THE Private Wealth and Private Client Review

Eighth Edition

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THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

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CONTENTS

PREFACE

In my foreword this year, I will focus on the continuing interest that is being devoted to the position of wealthy families and the markedly different approaches that prevail in Western Europe and the United States in terms of tax information exchange and anti-money laundering policy.

While public beneficial registers for companies will be introduced in the EU in the first quarter of 2020, the United States continues to pursue its own agenda where the primary focus of its anti-money laundering policy continues to be around financial institutions.

In broad terms, it is still accurate to say that the principal impetus for ongoing policy initiatives in this area is being driven by the EU, OECD and the Financial Action Task Force (FATF). This has been underlined by two important events in the past week or so as I finalise this foreword. Firstly, the decision of the UK Crown Dependencies[1] to voluntarily adopt public registers of beneficial ownership by 2023. Secondly, FATF's publication of its 2019 guidance for trust and corporate service providers (TCSPs) (the last version was published in 2008). I will return to both of these topics below but, in general terms, they underscore the sense of the 'transparency juggernaut' maintaining its momentum.

I will first deal with EU developments. The focus of activity here is the measures being introduced at Member State level to implement the Fourth and Fifth Anti-money Laundering Directives (4AMLD and 5AMLD, respectively). With some notable exceptions (including the UK, Malta Germany, Luxembourg, Portugal and Ireland), Member States have been quite slow to implement 4AMLD. In practice, implementation in other jurisdictions looks like it will be subsumed into the widened scope of 5AMLD.

So far as corporate registers are concerned, these are due to become public in the EU and wider EEA in early 2020 under 5AMLD (in the UK, the register was public from inception so the change here will be less marked). In the arena of trust registers, the scope of trusts that are within scope has been substantially expanded from those that generate tax consequences and those that are administered in the relevant jurisdiction. The Directive makes reference to 'express' trusts. There is significant uncertainty as to how this term will be construed as, on an expansive reading, it would require, in a UK context or co-ownership of land and joint bank accounts, to be reported. As a general proposition, trust registers are private and it would only be possible to gain access to the information on the beneficial owners of a trust where the applicant can demonstrate a legitimate interest.

It seems likely, from a consultation that has recently been launched by the UK government, that those seeking access to the trust register will have to demonstrate some

1 Jersey, Guernsey and the Isle of Man.

specific evidence of money laundering or terrorist financing activity to justify this. In essence, general 'fishing' expeditions by investigative journalists into the affairs of the wealthy will, hopefully, be discouraged.

Some curious features of the directive implementing 5AMLD have potentially wide-ranging consequences for trusts that are not regarded as resident in the EU or EEA. On a literal reading of the directive, it could be argued that such trusts will be required to register in circumstances where they have a business relationship with an obliged entity – this includes not only financial institutions but lawyers, accountants and other equivalent professionals. We will have to await the detailed regulations to see the final policy stance taken on this issue.

One other area where 5AMLD leads to a surprising outcome is in circumstances where a trust is deemed to control any company that is not incorporated within the EU or EEA. In these circumstances, the directive makes provision for public access to information about the trust; the logic here is that if the relevant company does not open up its information to public scrutiny then the trust that owns it should be disclosed instead. What is completely unclear at this stage is whether this will provide de facto public access to information about trusts that control non-EU or non-EEA companies or whether it will only afford such access in circumstances where the applicant already has detailed information about the relevant company or trust.

Another interesting issue that arises in Luxembourg, where a trust is the ultimate beneficial owner of a Luxembourg company, is that information about the settlor, beneficiaries, protectors and any other natural person exercising effective control will be publicly available on the corporate Register of Beneficial Owners from 31 August 2019. This is markedly different from the position under the UK Corporate register in the case of a trustee owner where the persons with significant control or 'PSC' rules look to those who control the trustee decisions alone rather than those who are beneficiaries of a trust.

The general scope of trust registers in the EU under 4AMLD is starting to become clearer. Following on from the UK and Malta, Ireland recently published its regulations at the end of January 2019. These regulations will, as noted, be potentially subject to material expansion once 5AMLD is implemented.

One general concept within 5AMLD is the proposal that trusts can be effectively passported; in other words, once the trust can evidence registration on one EU or EEA register, this will avoid the need for duplicate registrations. Whether this will result in any practical compliance gains or advantages remains to be seen. In terms of its scope, the information being provided on trusts in the centralised Beneficial Ownership Register will be restricted to information about individuals and will not address (as is the case with Common Reporting Standard (CRS)) asset values.

There are clear signs that the EU is intent upon exporting its concept of centralised trusts and corporate beneficial ownership registers to the rest of the world. Recent commentaries have suggested a move to a global standard in this regard by 2023. NGOs active in the transparency arena have started to advocate the creation of an overarching integrated global asset register for wealthy families although it is difficult to gauge policymakers' enthusiasm for such a radical step.

The position of the UK if Brexit finally happens is also interesting. The UK seems intent upon implementing 5AMLD and has shown no signs of losing its enthusiasm for expanding measures in this area along with its European neighbours. The UK has also been putting pressure on both its crown dependencies (CDs) and overseas territories (OTs)[2] to adopt the EU's position on public beneficial ownership registers for companies.

Before the CD's announcement on 19 June 2019,[3] it seemed that the OTs were more likely to agree to the EU's position because of their constitutional status where the UK has a stronger formal say in how they make policy. What is interesting about the CD's position is, in the statement issued by the three Island Governments on 19 June, they describe a three-stage process as follows:

1. *the interconnection of the islands' registers of beneficial ownership of companies with those within the EU for access by law enforcement authorities and Financial Intelligence Units;*
2. *access for financial service businesses and certain other prescribed businesses for corporate due diligence purposes;*
3. *public access aligned to the approach taken in the EU Directive.*

It seems obvious that the CD's collective approach here is to forestall criticism from the EU in particular by being seen to take the lead in moving to public access in a phased manner. The fact that public access is the last stage of this process is revealing. The willingness in interim stages to share information with the EU and obliged entities in the regulated sector may well be a model that other jurisdictions will consider following.

Whether the voluntary adoption of public registers of beneficial ownership for companies in the CDs will stimulate other jurisdictions to follow suit remains to be seen. There have been some indications that the UK and EU stance here is to promote a new global standard of public registers for companies by 2023 mentioned above. Given the UK's pronouncements here, it seems inevitable that the OTs will be forced to adopt equivalent measures to the CDs. It will be interesting to see whether other major offshore jurisdictions such as Switzerland and the Bahamas will react to these events.

As a different matter, the separate subject of establishing centralised trust registers outside the EU is bound to be raised as a parallel issue. This may take longer to surface than pressure to establish corporate registers, but seems bound to raise its head at some stage.

From a wider FATF perspective, the key development in 2019 is the publication in late June 2019 of updated guidance to non-financial services professionals. Three sets of parallel guidance to lawyers, accountants and TCSPs[4] have been issued. There has been a significant time gap since the previous edition, which was published in 2008.

One area where the new guidance will have an important impact in the context of TCSPs is in defining 'beneficial ownership'. In this regard, the new guidance follows an expansive view of what constitutes 'control' for the purpose of beneficial ownership akin to the approach taken in the UK Trust Register. This will be potentially significant going forward in considering who needs to be disclosed in the context of trust structures in governance terms. In particular, holding powers as a minority member of a group or a veto power with respect not only to the appointment and removal of trustees but also to the addition and removal of beneficiaries, for example, will be enough to render an individual as being characterised as a 'natural person exercising effective control'. This is potentially very significant because there

2 A wider group that includes Bermuda, British Virgin Isles ,the Cayman Islands and Gibraltar.

3 https://www.gov.je/News/2019/Pages/BeneficialOwnership.aspx.

4 https://www.fatf-gafi.org/publications/fatfgeneral/documents/public-consultation-guidance-tcsp.html.

has been no guidance offered by FATF since it published its 2012 recommendations on how to interpret this expression.

It is still very early to try and discern what the impact of the information flows triggered under CRS has been. For compliant structures, the provision of CRS information should only confirm what has already been disclosed by a taxpayer to domestic tax authorities. However, given the growing concerns being expressed by politicians on the 'inequality' theme, the assembling of information about asset holding positions of wealthy individuals may be the tool that is deployed in assessing the potential impact of future wealth or inheritance taxes where these are not currently employed.

There is also a potentially significant crossover from the FATF domain into CRS reporting. In particular, a broader concept of who may be regarded as a 'controller' in the anti-money laundering context is likely to be applied for CRS purposes in due course, given the express linkage that exists in CRS that directly imports FATF definitions of beneficial ownership into the concept of who may be reportable in a trust context as a 'controlling person'.[5] This could, in particular, lead specifically to the disclosure of family members who have more subtle or 'indirect' means of influence over a family trust structure.

One development in an aligned field worth mentioning is the rules on substance for entities incorporated in offshore jurisdictions. These substance rules have taken on an increased significance recently.

The EU Council has created a code of conduct for business taxation to limit the impact of low tax regimes. In 2017, it established a code of conduct group tasked with considering the measures on business tax within a number of non-EU jurisdictions.

In response to assessments undertaken by the EU, the affected jurisdictions (which include a number of the CDs and OTs) have introduced new rules requiring economic substance that will take effect in 2019.

These rules impact companies carrying on 'relevant activities'. The substance requirements have three principal components. These are to demonstrate, that within the jurisdiction, the company:

a is directed and managed;
b undertakes core income-generating activities; and
c has physical presence.

While these measures are primarily relevant in a base erosion and profit shifting (BEPS) context, they are indicative of wider trends in terms of being able to demonstrate the overall substance of these measures that are operated in offshore jurisdictions. This is of potentially greater significance to private wealth structures that may be seen as more passive than active.

There are nine relevant activities that cover banking, insurance, fund management and financing. One specific area includes the role of pure equity holding companies (PEHs). While supposedly aimed at private equity structures, it could conceivably impact a conventional holding company holding varied investments for a family trust.

At this early stage, there is no clear guidance that delineates the boundaries of what constitutes a PEH; what can be said is that family structures could find themselves impacted if the guidance is couched in wide terms.

5 See page 59 of OECD publication in commenting on meaning of 'controlling person' for CRS purposes.

There is no doubt that the increased cost and complexity of regulation is driving trends towards simpler structures with fewer layers and involving fewer jurisdictions. There appears to be a greater reluctance on the part of corporate service providers to offer a purely passive role as a registered office without any detailed understanding of the operation of the underlying entities themselves. This appears to be coupled with a trend towards re-domiciling entities into jurisdictions where substance can be demonstrated.

At the same time, an increasing awareness as to the implications of disclosure of beneficial ownership is also generating a more reflective view on the retention of control either by settlors or by beneficiaries or connected family members.

In summary, therefore, the theme of ever-greater levels of transparency and increased complexity of overlapping regulation continues. The dichotomy between Western Europe and the United States, in terms of their different approach to these issues, also remains very apparent to observers.

John Riches
RMW Law LLP
London
August 2019

Chapter 26

JAPAN

Masayuki Fukuda and Yushi Hegawa[1]

I INTRODUCTION

Japan has the world's third-largest economy, having achieved remarkable economic growth after the Second World War, and private wealth management among business owners and wealthy families has become popular in Japan. However, Japan may not be such a favoured jurisdiction for private wealth management compared to others, largely owing to the significant tax burdens of personal income tax and inheritance and gift tax for wealthy individuals, and there being little room for effective tax planning to lawfully avoid these taxes. Recently, tax reforms have been made to increase the tax burden of wealthy individuals, such as establishing a new marginal tax bracket for personal income tax of taxable income exceeding ¥40 million (45 per cent) and the new 'exit tax' regime. On top of this, the recent enforcement attitude of the Japanese tax authority towards wealthy individuals has become very active and rigorous: the media frequently reports that wealthy individuals (e.g., business owners) who planned to avoid taxes were audited and subject to a tax bill of billions of yen as the tax authority did not respect the position taken. These examples seem to be enough to warn wealthy individuals and professional tax advisers against aggressive tax planning, setting aside the option of subsequently disputing the assessment in the courts. The Japanese government's recent enforcement attitude is probably partially politically motivated, so that in exchange for raising the rate of the consumption tax (i.e., value added tax) from 5 per cent to 8 per cent in April 2014, then from 8 per cent to 10 per cent in October 2019, to be borne by the general public, any dissatisfaction or feeling of unfairness of the general public towards the seemingly low tax burden of wealthy individuals must then be mitigated.

In such an environment, Japanese tax planning considerations for high net worth individuals would inevitably have to shift towards utilising ready-made measures offered by tax laws, rather than using creative or novel structures or techniques – presumably considered by the Japanese tax authority as deviating from the original intent of the relevant tax provision – to pursue no or little tax burden.

II TAX

i Personal income taxation

Resident individuals

Generally, Japanese resident individuals are taxed at regular progressive rates on all types of income under the Income Tax Act (Act No. 33 of 1965, as amended), subject to the special

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tax rules discussed below under the Act on Special Measures Concerning Taxation (Act No. 26 of 1957, as amended). The marginal tax rate of individual income taxation is 55.945 per cent (comprised of 45 per cent national individual income tax, 0.945 per cent special reconstruction income surtax and 10 per cent local inhabitants tax) until 2037. The marginal rate applies to the portion of the taxable income exceeding ¥40 million; this new marginal rate bracket has been effective since 2015. Among others, business income and employment income (including directors' and officers' remuneration) are subject to the regular progressive taxation.

Special rules apply to income from financial assets, which are significant for Japanese high net worth resident individuals. Japanese-resident individuals are taxed on capital gains arising from sale of securities (shares, whether private or publicly listed, and bonds for which sufficient disclosures are made) at the flat rate of 20.315 per cent, substantially lower than the 55.945 per cent marginal rate. As for dividends, if the Japanese corporation distributing the dividends is a private or non-listed corporation, Japanese-resident individuals are subject to withholding tax at the rate of 20.42 per cent, and at the same time are subject to the regular progressive taxation to be reported by filing a tax return. Publicly listed corporations are subject to withholding tax at the rate of 20.315 per cent, and will be subject to the separate taxation at the rate of 20.315 per cent to be reported by filing a tax return; provided that, for individual shareholders who own 3 per cent or more of the total issued shares of the publicly listed corporation (typically owners or founders of the business), the treatment will substantially be the same as that for a private or non-listed Japanese corporation mentioned above.

Japanese-resident individuals are subject to the Japanese anti-tax haven or controlled foreign corporation (CFC) rules. As is common with wealthy Japanese-resident individuals, when he or she owns shares of a foreign corporation (e.g., as a holding company), he or she will be subject to these rules and taxed on a pro rata portion of the profits earned by the foreign corporation (i.e., to be aggregated with his or her own income), if, in general: Japanese-resident individuals (including non-resident individuals having certain special relationships with them) and Japanese corporations collectively own, directly or indirectly, more than 50 per cent of the foreign corporation; that particular Japanese-resident individual owns, directly or indirectly, 10 per cent or more of the foreign corporation; and the effective tax burden in a fiscal year of the foreign corporation is less than 20 per cent (less than 30 per cent if the foreign corporation is a certain shell company with little substance or cash-box company). This CFC rule has been overhauled and tightened by the 2017 tax reform, in response to the Base Erosion and Profit Shifting Action Plan 3, and is effective as of April 2018.

Non-resident individuals

Non-resident individuals are taxed in Japan only on certain specifically enumerated types of Japanese source income. Non-resident individuals having no permanent establishment in Japan are, in general, not subject to Japanese taxation on capital gains arising from sale of shares of a Japanese corporation, unless such non-resident individual, together with certain related persons (its affiliates and related parties, etc.) as defined in Japanese tax laws and partnerships in which it is directly or indirectly a partner: owns or owned 25 per cent or more of the total shares of the Japanese corporation at any time during a period of three years on or before the end of the calendar year in which the sale of such shares took place; and sells 5 per cent or more of the total shares of the Japanese corporation in that calendar year.

This exceptional rule is commonly referred to as the '25/5 rule' in practice. If this applies, non-resident individuals are subject to income tax at the flat rate of 15.315 per cent, to be reported by filing a tax return. Special rules apply if the Japanese corporation at issue is a certain real property holding corporation, e.g., Japanese REITs.

As for dividends, if the Japanese corporation distributing the dividends is a private or non-listed corporation, non-resident individuals having no permanent establishment in Japan are subject to withholding tax at the rate of 20.42 per cent. In the case of a publicly listed corporation, it is subject to withholding tax at the rate of 15.315 per cent; provided that, for individual shareholders who own 3 per cent or more of the total issued shares of that publicly listed corporation, the 20.42 per cent withholding tax rate will apply. This taxation is finalised only by the withholding tax (i.e., there is no need to file a tax return).

The foregoing Japanese taxation in Japan on foreign individuals having no permanent establishment in Japan can be modified by an applicable tax treaty between Japan and the country of residence of that foreign individual.

Exit tax for resident individuals

Because income taxation for non-resident individuals on financial assets is limited compared to that for resident individuals, particularly taxation on capital gains arising from sale of shares of a Japanese corporation as discussed above, this acts as an incentive for high net worth resident individuals to exit Japan to avoid taxation on the capital gains. Popular destinations for this purpose include Singapore, Hong Kong and Switzerland. To prevent high net worth resident individuals from doing this and so preventing the loss of Japan's tax revenue, an 'exit tax' regime was introduced, effective from 1 July 2015, by an amendment to the Income Tax Act. In general, Japanese-resident individuals owning certain financial assets (shares, bonds, derivatives, etc.) of ¥100 million or more (on a fair market value basis) are now taxed on the unrealised gains on these financial assets at the time of the exit from Japan to be a non-resident individual, as if they had sold such financial assets. While there are some exceptions (e.g., in the case of a temporary job assignment overseas followed by re-entry to Japan within a certain period) this exit tax is now a significant deterrent for high net worth resident individuals to migrate to foreign low-tax jurisdictions.

Information reporting and disclosure requirements

The 2012 tax reform introduced a regime of 'statement of foreign assets', where Japanese-resident individuals who have foreign assets exceeding ¥50 million (on a fair market value basis) must disclose details of their holdings in the statement of foreign assets. Similarly, the 2015 tax reform introduced a regime of statement of assets and liabilities, where individuals (resident or non-resident) who have to file a tax return and have: taxable income exceeding ¥20 million to be reported; and assets of which the total fair market value as of the end of a calendar year is ¥300 million or more or assets that are subject to the 'exit tax' regime of which the total fair market value as of the end of a calendar year is ¥100 million or more.

In the statement of assets and liabilities, individuals must disclose details of their holding of assets and liabilities. Failure to submit these statements will entail a surtax of 5 per cent on top of the penalty tax rate that otherwise applies. These are intended for the Japanese tax authority to collect information on high net worth individuals to effectively enforce the relevant tax laws. These regimes are based on the Act on Submission of Statement of Overseas Wire Transfers for Purpose of Securing Proper Domestic Taxation (Act No. 110 of 1997, as amended).

ii Inheritance and gift taxation

Inheritance tax and gift tax are imposed based on the Inheritance Tax Act (Act No. 73 of 1950, as amended) as follows:

a Japanese national and resident taxpayers, if they are an heir or a donee, are subject to Japanese inheritance and gift tax on worldwide (i.e., Japanese and foreign) assets that they acquired by the inheritance, bequest or gift;

b taxpayers who are Japanese nationals but not Japanese residents are taxed only on Japanese assets (but not on foreign assets), unless either the deceased or donor, or the heir or donee, used to reside in Japan at any time during the 10-year period preceding the commencement of the inheritance, bequest or gift; and

c taxpayers who are neither Japanese nationals nor Japanese residents are taxed also only on Japanese assets (but not on foreign assets), unless the deceased or donor used to reside in Japan at any time during the 10-year period preceding the commencement of the inheritance, bequest or gift.

This means that an attempt to avoid inheritance and gift taxation on foreign assets by becoming a non-resident or even a foreign national has become impractical, since it mandates a 'waiting period' of 10 years. Indeed, aiming to discourage such an attempt, the waiting period in the case of (b) above has been extended from five years to 10 years by the 2017 tax reform, and the 2017 tax reform has set a new 10-year waiting period in the case of (c) above. In addition, becoming a non-resident of Japan will generally trigger the exit tax explained above. Further to this, the Japanese tax authority has frequently disallowed the taxpayer's position that he or she became a non-resident of Japan, by finding him or her to still be a resident of Japan based on various factors, not only for income tax purposes but also inheritance and gift tax purposes.

The marginal inheritance tax rate is 55 per cent if the total value of the inherited assets succeeded to by an heir as a taxpayer exceeds ¥600 million, effective from 2015. Also, effective from 2015, standard deductions for inheritance tax were significantly reduced. This is obviously intended to expand the tax base of the inheritance tax and to increase taxation of high net worth families. The marginal tax rate of gift tax is 55 per cent if the total value of the gifted assets of a donee as a taxpayer exceeds ¥30 million; as such, gift tax can be significantly burdensome when assets of a significant value are gifted, and hence is a deterrent for succession of a business to the next generation.

The value of assets for inheritance and gift tax purposes is measured in accordance with the Asset Valuation Basic Circular of the Japanese tax authority (the Circular). Because room for creative tax planning is rather limited, a major part of the planning in practice was to try to reduce the value of the assets, taking advantage of the text of the Circular. However, the Circular contains a general anti-avoidance provision called General Rule Paragraph 6, and this has been actively invoked by the Japanese tax authority to disallow 'creative' (in its view 'abusive') tax planning to reduce the value of the assets based solely on the text of the Circular.

III SUCCESSION

i Overview

After the Second World War, the succession system was transformed in Japan. There are two kinds of succession: testate and intestate. In the case of intestate, the surviving spouse is always an heir. Children of the deceased are heirs of the first rank, the lineal ascendants (parents and grandparents) are heirs of the second rank, and the siblings (brothers and sisters) come third. If there is a spouse and children, the spouse will take half the estate and the remaining half is equally divided among the children, and heirs of the second and third rank have no share in the estate. If there is a spouse but no children, the estate is divided between the spouse who takes two-thirds of the estate and the lineal ascendants who take a third. If the lineal ascendants have already died, the spouse takes three-quarters and the siblings take a quarter.

The share of an illegitimate child used to be half of that of a legitimate child. However, the Supreme Court declared[2] that the relevant provision of the Civil Code of Japan (Act No. 89 of 1896 as amended) (the Civil Code) is unconstitutional and invalid and, thereafter, such discriminatory treatment was abolished.

If a prospective heir dies before the deceased, such heir's lineal descendant will become the heir (in addition, where a child's lineal descendant also dies before the deceased, such lineal descendant's lineal descendant will become the heir).

An heir will have a choice to accept or renounce succession. An heir may also accept succession with a reservation by declaring that he or she is liable for the debts of the deceased only up to the amount of the inherited estate. Renunciation or acceptance with reservation will have to be made within three months after he or she has become aware of the death of the deceased and of the fact that he or she is to succeed the estate. He or she must prepare an inventory of the estate and declare renunciation or acceptance at the family court in order to effect renunciation or acceptance with reservation. When an heir fails to renounce or accept succession with reservation within three months, he or she is deemed to have accepted the succession.

If there is no will, the estate of the deceased as well as his or her debts pass directly to the heirs. Until the estate is distributed among the heirs, it will be jointly owned by the heirs and each heir may dispose of its own share. The division of the estate will take effect retrospectively upon the death of the deceased, but the division may not affect the third party who acquires an interest in the estate before the division. Therefore, if an heir sold its share in the succeeded land to a third party before the division, such sale is valid even after the division.[3]

If there is a will, the distribution of the estate will be effected in accordance with the will. Any person over 15 years of age is capable of making a will. A will must follow the strict formalities set forth in the Civil Code. There are three kinds of ordinary wills: a will written in the testator's own hand (a holographic will); a will by notarised document; and a will by a sealed secret document. A will can be revoked at any time by the testator. However, certain categories of heirs (children, spouses and lineal ascendants, not including siblings) have a secured portion of the estate that they cannot be deprived of, even by will. If the lineal ascendants are the only heirs, a third of the estate will be reserved for them and otherwise, half of the estate will be reserved.

The Civil Code was amended as of 13 July 2019, and thereunder various amendments to the succession system were made, including the following:

a the spouse of the deceased may continue to live at the residence of the deceased so long as he or she is alive;

b holographic wills may be deposited at legal affairs bureaus;

2 Supreme Court Decision, 4 September 2013, Minshu 67-6-1320.

3 Supreme Court Judgment, 28 April 1967, Minshu 21-3-780.

c a provisional payment from bank deposits of the deceased will be permitted for payment of certain necessary expenses up to a particular threshold amount (see Section III.ii);
d gifts made 10 years or more before the commencement of succession will not be counted in the calculation of the statutory reserved portion of the estate for certain heirs; and
e an heir's succession of estate beyond its statutorily predetermined portion may not be perfected against third parties unless such succession is registered.

ii Recent Supreme Court change of rule

Under a previous judgment of the Supreme Court,[4] the bank deposit in the estate of the deceased was automatically divided in proportion to the statutorily determined ratio of succession and belonged to the statutory successors upon the death of the deceased. However, in 2016, the Supreme Court[5] changed its former view and held that the bank deposit in the estate of the deceased will not be automatically divided upon the death of the deceased and shall be dealt with by the division of the estate agreed or conciliated between the heirs or adjudicated by the family court. Following the Supreme Court's judgment, the Civil Code was amended so that a provisional payment from bank deposits of the deceased will be permitted up to a certain threshold amount to satisfy the heirs' practical needs such as payment of expenses for the funeral of the deceased or the heirs' impending cost of living.

iii Conflict of law rules

Under the Japanese conflict of law rules, in general, the succession is governed by the laws of the deceased's nationality. The execution and effect of a will shall be governed by the laws of the testator's nationality when the will is executed. However, Japan has ratified the Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions and pursuant to the domestic law enacted thereunder, a will be legally valid if a will complies with:

a the laws of country where the will is executed;
b the laws of the country of the testator's nationality when the will is executed or the testator is dead;
c the laws of the country of the testator's domicile when the will is executed or the testator is dead;
d the laws of the country of the testator's habitual residence when the will is executed or the testator is dead; or
e in the case of a will regarding immovable property, the laws of the country where such immovable property is located.

iv Applicable changes affecting personal property

While prenuptial agreements are not very popular in Japan, a couple may execute an agreement regarding their properties (couple's property agreement) prior to the filing of their marriage notice to the authority pursuant to the Civil Code. Such agreement shall be registered at the Legal Affairs Bureau so that it may be legally claimable against their heirs or other third parties.

4 Supreme Court Judgment, 8 April 1954, Minshu 8-4-819.
5 Supreme Court Judgment, 19 December 2016, Hanta 1433-44.

No legislation has been made regarding same-sex marriage and, therefore, no particular legal protection has been given to same-sex couples in Japan. Recently, some local municipalities enacted certain local regulations under which the municipality commenced to issue 'partnership certificates' to same-sex couples, although the legal effect of such certificates is not clear; arguably, a same-sex couple with such certificate might be treated the same as a de facto heterosexual couple.

IV WEALTH STRUCTURING AND REGULATION

i Vehicles and structures

Asset holding companies

Companies and corporations are the most widely used vehicles for wealth management in Japan. Typically, two types of companies will be available: a stock company and a limited liability company. Equity-holders of these companies are responsible for the financial obligations of the companies only to the extent of the subscription price paid for the equities owned by such equity-holders. A stock company is divided into two types: public companies and non-public companies. The shares of a public company shall be limited to transfer-unrestricted shares. Meanwhile, the shares of a non-public company may include transfer-restricted shares that may not be transferred without the company's permission. The term public or non-public as used here is a technical term, and is not equal to whether the company's shares are publicly listed or not. A limited liability company is modelled after a US LLC and may be converted into a stock company, which makes it a useful vehicle for start-up companies. When the shares in listed companies are transferred to asset holding companies, a large volume of shareholding reports or their amendment reports or extraordinary reports may be required to be filed with the financial authority and may also be subject to TOB regulations and insider trading regulations under the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended). To prevent disputes among family members in the future succession, it is recommended that the number of asset holding companies is the same as the number of family members (e.g., if there are two children and a spouse, three asset holding companies should be set up).

For high net worth individuals who own a business in the form of shares of a Japanese company operating the business (in many cases this is a publicly listed company), a Japanese asset holding company privately owned by the owner-individual is widely used. This is because dividends paid by the Japanese operating company to the Japanese asset holding company will be (except for a portion corresponding to interest on debts) exempt from corporation tax at the asset holding company's level (i.e., dividend received deduction), if the asset holding company owns more than a third of the outstanding shares of the Japanese operating company generally for six months or more before the record date for the relevant dividend. This effectively enables deferral of taxation at the level of the owner or individual on the dividends paid by the Japanese operating company, and he or she can avoid the 20.42 per cent withholding tax and the regular progressive taxation had he or she owned the shares directly. In addition, from a viewpoint of valuation for inheritance and gift tax purposes under the Circular, if the asset holding company is well structured so that it will not fall under a certain specified share or real property holding company, the valuation of the shares of the private asset holding company may be made by taking into consideration the share prices and other factors of some other similarly situated listed companies, without being bound solely by the market price of the underlying shares of the publicly listed Japanese operating company, which may result in a substantially lower valuation under the Circular. We should note, however, that the tax authority has recently often challenged structures using shell holding companies with a view to reducing the valuation under the Circular, by invoking the General Rule Paragraph 6 and by looking to the economic substance of such structures.

There are cases where an owner or individual has a private asset holding company that is a foreign company in some tax-favourable jurisdictions. In this case, the foremost concerns include application of the CFC rules as tightened by the 2017 tax reform, and a permanent establishment risk in Japan (where the owner manages everything for the holding company in Japan).

Associations and foundations

Associations and foundations are also popular vehicles for a family's wealth management in Japan. An association or foundation that does not intend to distribute its surplus may be established as a general-association judicial person or a general-foundation judicial person by just registering them without having to demonstrate their public purpose. They may apply for non-profit status as a public-interest-association judicial person through the office of the Prime Minister or a regional governor of prefecture, which then will establish committees consisting of private sector specialists to examine the public interest character of the applicant.

The gift or donation of an asset to public-interest-association judicial persons will generally be deductible as a qualified donation for the donor's income or corporation tax purposes. The gift or donation of appreciated assets (e.g., shares of the Japanese operating company) by a resident individual to public-interest-association judicial persons (and certain other qualifying corporations) may be exempt from capital gains taxation subject to a specific approval of the tax authority. Public-interest judicial persons are generally not subject to corporation tax on income from non-profit public activities. As such, public-interest association or foundation judicial persons are often used as a vehicle to own the shares of the publicly listed Japanese operating company as transferred from the owner or individual, as a stable shareholder that would prevent hostile takeovers of the Japanese operating company. Also, by doing so, the owner or individual can alienate these shares from his or her inheritance estate to reduce the future inheritance tax burden. At the same time, public-interest association or foundation judicial persons could be subject to Japanese gift tax as if they were individuals as to the gift that they received from an individual, if such gift is found to unjustifiably reduce the future inheritance tax burden of the individual. This gift taxation will be exempt if the public-interest association or foundation judicial persons are well structured in terms of governance, use of funds, etc. Generally, use of a foreign association or foundation instead of a Japanese one poses difficult tax issues and entails unpredictable tax risks.

Trusts

Traditionally, trusts have been used as substitutes for bank deposits and securities investments, or as vehicles for securitisation or other commercial transactions. Recently, however, they have become popular as vehicles for succession of business from the owner to its families (as substitute for a will) or for other wealth management purposes.

Trusts may be set up under the Trust Act (Act No. 108 of 2006, as amended). If the granter entrusts its properties to a trust, such properties will not be affected by the bankruptcy of the grantor or the trustee (bankruptcy remoteness) and the trusted properties are managed and disposed of solely by the trustee pursuant to the trust certificate. By setting up the trust, the grantor acquires the trust beneficial interests and may transfer such interests to a third party more smoothly than the trusted assets such as securities or real estates.

For tax purposes, a plain-vanilla trust (defined as a 'beneficiary-taxed trust') is, in general, treated as a conduit (i.e., a holder of the trust's beneficial interests will be deemed to directly own the underlying entrusted property). That is, a beneficiary-taxed trust cannot generally achieve deferral of taxation on income arising from the entrusted property, or alienation of the underlying entrusted property from the inheritance estate for tax purposes. Although there are two other types of trust, the tax regime is so strict and straightforward that there is little room for creative and effective tax planning using trust (including a beneficiary-taxed trust).

ii Anti-money laundering and other regimes

In Japan, money laundering of proceeds from certain serious crime is prohibited under the Narcotics Special Provisions Act (Act No. 94 of 1991, as amended) and the Punishment of Organised Crimes and Control of Crime Proceeds Act (Act No. 136 of 1999, as amended). Furthermore, to prevent money laundering and terrorist financing, the Criminal Proceeds Transfer Prevention Act (Act No. 22 of 2007, as amended (the Criminal Proceeds Act)) requires that specified business operators (SBOs) such as financial institutions and real estate agents: verify the counterparty of the transaction; prepare and preserve records of such verification and transaction; and report any suspicious transactions to the relevant authority.

In 2016, responding to the Financial Action Task Force (FATF)'s critical statement, the Criminal Proceeds Act was amended in various points, such as:

a an amendment to the procedures for assessment of suspicious transactions;

b SBOs were obliged to confirm that a new counterparty of transactions had adopted a similar level of internal anti-money laundering measures;

c expanding SBOs' obligations upon adopting internal anti-money laundering measures; and

d a requirement of strict verification when making transactions with foreign politically exposed persons, etc.

As a result of such amendments, anti-money laundering legislation became closer to other developed nations' anti-money laundering regimes. In 2018, the Japanese Financial Services Agency also adopted the 'Guideline on Anti-Money Laundering and Counter-Terrorist Financing', which requires financial institutions to facilitate their internal risk management systems on risk-based approach. In October to November 2019, FATF's assessor team will come to Japan and make an on-site visit including an interview with managers of financial institutions for the fourth round of the Mutual Evaluation of Japan.

While not yet enacted, it is reported that the government is planning to introduce reporting obligations for tax professionals and promoters who are involved in certain tax planning, in response to the BEPS Action Plan 12.

V OUTLOOK AND CONCLUSIONS

The current direction is to tighten taxation on wealthy individuals in Japan, both as a matter of tax policy and legislation and enforcement. As to enforcement, the tax authority has recently established divisions specialising in monitoring and auditing wealthy individuals; as such, the enforcement is expected to be much more active and rigorous. On the other hand, regarding taxpayers, the issue is not limited to tax or money – many wealthy individuals care about their reputation and so want to avoid sensational press reports that they under-reported their tax liability. This reputational risk tends to deter wealthy individuals from creative or novel tax planning at the outset because of the press coverage that appears once they are subject to an assessment, and even if they win in the courts years later, it would not necessarily lessen the damage to their reputation. Therefore, in the Japanese wealth management practice, what is sought from professional tax advisers may not be technical ability or creativity, but a way of ascertaining whether the Japanese tax authority is likely to find the planned transaction as abusive or excessive tax planning.

Appendix 1

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