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TAX UPDATE

NATIONAL TAX AGENCY – TREATMENT OF INCOME FROM THE SETTLEMENT OF CROSS-BORDER DERIVATIVE TRANSACTIONS

The ‘Outline of the 2022 Tax Reform Proposals’ (Proposal) was approved by the Cabinet on 24 December 2021. The Proposal explains that the law and regulations of income tax and corporation tax should be made clear that income from the settlement of exchange-listed or over-the-counter derivatives, which are prescribed under the Financial Instruments and Exchange Act, is not treated as Japanese source income from managing or holding of domestic assets. The same treatment should also be applied to foreign source income from managing and holding of foreign assets under the foreign tax credits system.

Based on the above approval by the Cabinet, the National Tax Agency (NTA) released the following information about the retroactive change in the treatment of income from the settlement of cross-border derivative transactions (Derivative Income) on 7 January 2022:

[Treatment in the past]

Derivative Income, excluding the income attributable to a Japanese permanent establishment (PE), was treated as follows:

- Derivative Income of a non-Japanese resident or foreign company is treated as Japanese source income as income from managing or holding of domestic assets.
- Derivative Income of a Japanese resident or Japanese company is treated as foreign source income as income from managing or holding of foreign assets.

[Treatment in the future]

In order to take a consistent tax position with the Proposal, Derivative Income, excluding the income attributable to a Japanese PE, will be treated as follows:

- Derivative Income of a non-Japanese resident or foreign company is NOT treated as Japanese source income as income from managing or holding of domestic assets.

- Derivative Income of a Japanese resident or Japanese company is NOT treated foreign source income as income from managing or holding of foreign assets.

The NTA also released the following information, since the above change in treatment is applied retroactively:

[\[Non-Japanese resident or foreign company\]](#)

A non-Japanese resident or foreign company which has made an over-payment of Japanese taxes due to the above changes in the treatment of Derivative Income can claim for refunds.

[\[Japanese resident or Japanese company\]](#)

A Japanese resident or Japanese company which has made an under-payment of Japanese taxes due to the above changes in the treatment of Derivative Income will need to file amended tax returns.

(The population of taxpayers who are required to file amended tax returns seems to be quite small because of currently existing common practice mentioned below <Supplemental information>.)

[<Supplemental information>](#)

The background of the proposal for the above tax reform seems to be based on the judgements made by the National Tax Tribunal on 25 March 2019, in which the National Tax Tribunal concluded that income from the over-the-counter foreign exchange margin transactions, etc. by non-Japanese residents is treated as Japanese source income from managing or holding of domestic assets under the Japanese tax law. Since the treatment in the future as described above has been common practice, the Japanese tax treatment of Derivative Income had been unstable due to the above judgements.

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