

KPMG Japan tax newsletter

New tax measures for Sharia-compliant financing structures

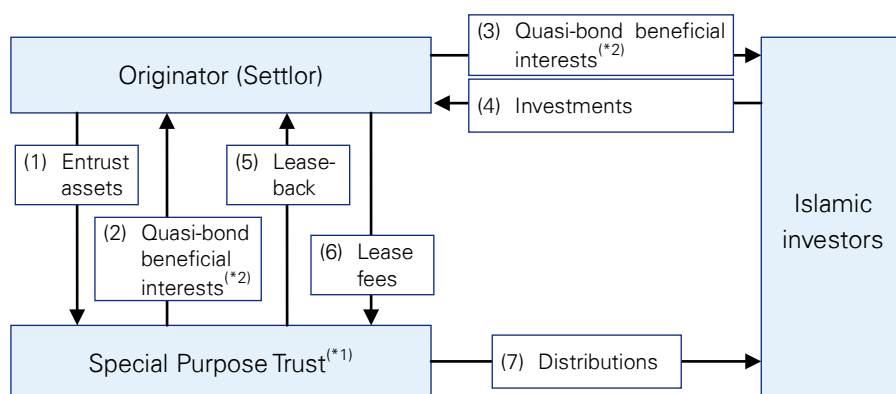


On 16 November 2011, it was announced that the amendments to the Asset Liquidation Act and related Japanese tax laws will be enforced on 24 November, in accordance with 'the Act for Amendment of the Financial Instruments and Exchange Act, etc. for Strengthening the Foundations of Capital Markets and the Financial Industry' promulgated on 25 May 2011.

As a result of the amendments, quasi-bond beneficial interests of Special Purpose Trusts (SPTs) have been structured as Islamic bonds (Sukuk) so that Islamic investors, who are prohibited from receiving interest, can make investments into them, and preferential tax measures in relation to quasi-bond beneficial interests have been introduced.

1. Structure using quasi-bond beneficial interests of SPTs

The illustration below is a structure using quasi-bond beneficial interests of SPTs presented by the Financial Services Agency (FSA) in their statements concerning their recommendations for the 2011 tax reform.



(Source: December 2010, FSA 'The 2011 Tax Reform')

(*) Special Purpose Trusts (SPTs)

An SPT is a trust provided for under Article 2(13) of the Asset Liquidation Act, i.e. a trust that is created pursuant to the provisions of this Act for implementing asset securitization and having more than one person acquire beneficial interests in a trust held by the settlor at the time of conclusion of the trust contract, by dividing the beneficial interests thereof.

(*) Quasi-bond beneficial interests

Quasi-bond beneficial interests are a class of beneficial interests for which a predetermined amount is to be distributed with regard to the distribution of monies during the trust period.

By virtue of the amendment to the Asset Liquidation Act, new requirements for quasi-bond beneficial interests were added in order to make them more similar to corporate bonds, i.e. where providing for quasi-bond beneficial interests in an SPT contract, it must include conditions that the principal should be redeemed at a predetermined point in time and beneficiary certificate holders of the quasi-bond beneficial interests have no voting rights for resolutions at a beneficiary certificate holders' meeting except for important matters (Article 230(1)(ii) of the Asset Liquidation Act). Moreover, a requirement to issue other types of beneficial interests when issuing quasi-bond beneficial interests was abolished.

Note that quasi-bond beneficial interests of an SPT discussed in 2, 3 and 4 below are those provided for in Article 230(1)(ii) of the Asset Liquidation Act.

2. Tax treatment for Islamic investors

Preferential tax measures have been introduced for quasi-bond beneficial interests of an SPT held by Islamic investors not having a permanent establishment in Japan.

(1) Profit distributions and gains on redemption

Interest on and gains on redemption from book-entry corporate bonds (issued on or before 31 March 2013) received by non-resident individuals or foreign companies are tax exempt under certain conditions. This rule has been expanded to cover profit distributions and gains on redemption from book-entry quasi-bond beneficial interests (issued on or before 31 March 2013) of SPTs.

Note that this rule does not apply to profit distributions and gains on redemption from book-entry quasi-bond beneficial interests of an SPT received by related persons of the originator of the SPT.

(2) Capital gains

Although capital gains from disposal of shares in a Japanese company by a foreign company are subject to Japanese corporate tax in either of the following cases, this rule will not apply to quasi-bond beneficial interests of an SPT:

- (i) Where the foreign company has held 25 percent or more of the shares in the Japanese company at any time during the fiscal year of sale or the preceding 2 taxable years, and at least 5 percent of the shares are sold by the foreign company within the fiscal year of sale
- (ii) Where the Japanese company is a real estate holding company (a company whose Japanese real property interests equal or exceed 50 percent of its total assets on a fair market value basis)

Thus, capital gains arising from disposal of quasi-bond beneficial interests of an SPT by a foreign company will not be taxed in Japan. Note that capital gains

arising from disposal of quasi-bond beneficial interests by a non-resident individual are also non-taxable in Japan.

3. Tax treatment for SPTs

An SPT is treated as a corporate-taxed trust, i.e. a trust company that is the trustee of the SPT is liable for corporate tax on income derived from the SPT. Profit distributions paid by an SPT are deductible in calculating taxable income of the SPT provided the tax qualifying requirements are satisfied. Such requirements were amended as follows:

Before amendment	After amendment
A. Conditions for the SPT	A. Conditions for the SPT
<p>All of the following requirements are satisfied:</p> <p>(a) The SPT contract is notified to the government.</p> <p>(b) One of the following conditions is satisfied:</p> <p>(1) The public offering of beneficial interests of the SPT by the issuer has been conducted by way of a solicitation of acquisition, and the total issue price of the beneficial interests is not less than 100 million yen.</p> <p>(2) As a result of the public offering of beneficial interests of the SPT conducted by the issuer, the beneficial interests have been accepted by not less than 50 persons.</p> <p>(3) As a result of the public offering of beneficial interests of the SPT conducted by the issuer, the beneficial interests have been accepted only by a qualified institutional investor(s).</p> <p>(c) The ratio of domestic offered beneficial interests to total offered beneficial interests is greater than 50 percent.</p> <p>(d) Any other requirements specified by a Cabinet Order</p>	<p>All of the following requirements are satisfied:</p> <p>(a) The SPT contract is notified to the government.</p> <p>(b) One of the following conditions is satisfied:</p> <p>(1) The public offering of quasi-bond beneficial interests of the SPT by the issuer has been conducted by way of a solicitation of acquisition, and the total issue price of the quasi-bond beneficial interests is not less than 100 million yen.</p> <p>(2) As a result of the public offering of quasi-bond beneficial interests of the SPT conducted by the issuer, the quasi-bond beneficial interests have been accepted only by a qualified institutional investor(s).</p> <p>(3) As a result of the public offering of beneficial interests (excluding quasi-bond beneficial interests) of the SPT conducted by the issuer, the beneficial interests have been accepted by not less than 50 persons.</p> <p>(4) As a result of the public offering of beneficial interests (excluding quasi-bond beneficial interests) of the SPT conducted by the issuer, the beneficial interests have been accepted only by a qualified institutional investor(s).</p> <p>(c) The ratio of domestic offered beneficial interests (excluding quasi-bond beneficial interests) to total offered beneficial interests is greater than 50 percent.</p> <p>(d) Any other requirements specified by a Cabinet Order</p>
B. Conditions for a fiscal year of the trust company as a trustee of the SPT	B. Conditions for a fiscal year of the trust company as a trustee of the SPT
<p>All of the following requirements are satisfied:</p> <p>(a) At the end of the fiscal year, the trust company does not fall under the category of a family company.</p> <p>(b) The amount of distribution of profit pertaining to the fiscal year exceeds 90 percent of the amount of distributable profits of the SPT for the fiscal year.</p> <p>(c) Any other requirement specified by a Cabinet Order</p>	<p>All of the following requirements are satisfied:</p> <p>(a) At the end of the fiscal year, the trust company does not fall under the category of a family company, unless the SPT satisfies condition A(b)(1) or (2) above.</p> <p>(b) The amount of distribution of profit pertaining to the fiscal year exceeds 90 percent of the amount of distributable profits of the SPT for the fiscal year, excluding a certain amount^(*) when quasi-bond beneficial interests are issued.</p> <p>(c) Any other requirement specified by a Cabinet Order</p>

^(*) In principle, the net amount of 5 percent of the ending balance of the principal of the quasi-bond beneficial interests of the SPT less the beginning balance of the retained earnings for the fiscal year

The above amendments will be applied for fiscal years ending on or after 24 November 2011.

4. Other related amendments

(1) Repo transactions

Interest and lending fees paid to foreign financial institutions in respect of certain bond gensaki repo transactions and securities lending transactions are tax exempt under certain conditions.

The above tax exempt regime has been expanded to cover book-entry quasi-bond beneficial interests.

(2) Profit distributions from quasi-bond beneficial interests received by financial institutions

When certain financial institutions including banks having business offices in Japan, Financial Instruments Business Operators prescribed under the Financial Instruments and Exchange Act or similar business operators receive interest on government or company bonds recorded in the transfer account book prescribed in the Act on Book-Entry Transfer of Company Bonds, such interest is not subject to withholding tax to the extent of the interest arising for the recorded period.

This exemption regime has been expanded to include profit distributions from book-entry quasi-bond beneficial interests.

(3) Registration tax/real estate acquisition tax

Under the structure indicated in 1 above, if the originator repurchases assets entrusted to the SPT on the termination of the SPT contract, registration taxes and real estate acquisition taxes will be exempt if certain conditions are met.

KPMG Tax Corporation

Izumi Garden Tower, 1-6-1 Roppongi, Minato-ku,
Tokyo 106-6012
TEL : +81 (3) 6229 8000
FAX : +81 (3) 5575 0766

Epson Osaka Building 14F, 3-5-1 Bakuro-machi, Chuo-ku,
Osaka 541-0059
TEL : +81 (6) 4704 3188
FAX : +81 (6) 4704 3962

Dainagoya Bldg. 5F, 3-28-12 Meieki, Nakamura-ku,
Nagoya 450-0002
TEL : +81 (52) 569 5420
FAX : +81 (52) 551 0580

www.kpmg.or.jp/tax
info-tax@jp.kpmg.com

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