). If a taxpayer who paid the exit tax returns to Japan within five years of the initial emigration, and if such taxpayer still owns the taxable assets, he/she can apply for a cancellation and refund of the exit tax. Also, the tax authorities may grant a grace period of five years (which may be extended up to 10 years) to a taxpayer who has an exit tax liability if certain conditions (including the provision of collateral) are met.

iv Key issues relating to cross-border structuring

Given the recent introduction of the exit tax, simple emigration from Japan to a country with lower income tax rates or no gift or inheritance tax is no longer a fully tax-free wealth management option for those who have a significant amount of taxable assets. While the exit tax will apply to certain assets upon emigration, it remains the case for gift and inheritance tax purposes that only the assets of the donor or decedent that are located in Japan would be subject to Japanese gift or inheritance tax as long as both the donor or decedent and donee or heir have been non-residents of Japan for more than five years prior to the gift or inheritance. Therefore, if a taxpayer whose assets mainly consist of foreign assets and his or her donee or heir emigrate from Japan to a country with no gift or inheritance tax and live there for more than five years, Japanese gift or inheritance tax could be avoided. However, with the introduction of the exit tax, deemed capital gains tax would be payable with respect to certain assets at the time of expatriation. That being said, since the capital gains tax with respect to listed or non-listed shares is generally a flat rate of 15.315 per cent, which is significantly lower than the highest bracket of 55 per cent applicable to gift or inheritance tax, emigration from Japan can still be a feasible option for high net worth individuals. Therefore, residency continues to be an important issue for cross-border wealth management structuring. Generally, residency for income tax purposes is determined in the same manner as for inheritance and gift tax purposes.

As stated in Section II.i and Section II.ii, *supra*, persons having a domicile in Japan and persons having a residence in Japan for one year or more are treated as residents for income tax purposes, and persons having a domicile in Japan are treated as residents for inheritance or gift tax purposes. Domicile as used in the Income Tax Law and Inheritance Tax Law is interpreted to mean the 'principal base and centre of one's life'.[4] 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 non-resident cannot be simply decided based on specific and clear numbers (e.g., days spent in Japan) under domestic laws in Japan, unlike those countries that have a 183-day rule. There are many court decisions on whether the taxpayer or relevant individual in question has a domicile in Japan.[5] Generally speaking, whether an individual has a domicile in Japan would be decided taking into account many facts, including the time spent in Japan, place of living, place of domicile of his or her family, place of his or her occupation and place of his or her assets.

v Reporting requirements and penalties

In relation to reporting requirements that are of particular interest to individuals with both Japanese and international assets, a reporting requirement for overseas assets was introduced from 1 January 2014 (the foreign asset report). In an effort to improve compliance and enforcement of reporting of income from overseas assets, the foreign asset report requirement was introduced for permanent individual residents who own overseas assets of more than ¥50 million in aggregate. A permanent individual resident means an individual resident who has Japanese nationality or who has been in Japan in excess of five years out of the preceding 10 years.

These individuals are required to file a foreign asset report with the Japanese tax authorities. Under the foreign asset report requirement, the assets that would be classified as Japan-based (domestic) assets for inheritance tax purposes but are deposited into an offshore account or entrusted to an overseas trust will be within the scope of this reporting requirement. The penalty for fraudulent reporting is imprisonment of up to one year, or a fine of up to ¥500,000. For those who do not submit the details of overseas assets by the due date without any acceptable reasons, the penalty is also imprisonment of up to one year, or a fine of up to ¥500,000. Of course, the details of overseas assets are subject to tax audits by the NTA.

Apart from the foreign asset report, all resident taxpayers in receipt of earned income over ¥20 million are required to file a statement of assets and liabilities on a worldwide basis, which has to include domestic assets and liabilities. However, if the

4 Supreme Court, Judgment, 18 February 2011; Saikou Saibansho Minji Hanreishu (236) 71.

5 See Supreme Court, Judgment, 18 February 2011, footnote 4, *supra*; Tokyo High Court, Judgment, 28 February 2010, *Hanrei Times* (1278) 163.

assets have been already reported on a foreign asset report, it is not necessary to duplicate the reporting on the statement of assets and liabilities.

vi Tax treaties

As stated in Section II.v, *supra*, the Japanese government has been strengthening the enforcement of laws against cross-border tax avoidance and trying to accomplish further transparency and scrutiny of offshore assets. In this respect, the Japanese government has recently signed a number of information-exchange treaties with low or no-tax countries (e.g., Guernsey, Jersey, Isle of Man, Cayman Islands, Bahamas, Bermuda, Macao, British Virgin Islands), in addition to the existing tax treaties with provisions on exchange of information.

III SUCCESSION

i Overview

Under Japanese law, the rules of inheritance are governed by the law of the nationality of the decedent.[6] The nationality of the decedent's spouse or heirs will not be taken into account. Therefore, if a decedent's nationality at the time of his or her death is Japanese, Japanese law governs the rules of inheritance. Japanese inheritance law always applies to a decedent who has Japanese nationality, regardless of the place of his or her real property.

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

ii Division of assets on divorce

On divorce, assets obtained during marriage except those described below are deemed common property in substance (even when an asset is obtained under the name of either one of the married couple) and therefore divided equally, even if one of them did not earn any income. In contrast, any assets obtained prior to marriage belong to the original owner. Also, assets that were inherited from a spouse's own family are excluded from the division of assets on divorce.

iii Division of assets at death

The Civil Code provides a list of statutory heirs. The decedent's spouse becomes a successor under all circumstances. In addition, the Civil Code provides three levels of successors: (1) child or children of the deceased, (2) lineal ascendants of the deceased and (3) siblings of the deceased. If there is any person who belongs to a higher priority level, no one in a lower priority level will become a statutory successor. Unless the deceased has made a will, these statutory heirs will obtain a certain portion of the estate as outlined in the table below.

6 Article 36 of the Act on General Rules for Application of Laws.

As explained above, although all the rights and obligations of the deceased transfer to heirs automatically at the time of the decedent's death, property division in many cases has to be made on the basis of an agreement among the heirs. When the wishes of the decedent are not expressly known (e.g., the decedent dies without a will or has a will that does not meet the statutory requirements for a will), division will be decided on the basis of the statutory portions provided for in the Civil Code.

When the wishes of a decedent are expressly known by way of a will, property division should generally be conducted in accordance with the will, although wills are not used in Japan as commonly as in other countries. There are three types of wills that are accepted and regarded as legally binding, which are explained below.

As is the case in other civil law jurisdictions, the statutory reserved portion of certain statutory heirs is provided for in the Civil Code. The 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 deceased may determine the allocation of his or her estate property by will, his or her spouse, child or children and lineal ascendants as heirs will have a right to receive their statutory shares of the estate under forced heirship rules. The decedent's siblings do not have a statutory reserved portion.

(1) Spouse	Spouse: 100%	Spouse: one half
(2) Child or children	Children: 100% in total (equally for each)	Children: one half in total (equally for each)
(3) Spouse and child or children	Spouse: one half Children: one half in total (equally for each)	Spouse: one quarter Children: one quarter in total (equally for each)
(4) Lineal ascendants	Lineal ascendants: 100% in total (equally for each)	Lineal ascendants: one third in total (equally for each)
(5) Spouse and lineal ascendants	Spouse: two thirds Lineal ascendants: one third in total (equally for each)	Spouse: one third Lineal ascendants: one sixth in total (equally for each)
(6) Siblings	Siblings: 100% in total (equally for each)	Siblings: no statutory reserved portion
(7) Spouse and siblings	Spouse: three quarters Siblings: one quarter in total (equally for each)	Spouse: one half Siblings: no statutory reserved portion

If an heir wishes to waive the inheritance or accept the inheritance to the extent of the positive assets, notification to a family court has to be made within three months from the date the heir is informed of the inheritance.

iv Formalities for wills

As Japan ratified in 1964 the 1961 Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions, the validity of a will made in a form that satisfies foreign law requirements may be admitted. As a matter of form, a will made in accordance with any of the following laws is regarded as valid in Japan:

a the laws of the place of act (the place where a will is made);

b the laws of the country of which the testator has nationality at the time of formation of the will or at the time of death;

c the laws of the place where the testator has a domicile at the time of formation of the will or at the time of death;

d the laws of the place where a testator has habitual residence at the time of formation of the will or at the time of death; or

e with regard to a will concerning real property, the laws of the country where the real property is located.

Under Japanese law, there are three formalities for wills provided in the Civil Code: (1) will by holographic document, (2) will by notarised document and (3) will by sealed and notarised document. The inheritance procedure generally goes smoothly if the testator makes a will by notarised document as this type of will does not require a probate by a court.

v Applicable developments affecting succession

Previously, the Civil Code provided that 'the share in inheritance of a child out of marriage shall be one half of the share in inheritance of a child in marriage.' This provision had reflected traditional Japanese respect for legal marriage. However, on 4 September 2013,[7] the Supreme Court of Japan ruled that this provision was unconstitutional and determined that a child of a deceased man born out of marriage could inherit the same amount of assets as the man's three legitimate children.

After the Supreme Court's decision, the Civil Code was amended and the above-mentioned provision was deleted from the Code in December 2013.

IV WEALTH STRUCTURING AND REGULATION

There are a number of wealth management planning methods. These methods can be categorised into two types: onshore structuring and offshore structuring.

i Onshore wealth structuring

Trusts

For Japanese income tax purposes, a trust is treated, depending on its legal character, as transparent, not transparent but not a taxable entity, or a deemed corporation. That being said, trusts that are used for wealth management purposes are generally categorised as transparent trusts. When an individual acquires a trust beneficiary interest upon the death of the decedent, inheritance tax would be imposed on such an individual.

Although currently the use of trusts is not very common for wealth management purposes, there may be an increasing need for the new trust structures that have been made available as a result of the revision of the Japanese Trust Law in 2007. These new trust structures include trusts substituting wills, and trusts under which the subsequent beneficiaries can be designated in advance by the settlor. By settling the latter type of trust, for example, the settlor may designate his or her spouse as the beneficiary after his

7 Supreme Court, Decision, 4 September 2013; website of the courts in Japan: www.courts.go.jp/hanrei/pdf/20130904154932.pdf.

or her death and also designate his or her child as the beneficiary after the spouse's death. It is expected that these trusts will be used to prevent future disputes between the heirs, although they are not designed to reduce inheritance taxes.

Private foundations

A charitable organisation that does not issue any ownership interest (e.g., an incorporated association or a foundation) is sometimes used for wealth management planning. As there is no ownership interest in these entities, the assets acquired by them would not be included in the estate upon the death of the decedent, and thus would not be subject to inheritance tax upon the death of the founder. Although these entities are generally subject to corporation income tax on gains by gift, if certain conditions are met, the income could be exempt from corporation income tax.

Business succession and assessment of shares of privately owned companies

As previously mentioned in Section II, *supra*, the value of each estate asset is determined based on the Basic Property Valuation Circular. Assets that require complex valuation calculations are shares in an unlisted company. The calculation of the value of these shares varies depending on the size of the company, which is determined by the number of employees, gross assets and annual sales. Generally, the value of unlisted shares in a large company is calculated based on the share price of comparable listed companies using a certain formula (the Comparable Industry Sector Method). For small companies, generally, the value is calculated based on the net assets for inheritance tax purposes (the Net Asset Method). The value of a medium unlisted company is calculated based on a combination of the Comparable Industry Sector Method and the Net Asset Method.

It is a commonly used wealth management structuring tool to lower the value of the shares in a privately owned corporation by adjusting certain figures that are taken into account when calculating the share price utilising the applicable formula.

ii Offshore wealth structuring

Emigration

Although it does not constitute complex wealth management planning, a considerable number of wealthy individuals have been emigrating from Japan to countries with lower taxes. This movement is aimed at minimising the Japanese income tax burden, and sometimes also inheritance taxation. As illustrated in the table in Section II.ii, *supra*, offshore assets will not be subject to Japanese inheritance tax as long as both the donor or deceased and donee or heir are non-residents of more than five years' standing. Although the introduction of the exit tax should significantly affect the behaviour of wealthy individuals, emigration from Japan can still be a feasible option for them as described in Section II.iv, *supra*.

Corporate inversion

As mentioned above, if both a donor or deceased and a donee or heir are non-residents at all times in the last five years, only domestic assets will be subject to Japanese inheritance tax. However, as described above, corporate shares are deemed Japan-based assets if the issuing company has its head office or its principal office in Japan. Since a large number of high net worth individuals own enterprises (whether listed or non-listed) that are incorporated in Japan, the shares in these enterprises will not be treated as foreign assets despite the fact that the owner lives outside Japan.

If these emigrants wish to avoid inheritance or gift taxes imposed on the value of their shares in these corporations, they need to conduct corporate inversion transactions, through which the Japanese corporation becomes a subsidiary of a foreign parent corporation with the owner holding the shares in the foreign parent corporation. Although the introduction of the exit tax should significantly affect these transactions (as there will be deemed capital gains taxation at the time of emigration from Japan), the combination of a corporate inversion and an emigration from Japan may still be a possible option for high net worth individuals owning enterprises that are incorporated in Japan in order to avoid a significant amount of inheritance or gift taxes as described in Section II.iv, *supra*.

Private foundations

Offshore private foundations are sometimes used to separate certain assets from the estates of wealthy individuals.

V CONCLUSIONS AND OUTLOOK

The Japanese government has recently reduced the corporate tax rate (the effective rate was reduced to 32.11 per cent in 2015)[8] and has been discussing further reductions in a bid to encourage enterprise. On the other hand, as mentioned above, the income tax and inheritance tax rates were increased from January 2015. Further, the consumption (sales) tax rate was increased from 5 per cent to 8 per cent on 1 April 2014, and is expected to increase further to 10 per cent on 1 April 2017. All in all, it cannot be said that Japan is becoming more tax-friendly for high net worth individuals. As stated above, this high taxation regime has caused wealthy individuals to move to countries with lower taxes, such as Singapore, Malaysia, New Zealand and Hong Kong. The recent introduction of the exit tax was aimed at discouraging that type of exodus. Although the effect of the exit tax is not yet entirely clear, it may be insufficient to deter some individuals from leaving Japan for jurisdictions with less burdensome income and inheritance or gift tax regimes.

8 Source: Website of Ministry of Finance. https://www.mof.go.jp/tax_policy/summary/corporation/084.htm

Appendix 1

ABOUT THE AUTHORS

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Atsushi Oishi has practised law since 1998 and joined Mori Hamada & Matsumoto in 2000. He obtained an LLB at the University of Tokyo in 1996, and an LLM at New York University School of Law in 2003. He was with Weil Gotshal & Manges in New York from 2003 to 2004.

Mr Oishi works primarily in the practice areas of tax (including wealth management) and mergers and acquisitions (M&A). He has been involved in numerous tax-related cases, such as handling tax investigations and filing appeals against tax authorities, as well as handling a wide variety of transactional matters, including cross border M&A transactions and corporate reorganisations. He has received awards from many groups, including *Chambers Global*, *Chambers Asia*, *IFLR1000*, *PLC Which lawyer?*, *Best Lawyers*, *Asialaw Profiles*, *The Legal 500*, *Tax Directors Handbook*, and the Nikkei's 'Corporate Legal Affairs and Lawyer Survey 2013'.

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Makoto Sakai joined Mori Hamada & Matsumoto in 2004. He obtained an LLB at the University of Tokyo in 2003, and an LLM at Cornell Law School in 2009. He was with Gibson, Dunn & Crutcher in Los Angeles from 2009 to 2010. He was seconded to the Tokyo Regional Taxation Bureau from 2011 to 2013 working in the department that handles audits of large businesses.

Mr Sakai works primarily in the practice areas of wealth management, tax and mergers and acquisitions (M&A). He provides advice to both domestic private clients and international private clients. He also handles M&A transactions and corporate reorganisations from both corporate and tax planning perspectives, as well as tax investigations and appeals filed against tax authorities and tax disputes. Making the most of his experience as a former Review Officer (International Examination) at the Large

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