

## Proposal: FY2004 Tax Reform (Main Points)

Ministry of Finance  
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With a view to contributing to sustainable invigoration of the economy and society, while taking into account the current economic and fiscal environment, the FY2004 tax reform will take measures in taxation of land and housing, SMEs, financial assets and stocks, corporation, and international transactions. Likewise, taking into account the view of contributing to reforms of social security systems, review of taxation of pensions for ensuring inter-generational fairness as well as fairness within the same generation. In addition, taking necessary measures to promote autonomy of local governments.

### Notes:

1. The permanent tax reductions (national and local) for individuals and corporations, which substantially exceed 6 trillion yen, (introduced in FY1999) will continue in FY2004.
2. 1.5 trillion yen tax cuts (national and local) enacted in FY2003 will be applied in FY2004

### Taxation of land and housing

#### Residential Houses

- Extend the application of tax credit for residential mortgages as follows

Year of inhabitation	Qualified amount of outstanding mortgage (QOM)	Amount of tax credit (% of QOM)
CY2004	Y50 million or less	1% (for year1 – year10)
CY2005	Y40 million or less	1% (for year1 – year8) 0.5% (for year9 – year10)
CY2006	Y30 million or less	1% (for year1 – year7) 0.5% (for year8 – year10)
CY2007	Y25 million or less	1% (for year1 – year6) 0.5% (for year7 – year10)
CY2008	Y20 million or less	1% (for year1 – year6) 0.5% (for year7 – year10)

- Extend the application of losses carried forward from the replacement of residential houses. The sold house does not have to be mortgaged. The application of the special tax rate will be extended for 3 years.
- Introduce new losses carried forward from the sale of mortgaged residential houses.

#### Land

- Long term capital gains of land and housing
  - The tax rate of income tax for long-term capital gains on the sale of land and housing will be reduced from 26% (current level) to 20% (national 15% and local 5%).
  - The special tax rate of income tax for capital gains on land for creation of high-quality residential land will be reduced to 14% (up to 20 million yen). The application of the special tax rate will be extended for 5 years.
  - Abolish special deductions (Y1 million) for long term capital gains
- The tax rate of income tax for short-term capital gains from the sale of land and housing will be reduced to 39% (national 30% and local 9%).
- Aggregation of capital gains and losses from the sale of land and housing with other items of income will be abolished.  
Note: These measures will be applied for sales made on or after 1st January, 2004.

### **Taxation of SMEs**

- The income tax rate on capital gains of unlisted stocks will be reduced from 26% (current level) to 20%.
- The scope of qualified “ventures” for the purpose of reduced taxation of income tax under the “angel taxation”<sup>1</sup> system will be expanded to include investment in ventures through certain ‘green sheet listed’ investment funds and security corporations.
- The amount of certain stocks of family owned SMEs that are eligible for a special reduced calculation of inherited assets for the purpose of inheritance tax will be increased to Y1,000 million (currently Y300 million)
- Gain on the sale of inherited unlisted stocks to the issuing corporation for the purpose of paying inheritance tax will be taxed as capital gains, rather than deemed to be dividends.<sup>2</sup>

### **Taxation of Financial Assets and Stocks**

- Capital gains on open stock investment funds (stock-type investment trusts) will be taxed at the same reduced rate as capital gains of stocks.
  - Apply reduced rate of 10% (national 7%, local 3%) on capital gains
  - Capital losses may be carried forward for 3 years.
  - Added to the scope of assets that may be held in a “special account” under which tax will be paid by withholding and the filing of returns will not be required.
- The tax rate on capital gains of unlisted stocks will be reduced to 20%. (Repeat of item mentioned above)
- Banks will be allowed to operate “special accounts”.

### **Corporations**

- Extend the period for losses carried-forward from 5 years (currently) to 7 years.
  - This will be applied retroactively for three previous taxable years (ie. businesses years beginning on or after 1st April 2001).

- Periods of statutory limitations and book keeping obligations will be extended.
- Abolish the 2% additional tax for corporations electing consolidated taxation

### **International Taxation**

- Implement new Japan-US tax treaty by introducing new domestic legislation reflected by an updated tax treaty policy.
  - Clarify taxation and its procedures on business entities that are subject to different tax treatments in Japan and in the other contracting state.
  - Introduce procedural rules for applying treaty benefits only to residents in contracting states who satisfy the criteria for the benefits.
- Further exploration of bilateral tax treaties with other countries.

### **Pensions**

- With the view of contributing to pension reform, review taxation of pensions to promote fairness among generations and within cohorts:
  - The additional part of public pension deduction for persons age 65 and over will be abolished.
  - Likewise, exemption for the elderly (Y500,000) will be abolished.
  - A special additional guaranteed amount of public pension deduction (Y500,000) will be introduced as consideration for pensioners with only standard amounts of pension income.  
(These measures will be applied from CY2005)

#### *References:*

- Minimum amount of income subject to income taxation for a household with a couple (aged 65 and over): Y2,053 thousand/p.a.
- Standard amount of pension benefits
  - Employee pensions: Y2,035 thousands /p.a.
  - Basic pension: Y797 thousands /p.a.

(p.t.o)

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<sup>1</sup> Angel taxation: Only half of the capital gains of the sale of stocks of qualified ventures are taxed. The amount of investment in qualified ventures is deductible from the amount of capital gains of stocks in the same taxable year.

<sup>2</sup> Under income tax, a deemed dividend is taxed at progressive rates while capital gains is taxed at a flat rate

- Increase the limitation on the amount of contribution to the Defined Contribution Pension (DCP) for employees to encourage self-help efforts by employees.

	Contribution by employees only	Contribution by employers only	
		Employees not covered by other occupational pensions	Covered by occupational pensions
Current level	Y180,000 /p.a.	Y432,000 /p.a.	Y216,000 /p.a.
Reform	Y216,000 /pa	Y552,000 /p.a.	Y276,000 /p.a.

#### **Local governments and local taxes**

- As part of “three part reform”, carry out full-fledged transfers of tax revenue sources from individual income tax (national tax) to local inhabitants tax by FY2006. As a bridging measure, introduce local transfers of income tax (Y424.9 billion) in FY2004, which will be shared by local governments in proportion to population size.

Note: Per capita rate local inhabitants tax will be applied to a wife whose husband is paying per capita rate inheritance tax (such a wife is exempt from payment of the tax).

(Reference)

FY2004 Tax Reform (Initial Year)  
Tentative estimation of revenue changes made by the reform  
(Inland Revenue, National)

	(Billion Yen)
Taxation of land and housing	-4
SMEs	-1
Corporation tax	-53
Pension	+39
Streamlining of special taxation measures (corporation tax)	+10
<b>Subtotal</b>	<b>-9</b>
Local Transfer of income tax	-425
<b>Net of items above</b>	<b>-434</b>