

HR & Tax Alert



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UK & Japan – New Double Tax Treaty Comes Into Effect

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Executive summary

The new Double Tax Convention between Japan and the United Kingdom will become effective in Japan from 1 January 2007. It will be effective for withholding purposes in the UK from 1 January 2007 and for income and capital gains tax purposes from 6 April 2007. This alert discusses issues which may affect expatriate assignees.

Changes in the new treaty

The new treaty follows the OECD model treaty more closely than the 1969 version although in practice the less precise wording of the old treaty was interpreted as applying OECD rules in any case.

183 day rule

The major change from an expatriate's point of view is that Article 14 now only offers exemption for employment income under the "183 day rule" to employees who are not present in the host country for 183 days in a twelve month period beginning or ending in the taxable year or year of assessment concerned. For someone in the UK in 2006/07 for less than 183 days where all other conditions are satisfied, exemption from UK tax will still apply. However if the individual is still here in 2007/08 the days spent here in 2006/07 will be taken into account in deciding whether the days present rule is exceeded during a twelve month period ending in the later year. The same look back rules will apply to assignees in Japan in 2006 and 2007.

Employment on international boats and aircraft

First taxing rights on income from employment exercised on a boat or aircraft operated in international traffic remains with the country in which the ship or aircraft is managed and controlled.

Remittance clause

The remittance clause, whereby income only taxable on a remittance basis but which is not remitted can fall back into charge in the other country is retained.

Investment income

As before, interest derived by an individual is taxable in both states although where the source is in one country and the individual is resident in the other, the country of source can only impose a 10% tax rate and the country of residence must give a credit.

In the same way, tax on most dividends is limited to 10% in the country of source. Total exemption in the country of source applies to certain companies holding shares which are resident in the other country and to qualifying pension schemes. In limited circumstances Japan will give credit for UK corporation tax on the relevant company profits.

Capital gains on shares and share options

The treaty says that capital gains from the sale of quoted shares are only taxed in the country of residence but the protocol retains the UK right to impose its five year rule in respect of assets held before departure by longer term residents. Without

the protocol a treaty ratified after the domestic legislation could be seen to override sovereign will.

The protocol determines that share option gains should be treated as employment income. To the extent (and only to the extent) that a gain is taxable in

both countries the gain is deemed to have accrued over the whole period from grant to exercise and each country taxes the gain relating to residence in that country. This is a departure from normal OECD practice which apportions gain between grant and vesting.

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