

## 4 Taxation of Government Bonds

Taxation of JGBs varies depending on the bondholder — e.g. resident individual, domestic corporation, domestic financial institution, nonresident individual, foreign corporation — and on the type of bonds.

In order to secure smooth and stable financing at a time when large-scale JGB issuance is expected to continue, it is essential to have a deep and diverse investor base. To that end, various tax exemption schemes, including providing tax exemption for interest, are offered to certain qualified investors under certain conditions. To promote JGB holdings, the tax exemption schemes are offered not only to domestic financial institutions and certain corporations, but also to nonresident individuals and foreign corporations (☞).

### (1) Individuals (residents)

#### A. Coupon-bearing bonds

Interests, capital gains and profits from redemption on coupon-bearing bonds are subject to separate self-assessment taxation at a rate of 20% (15% income tax + 5% local tax) (☞) and profit/loss offset among them and listed shares is allowed.

With regards to interests, taxes are withheld when a coupon is paid.

Other tax breaks, known as “Maruyu” and “Tokubetsu-Maruyu” tax-free saving schemes which provide tax exemption on interest income from JGBs, are offered to individuals with disabilities and certain other types of individuals.

#### B. T-Bills and STRIPS

Capital gains and profits from redemption on T-Bills (Treasury Discount Bills) and STRIPS (principal-only book-entry transfer JGBs and coupon-only book-entry transfer JGBs) are subject to separate self-assessment taxation at a rate of 20% (15% income tax + 5% local tax) (☞) and profit/loss offset among them and listed shares is allowed.

At the time of redemption, tax on profits from redemption is withheld.

○ See Fig. 2-25 for taxation for individuals.

☞ The MOF does not accept tax consultation requests, which should be referred to a tax office close to you. Remember that the MOF cannot transfer any call to any tax office or telephone consultation center.

☞ In addition to the income tax, a special income tax for reconstruction (2.1% of income tax in principle) is imposed from 2013 to 2037.

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Fig. 2-25 JGB Interest Taxation System (for individuals)

| Category                            | Type of income  | Taxation  |
|-------------------------------------|---|---|
| Coupon-bearing bonds                | Interest (interest income)  | <input type="radio"/> Separate self-assessment taxation<br>Withholding at source upon interest payment (it has two options as below) <ul style="list-style-type: none"> <li>• Not to file final tax return (tax payment is completed only by withholding.)</li> <li>• To file final tax return as income gain, etc. on listed shares, etc.</li> </ul>   |
|                                     |   | <input type="radio"/> Tax exemption (only for the disabled, etc.) <ul style="list-style-type: none"> <li>• <i>Maruyu</i><br/>                         (Non-taxable interest income from small-sum deposits of the disabled, etc.)<br/>                         Maximum face value: ¥3.5 million</li> <li>• <i>Tokubetsu-Maruyu</i><br/>                         (Non-taxable interest income from small-sum public bonds held by the disabled, etc.)<br/>                         Maximum face value: ¥3.5 million</li> </ul> |
|                                     | Profits from redemption (capital gain)<br>Profit from sale (capital gain) | <input type="radio"/> Separate self-assessment taxation<br>Paid by declaration as taxation on capital gains, etc. on listed shares, etc.  |
| Discount Bonds (T-Bills and STRIPS) | Profits from redemption (capital gain)                                    | <input type="radio"/> Separate self-assessment taxation<br>Withholding at source upon redemption  |
|                                     | Profit from sale (capital gain)   | <input type="radio"/> Separate self-assessment taxation<br>Paid by declaration as taxation on capital gains, etc. on listed shares, etc.  |

Note 1: The tax rates on the income above are 15% income tax (special income tax for reconstruction (basically 2.1% of income tax) is imposed additionally from 2013 to 2037) and 5% local tax.

Note 2: Profit/loss offset among the income above and listed shares is allowed.

## (2) Domestic Corporations

### A. Coupon-bearing bonds

Interests, capital gains and profits from redemption on coupon-bearing bonds are counted as profit, and are subject to corporate tax and the houjinzei-wari local tax (municipal tax multiplied by a certain rate) (Public Interest Incorporated Associations or Public Interest Incorporated Foundations may be exempt from tax).

With regards to interests, taxes are withheld when the interests are paid. Financial institutions such as banks, and financial instruments firms and domestic corporations capitalized at 100 million yen or more may be exempt from withholding tax imposed on the interest income.

### B. T-Bills and STRIPS

Capital gains and profits from redemption on T-Bills and STRIPS (principal-only book-entry transfer JGBs and coupon-only book-entry transfer JGBs) are counted as profit, and are subject to corporate tax and the houjinzei-wari local tax (municipal tax multiplied by a certain rate) (Public Interest Incorporated Associations or Public Interest Incorporated Foundations may be exempt from tax).

With regards to profits from redemption received by General Incorporated Associations or General Incorporated Foundations (excluding Public Interest Incorporated Associations or Public Interest Incorporated Foundations), etc., taxes are withheld at the time of redemption.

### (3) Nonresident Individuals and Foreign Corporations

#### Coupon-bearing bonds, T-Bills and STRIPS

Interests, etc. on book-entry transfer JGBs (interests on book-entry transfer JGBs or profits from redemption of T-Bills and STRIPS) held by nonresident individuals or foreign corporations without a permanent establishment in Japan are exempt from tax under certain conditions under the tax exemption scheme as described in (4) below. Aside from such tax exemption scheme, if there is a tax treaty in effect between Japan and the country of residence of the nonresident individuals or the country where the foreign corporation is located, and the tax rate on interest stipulated under the treaty is set lower than 15%, the withholding tax rate on the interests, etc. from book-entry transfer JGBs will be lowered to match the rate stipulated under the treaty, provided that the relevant procedures have been completed.

In addition, for coupon-bearing bonds held by foreign corporations with a permanent establishment in Japan, the income tax is withheld, but the income tax withheld will be deducted from their corporation tax.

### (4) Tax Exemption Scheme for Nonresident Individuals and Foreign Corporations

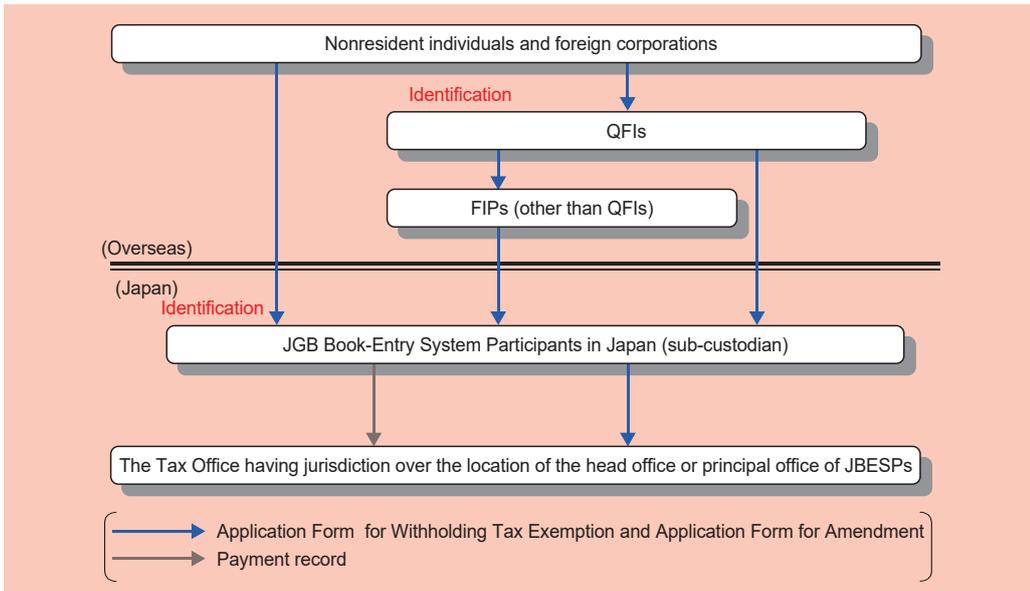
In order to secure smooth and stable financing at a time when large-scale JGB issuance is expected to continue, it is essential to have a deep and diverse investor base. Toward this goal, beginning in September 1999 and thereafter, various tax exemption schemes, including providing tax exemption scheme for interest on JGBs, have been introduced to enable nonresident individuals and foreign corporations to invest more easily in JGBs. Such schemes are established with the consideration of fair and equitable taxation, and are offered to nonresident individuals and foreign corporations under certain conditions (☞).

☞ Including trustees of Qualified Foreign Securities Investment Trusts and Foreign Pension Trusts.

#### A. Income Tax

Interests, etc. on JGBs (interests on JGBs or profits from redemption on T-Bills or STRIPS) held by nonresident individuals or foreign corporations (including trustees for Qualified Foreign Securities Investment Trusts and Foreign Pension Trusts) without a permanent establishment in Japan in transfer accounts at a JBESP (financial institutions or financial instruments firms in Japan acting as account management institutions for JGBs) or a Qualified Foreign Intermediary (QFI) are exempt from income tax, provided that certain requirements have been met.

Fig. 2-26 Overview of Tax Exemption Scheme for Nonresident Individuals and Foreign Corporations



**B. Corporation Tax**

The corporation tax does not apply to interests, etc. on JGBs held by nonresident individuals or foreign corporations (including trustees for Qualified Foreign Securities Investment Trusts and Foreign Pension Trusts) without a permanent establishment in Japan in transfer accounts at a QFI, etc.

**C. Bond *Gensaki* Transactions and Securities Lending Transactions**

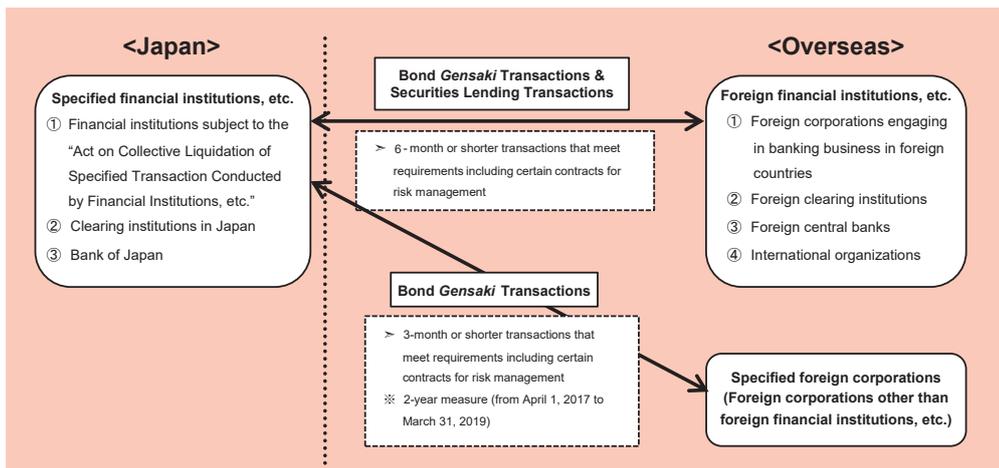
Interests that foreign financial institutions, etc. (①) receive from specified financial institutions, etc. (②) in Japan on their Bond *Gensaki* Transactions or Securities Lending Transactions and that those specified foreign corporations (③) receive from specified financial institutions in Japan on their Bond *Gensaki* Transactions are exempt from tax, provided that certain requirements are met.

① Foreign financial institutions, etc. are foreign corporations that operate banking business, financial instruments business or insurance business, foreign clearing institutions, foreign central banks and international organizations.

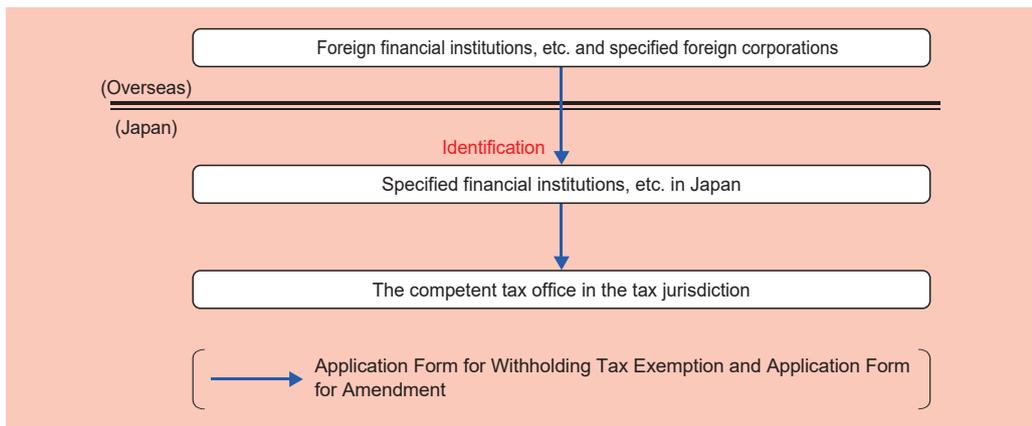
② Specified financial institutions and financial instruments firms, etc. that are subject to the “Act on Collective Liquidation of Specified Transaction Conducted by Financial Institutions, etc.,” financial instruments transaction clearing institutions (clearing institutions in Japan) and the Bank of Japan.

③ Specified foreign corporations are foreign corporations other than foreign financial institutions, etc. (However, they exclude stakeholders and corporations in countries or regions that have no tax treaties with Japan. Stakeholders are those who directly or indirectly own 50% or greater stakes in specified financial institutions or are owned 50% or more by specified financial institutions and those who effectively control or are controlled by specified financial institutions, etc.)

Fig. 2-27 Bond *Gensaki* Transactions, etc. Subject to Tax Exemption Scheme for Nonresidents



**Fig. 2-28 Overview of Tax Exemption Scheme for Nonresident Individuals and Foreign Corporations (Bond *Gensaki* Transactions)**



**Fig.2-29 Recent Tax-Related Initiatives**

| Fiscal Year | Tax Reform (Main Points)   |
|-------------|--|
| FY1999      | <ul style="list-style-type: none"> <li>Application of tax exemption to interest on coupon-bearing JGBs held by nonresident individuals or foreign corporations which are directly deposited in transfer accounts at JBESPs.</li> <li>Exemption from tax for redemption profit arising from TBs/FBs (which are now collectively called "T-bills") held by foreign corporations which are directly deposited in transfer accounts at JBESPs.</li> </ul>  |
| FY2000      | <ul style="list-style-type: none"> <li>Application of tax exemption for the accrued interest on JGBs that need to be paid back to the national treasury when the JGBs have been reopened (i.e. additional issuance of the existing JGBs).</li> </ul>   |
| FY2001      | <ul style="list-style-type: none"> <li>Expansion of the tax exemption to cover interest on coupon-bearing JGBs held by nonresident individuals or foreign corporations in transfer accounts with QFIs.</li> </ul>  |
| FY2002      | <ul style="list-style-type: none"> <li>Expansion of the tax exemption to cover the interest on JGBs held by non-judicial foreign investment trusts, provided that the investment trusts are publicly offered and are not offered in Japan.</li> <li>Application of tax exemption, under certain conditions, to loan interest generated from Bond Gensaki Transactions involving JGBs, which is received by foreign financial institutions (till March 31, 2004).</li> <li>Introduction of STRIPS related tax systems in light of the limitation that only corporations can hold principal-only book-entry transfer JGBs and coupon-only book-entry transfer JGBs.</li> <li>Adoption of the necessary tax related measures in conjunction with the transition to the new JGB book-entry transfer system.</li> </ul>   |
| FY2003      | <ul style="list-style-type: none"> <li>Application of withholding tax exemption to the interest on coupon-bearing JGBs held by non-financial domestic companies capitalized at 100 million yen or more.</li> <li>Application of withholding tax exemption to the interest on coupon-bearing JGBs held by Japan Government Bond Clearing Corporation.</li> </ul>  |
| FY2004      | <ul style="list-style-type: none"> <li>Expansion of tax exemption to cover redemption profit arising from TBs/FBs (which are now collectively called "T-bills") held in transfer accounts with QFIs by foreign corporations.</li> <li>Extension of the applicable period of tax exemption on loan interest generated from Bond Gensaki Transactions which is received by foreign financial institutions by 2 years (till March 31, 2006).</li> </ul>   |
| FY2005      | <ul style="list-style-type: none"> <li>Expansion of eligible holders of Inflation-Indexed bonds to include foreign juridical persons, provided that they are not subject to income tax on interest income.</li> <li>Relaxation/Simplification of the various procedural requirements to apply for beneficial tax treatment schemes related to JGBs held by nonresident individuals or foreign corporations, including: (i) simplification of the procedure required for notification from QFIs to JGB Book-Entry System participants in Japan when the nonresident individuals or foreign corporations hold the JGBs in transfer accounts with QFIs and (ii) simplification of the procedures required for application of tax exemption concerning the interest on coupon-bearing JGBs to those who have tax exemption concerning TBs/FBs (which are now collectively called "T-bills") under certain conditions.</li> </ul> |
| FY2006      | <ul style="list-style-type: none"> <li>Extension of the applicable period of tax exemption on loan interest generated from Bond Gensaki Transactions which is received by foreign financial institutions by 2 years (till March 31, 2008).</li> </ul>  |
| FY2008      | <ul style="list-style-type: none"> <li>Tax exemption on loan interest generated from Bond Gensaki Transactions which is received by foreign financial institutions becomes a permanent measure.</li> </ul>   |
| FY2010      | <ul style="list-style-type: none"> <li>The book prepared for each investor by JBESPs upon receiving notice from QFIs can be omitted under certain conditions.</li> <li>Expansion of the scope of the qualified foreign securities investment trusts.</li> </ul>  |
| FY2011      | <ul style="list-style-type: none"> <li>Procedures for applying tax-exemption measures on interest of book-entry transfer JGBs to Foreign Pension Trusts, partnerships and Trusts Taxable on Beneficiaries were refined.</li> <li>With respect to the Securities Lending Transactions using JGBs, tax exemption measures were applied on the interests received by foreign financial institutions, etc. as in the case of Bond Gensaki Transactions.</li> </ul>   |
| FY2012      | <ul style="list-style-type: none"> <li>Submission, etc. of Application Form for Withholding Tax Exemption on interests of book-entry transfer JGBs pertaining to the trust property of Trusts Taxable on Beneficiaries were made possible to be performed by the trustees of the relevant trust.</li> </ul>  |
| FY2013      | <ul style="list-style-type: none"> <li>After January 2016, the taxation system for public and corporate bonds will be changed to separate taxation. Moreover, the extent of profit-loss offsetting for financial products will be expanded to public and corporate bonds (Integration of financial income taxes).</li> </ul>   |
| FY2014      | <ul style="list-style-type: none"> <li>Regarding the integration of financial income taxes to be implemented in January 2016, the scope of discount bills has been revised.</li> </ul>   |
| FY2017      | <ul style="list-style-type: none"> <li>Expansion of tax exemption to cover loan interest generated from Bond Gensaki Transactions using JGBs which is received by specified foreign corporations. (till March 31, 2019).</li> </ul>  |