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Japan`s Tax issues related to investing in Real Estate

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Introduction of the Speaker

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- 10 years' experience at one of Big4 firms, KPMG including working experience in Los Angeles office, before starting my own firm
- Specialize in tax and accounting advisory service for foreign companies in Japan, and Japanese global companies
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How to collect individual income tax in Japan

- Withholding tax system – Generally, the company (employer) collect the taxes from employees and pay them directly to Tax authority
- Individual Tax return (*Kakuteishinkoku*) – You have to submit your tax return yourself if your additional income is over 200K yen or your total revenue is over 20 million yen. You can obtain the detailed manual at NTA web site.
  - Blue return (*Aoiroshinkoku*) – You can use the special deduction for the enterprise income amounting to 650K yen if you submit the request form, and also keep the proper bookkeeping.
  - White return (*Shiroiroshinkoku*) – no special request needed.

Special taxes imposed at acquisition

- Consumption tax(*Shouhizei*) – imposed for building portion of the property, not for the land portion when the property was obtained from relatively big companies.
- Property acquisition tax(*Koteishisansyutokuzei*) – on average, around 1% - 2% is imposed after 6 months form the acquisition.
- Registration tax(*Tourokumenkyozei*) - around 0.3% - 2%
- Stamp tax(*Inshizei*) – around 30K yen

Taxes for individual residence

<u>Good!</u>

- Tax Deduction for mortgage interest - You can deduct the amount of your mortgage interest as **<u>tax deduction</u>** amounting to 400K yen per year.
- Earth quake insurance deduction – 50K yen at maximum as an expense.

<u>Bad!</u>

- Fixed assets tax – around 0.5%-1.5% of the purchase amount is taxed every year(also for investing purpose).

Taxes for Investors in Real Estate

- Taxable income (*Kazeisyotoku*) is calculated by deducting all related expenses from the total revenue. The purchase amount of the property is gradually expensed (Depreciation), and deducted from the revenue.
  - Entertainment cost can be its expenses when some conditions are met, but the cost for clothing is never allowed.
- Individual income tax (*syotokuzei)* is calculated by applying the specific tax rate to the taxable income. Also, residence tax (*juminzei*) and enterprise tax (*jigyouzei*) is imposed to taxable income.
- No consumption tax is imposed to the revenue related to rent income.

What is Depreciation?

- Depreciation - The purchase amount of the property for building portion is gradually expensed , and deducted from the revenue.
  - Depreciation period is based on the type of the properties.
  - No cash-out occur at depreciation, but deductible for tax purpose.

- If the building portion is relatively large, the more depreciation is recognized. However, the more capital gain is recognized as the book value at the sale is lower.

Tax Rate for individuals

- The tax rate for individual income tax is as follows(residence tax and enterprise tax are excluded):

Taxable Income (TI) and the Tax Rate for individual income tax	
Taxable Income	Tax Rate
less than 1.95M yen	5% of TI
1.95 to 3.3M yen	10% of TI exceeding 1.95M yen minus 97,500 yen
3.3 to 6.95M yen	20% of TI exceeding 3.3M yen minus 427,500 yen
6.95 to 9M yen	23% of TI exceeding 6.95M yen minus 636,000 yen
9 to 18M yen	33% of TI exceeding 9M yen minus 1,536,000 yen
more than 18M yen	40% of TI exceeding 18M yen minus 2,796,000 yen

- Japan use progressive tax system. The combined tax rate is around <u>30% for TI of 5M</u> yen, around <u>40% for TI of 10M</u> yen, and around <u>50% for TI of 20M</u> yen.

Taxes when you sell the property

- Individual income taxes are imposed to the gain (the revenue minus the acquisition cost adjusted for the depreciation and the related expenses).
- You can deduct 30M yen for taxable income calculation at the sale of your primary residence.
- The special tax rate is applied to the gain by individuals:
  - Short term: the combined tax rate of 40% is applied if the sale is within 5 years from the purchase.
  - Long term: the combined tax rate of 15% - 20% is applied.

Making a Corporation

- Rent income is first pooled to the corporation, and then paid to you as a salary income.
  - Corporate income tax rate is around 38% when the table income is over 8million yen, and around 24% when the taxable income is lower. Thus, it`s possible to lower the tax rate when certain conditions are met.
  - Corporation is useful when you can divide the income to more than 1 employees (ex, your spouse) to decrease the tax rate.
  - Salary deduction can be used for salary income calculation.
- However, the set up cost is more than 300K yen, and many paper works are needed at the set-up and afterwards.

Useful Materials

- National Tax Agency (*Kokuzeicyou*)
  - http://www.nta.go.jp/foreign_language/
- JETRO
  - http://www.jetro.go.jp/en/invest/setting_up/laws/section3/
- GaijinTax.com
  - http://gaijintax.com/

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