CROSS-BORDER ESTATE PLANNING IN JAPAN

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I. Introduction to Estate Planning.

A. What is estate planning? An individual’s controlled disposition of assets during life and after death to heirs/beneficiaries while minimizing taxes and other costs to the extent legally possible.

B. Succession. “Succession” or “Probate and Estate Administration” is the legal process by which:

1. Decedent’s assets are determined;
2. Debts and taxes are identified and paid;
3. Heirs/beneficiaries and their respective entitlement determined; and
4. Title ownership to remaining assets is transferred to the appropriate heir/beneficiary.
5. Processes/concepts between succession in Japan and other countries such as the U.S. are very different.

C. Taking Stock. Information needed for estate planning includes:

1. Assets. Cash and CDs, Stocks and Bonds, Real Estate, Retirement Assets (IRA, 401k), Life Insurance, Tangible Property (Jewelry, Antiques, Art), Family Business, Partnership/LLC interests, Beneficiary of a Trust, Joint Accounts, Expected Inheritance.


3. Citizenship. Expatriate, Spouse, Children, Other Beneficiaries.

4. Marriage. Is the marriage recognized under applicable law?


6. Situs (Location) of Assets/Liabilities.

D. Beneficiaries - Who is to receive the assets?

1. Spouse and Children.
2. Grandchildren.
3. Former Spouse / Children From Prior Partner.
4. Adopted Children.
5. Spouses of Children/Grandchildren.
6. Other Relatives, Charities, etc.

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E. What assets is each beneficiary entitled to?
1. Who gets the house?
2. Who gets the family treasures?
3. Should I leave cash or property?
4. Who should succeed to my business?
5. Who should have an ownership interest in my business?

F. When will beneficiaries get the assets?
1. Immediately (upon gift or death).
2. Income for life only.
3. Upon reaching a certain age (majority, 18, 21, 25, 35?).
4. Periodically – monthly, quarterly, annually (specific amount or percentage of income/assets).
5. For specific uses (health, education, maintenance, rehabilitation).
6. Management of assets (trustee).

G. Who will manage the assets (now or in the future)?
1. Spouse or adult children.
2. Trustworthy relatives or friends.
3. Professional trustee/assets manager.
4. Who will control/manage the assets?
5. Who decides to whom assets should be given?
6. Who decides when and how much assets to give?

H. Custody (Guardianship) of Dependents. If both spouses cannot care for dependents:
2. Separate the functions of guardian (custody over dependents) from trustee (custody over the assets) to help ensure that assets are used appropriately for the dependents.

I. Succession/Probate Law. What does the applicable law provide as to who is to receive the assets? What alternatives are available?

J. Taxes. What taxes may apply? How can taxes be minimized?

II. Conflict of Law – Application of Japan Succession Law in Cross-Border Cases.
A. Determining Whether Japan or Home Country Law Applies.
1. Generally, Japan applies the succession law based on the decedent’s nationality. In the case of U.S. persons, this means the probate law of the person’s home state.
2. However, most states’ (common) law provides that, with respect to personal property, the law of the decedent’s domicile should apply and, with respect to real property, the law of the place where the property is
located should apply. Certain states permit state law (rather than law of the domicile) to apply to personal property held or managed in that state.

3. Thus, if a US expatriate is domiciled in Japan, then Japan succession law may end up applying to his personal property, even though Japan law does not intend or anticipate that result.

4. For non-U.S. expatriates, Japan may apply their home country succession law to both real and personal property if their home country law provides that the law of the decedent’s nationality should apply.

B. Real Property.

1. With respect to expatriates of the U.S. and other common law jurisdictions, and certain civil law countries, the succession law applicable to real property is generally the law of the jurisdiction in which the real property is located.

2. With respect to expatriates of certain civil law countries, the succession law applicable is generally the law of the decedent’s nationality.

C. Personal Property.

1. With respect to expatriates of the U.S. and other common law jurisdictions, and certain civil law jurisdictions, the succession law applicable to personal property is generally the law of the jurisdiction in which the decedent was domiciled at death. Certain U.S. states permit state law (rather than law of the domicile) to apply to assets held or managed in that state.

2. With respect to expatriates of certain civil law countries, the succession law applicable is generally the law of the decedent’s nationality.

D. Domicile.

1. Japan Law. The place of permanent residence (jushe); the base and center of livelihood of an individual, as opposed to place of abode or physical residence (kyoshu).

2. U.S. Law. The place of a true, fixed, and permanent home, to which, whenever absent, there is an intent to return.

E. Dealing With the Uncertainty. Unfortunately, the Japan conflicts law is not highly developed (as there have been few cases of decedent expatriates with Japan assets) and thus, it is unclear how a Japan court would rule in specific cases. If it is necessary to ensure certain results, then it may be possible to choose the law of a state which will apply its own law or to change the situs of assets.
III.  Estate Planning Process in Japan.

A.  Succession (*Souzoku*).  Unlike the U.S. and other common law countries (where a decedent’s assets are automatically transferred to an “estate” upon the decedent’s death and, after all debts and applicable taxes have been paid by the estate, to the heirs/beneficiaries), in Japan the successors are deemed to succeed to the decedent’s property (except for certain rights and property which are entirely personal and thus, cannot be inherited) and debts immediately upon the decedent’s death.

B.  Statutory Share (*Souzokubun*).  If the decedent did not have a valid Will, then under the statutory share rules of the Succession provisions of the Japanese Civil Code (*Minpo*), if the decedent is survived by:

1.  Spouse and children, then the spouse is entitled to one-half the decedent’s assets and the children share equally the other half (any children of a predeceased child are entitled to share the predeceased child’s share);

2.  Spouse and lineal ascendants (mother & father), but no children or other issue (grandchildren), then the spouse is entitled to two-thirds and the lineal ascendants share the remaining one-third;

3.  Spouse and siblings of decedent, but no children or other issue or ascendants, then the spouse is entitled to three-fourths and the siblings share the remaining one-fourth;

4.  Spouse, but no children or other issue, ascendants, or siblings, then the spouse is entitled to all the decedent’s assets; or

5.  Children or other issue (grandchildren), but no spouse, then the children share equally all of the decedent’s assets (any children of a predeceased child are entitled to share the predeceased child’s share).

Under the current Civil Code, a child of the decedent who was not born to the decedent’s spouse are deemed “illegitimate” and entitled only to one-half the share of a “legitimate” child.  However, on September 4, 2013, the Japan Supreme Court ruled that this Civil Code provision limiting the inheritance rights of illegitimate children to less than that of legitimate children is unconstitutional.

C.  Marriage Under Japan Law.  To be entitled to spousal statutory share rights and be otherwise recognized as a “spouse” under Japan law, the marriage must be recognized under Japan law.  Generally, the requirements of marriage are governed as to each person by the law of the country of their nationality, but the formalities of (procedures for) marriage are governed by the law of the place where the marriage takes place.  In the case of marriages taking place in Japan, in general the legal requirements for marriage under Japan law must be met and the Japanese marriage (registration) procedures must be followed.  In the case of marriage to Japanese nationals (whether in Japan or another country), in general such marriages must be properly registered under the
Family Registration Law at the place of where the Japanese national’s family registration is located or, if residing outside of Japan, such marriages may be registered with the Japanese consular authorities.

D. Estate Planning. Japan law permits individuals to create their own estate plan, but only to a limited extent. If the intestacy provisions are not desired, a Will may be used, the provisions of which are subject to the forced heirship (iryubun, or legally secured portion) rules.

1. Jointly-Held Property. Joint ownership with right of survivorship is not generally recognized under Japan law. However, Japan recognizes joint ownership (co-ownership) generally and, if the decedent has no successors, then the other joint (co-) owners will succeed to the decedent’s interest.

2. Beneficiary-Designated Property. Beneficiary-designated property is generally limited to life insurance.

3. Will. In addition to the disposition of property, guardians for dependents may be named in the Will. A Will may be changed or revoked at any time before death.

4. Trust. The Trust Law (Shintaku Hou), which took effect on September 30, 2007, generally provides additional flexibility in using trusts for estate planning (see below).

E. Japanese Wills (Igon or Yuigon). Generally, three types of Wills are valid in Japan:

1. Holographic Will (Jihitsu Shosho Igon). A document prepared in the decedent’s own handwriting (need not be in the Japanese language), with any seal affixed, signed, and dated. Must be filed with the Family Court upon the decedent’s death.

2. Notarial Will (Kosei Shosho Igon). A document prepared in its entirety by a notary (kōshōnin) to whom the decedent recited his intentions in the presence of two witnesses, signed by the decedent and witnesses, attested by the notary and kept by the notary. The notary retains the original Will; however, the Will does not need to be filed with the Family Court upon the decedent’s death to become effective.

3. Will by Secret Document (Himitsu Shosho Igon). A document (handwritten or typed) seal affixed/signed by the decedent and placed in an envelope and sealed (seal affixed). The decedent presents the envelope to a notary before two witnesses, declaring the contents to be his Will. The notary writes this information on the envelope and sign, along with the decedent and witnesses. Must be filed with the Family Court upon the decedent’s death.

4. Wills of Non-Nationals. Non-Japan nationals can choose to use a Japan Will or a Will from their home country. The form of non-Japan
Wills (preparation and execution) is valid if made in compliance with the law of the:

a. Place where the Will is made;
b. Country of the testator’s nationality either at the time of making the Will or at death;
c. Domicile or usual residence of the testator either at time of making the Will or at death;
d. In the case of immovables (real property), the law of the place where the immovable is situated.

F. Forced Heirship (Legally Secured Portion – Iryubun). Notwithstanding the provisions of a Will, certain statutory successors are entitled to a minimum portion of the decedent’s assets.

1. One-Half of Statutory Share. Generally, a surviving spouse, children and other issue are entitled to elect to take half of their respective statutory share. Ascendants (parents and grandparents) are entitled to one-third of their statutory share, but siblings are not entitled to take any legally secured portion. The right to a legally secured portion applies regardless of the nationality/citizenship or residence of the heirs. Thus, if a decedent is survived by a spouse and one child, then the spouse and child are each entitled to elect to take at least 25% (one-half of their respective intestate share (50%)), regardless of how the decedent’s assets are to be distributed under his/her Will.

2. Property to Which Forced Heirship Applies. With respect to a non-Japanese national domiciled in Japan, the property to which the forced heirship rules apply will depend on whether Japan law applies (as determined under the conflict of law rules discussed above) to all of the non-Japanese national’s personal property and Japanese real property.

G. Trusts. The Trust Law (Shintaku Hou), which took effect on September 30, 2007, generally provides additional flexibility in using trusts for estate planning. However, the duties of the trustee and rights of beneficiaries are not well-developed under current law. As a practical matter, personal trusts are not generally used in Japan. There are three ways in which a trust can be created as provided in the law:

1. By Contract. A trust can be created through a contract between a grantor and a trustee. A beneficiary is irrelevant in this case.

2. By Will. A grantor can create a trust in his Will.

3. By Trust Deed. A trust created only by the declaration of a grantor. For example, the Trust Law permits certain self-declared trusts (jiko shintaku) in which a settlor is also trustee (but it is unclear whether the settlor can also be a beneficiary of such a trust).
H. **Succession Procedure, Practical Aspects.** As a practical matter, succession (transferring title of a decedent’s assets) is a matter of satisfying the local registry office with respect to land, the corporation or transfer agent with respect to stock shares, or the bank with respect to deposit accounts, etc. Unless there is a dispute, succession matters are not handled by the Japanese courts. Probate documents from the home country, documents listing the legal heirs, and/or powers of attorney given by the estate’s personal representative/executor or heirs to persons in Japan, along with Japanese translations, may be sufficient to satisfy most requirements for transferring title ownership. However, the actual documents required will depend on the individual policies of the legal affairs bureau, corporation, bank, etc., where title/custody of the asset is held.

I. **Debts and Renunciation.** Statutory successors succeed not only to the assets of the deceased, but also to the deceased’s debts. If the decedent’s debts exceed his assets, then the successors may renounce their right to succession to avoid incurring the personal liability for the decedent’s debts. Because a renunciation affects all aspects of succession, the successors may alternatively make a qualified acceptance which would limit their liability only to the decedent’s property received by succession.

J. **Guardianship.** For minor children surviving the death of both parents, the last parent exercising parental power may designate a guardian by Will. If no guardian is named, the Family Court will appoint a guardian.

IV. **Estate Planning in the U.S. and Other Common Law Jurisdictions**

A. **Transfer of Ownership of Decedent’s Property.** Upon death, title to a decedent’s property must be transferred to the heirs/beneficiaries. Legal transfer of title occurs either automatically or through a probate court proceeding, based on the type of property:

1. **Jointly-Held Property (with Right of Survivorship).** Title passes automatically to the other joint owner(s). (Real Estate, Deposit Accounts)

2. **Beneficiary-Designated Property.** Title passes to the designated beneficiary. (Life Insurance, IRA, 401k).

3. **Trust Property.** Property held in a trust (not directly by decedent) remains in the trust. Property is distributed to trust beneficiaries according to the trust terms.

4. **Probate Property.** All remaining property automatically becomes part of the “Estate,” an independent person under the law, which is under jurisdiction of a probate court. To transfer title, the court will issue orders specifying the new owners of the various Estate assets.

B. **Purposes of Probate and Estate Administration.**

1. Marshall (collect) and value decedent’s assets.
2. Determine and pay decedent’s debts and taxes.

3. Determine heirs/beneficiaries, asset/amount due to each, and distribute the remaining assets to them.

C. **Probate and Estate Procedure.**

1. Petition filed in probate court.

2. Appointment of Personal Representative (Executor).

3. Petition to recognize/validate any Will.

4. Publish notice to creditors/heirs.

5. Accounting for assets/debts/taxes. Obtain appraisals for property.

6. Determine heirs/beneficiaries.

7. Pay debts/taxes; File tax returns

8. Distribute remainder to heirs/beneficiaries.

D. **Time and Expense of Probate and Estate Administration.**

1. Fees for court, personal administrator, accountants, lawyers, appraisers, publishing notice, managing property.

2. Can take several months or several years to locate assets, publish notices, resolve any disputes.

E. **No Estate Plan.** If you do not make your own estate plan, then, depending on the type of assets you own, the law will provide who will be entitled to your assets, which assets they will receive, and how much of each asset they will receive.

1. **Joint Ownership.** Including Joint Ownership With the Right of Survivorship and Tenants by the Entireties – Bank deposit accounts, real property.

2. **Beneficiary Designation.** Life insurance, qualified RETirement plan assets, U.S. Savings Bonds, trusts.

3. **Intestacy Rules.** All other assets generally fall under state intestacy law. Intestacy law generally favors (in order of priority) a surviving spouse, children, other descendants, parents, siblings, grandparents, cousins.

F. **Estate Plan.** If you make your own estate plan, then the estate structures you create will generally determine who will be entitled to your assets, which assets they will receive, how much of each asset they will receive, and when they will receive such assets.
1. **Jointly-Held Property (with Right of Survivorship).** Easy, low cost to set up and administer. Cannot control property after the transfer. Can be used for many types of property such as real estate, deposit accounts, stocks, etc.

2. **Beneficiary-Designated Property.** Easy, low cost to set up and administer. Cannot control property after the transfer. Can be used for many types of property such as real estate, deposit accounts, stocks, life insurance, etc.

3. **Will.** Generally, dictates how assets passing through probate administration are to be distributed to beneficiaries. Guardians for dependents may be named in the Will. Must be executed (signed) with some formalities (generally, two witnesses, a notary). May be changed or revoked at any time before death.

4. **Trust.** An arrangement in which a person (settlor/grantor) transfers property (trust corpus) during his life or at his death to another person (trustee) for the benefit of a person (beneficiary).
   
   a. **Intervivos Trust.** A trust created by the settlor during his life which can be revoked or changed by the settlor at any time, or can be irrevocable (neither the settlor nor anyone else cannot change the trust terms, except in certain circumstances).
   
   b. **Revocable Living Trust (RLT).** A type of intervivos trust created during the settlor’s life to hold assets. During the settlor’s life, he is the settlor, trustee and beneficiary. May be changed or revoked at any time before death. At settlor’s death, a successor trustee takes over and persons named in the trust (spouse, children) become beneficiaries. In addition, the trust becomes irrevocable to ensure that no changes can be made to thwart the settlor’s wishes.

   The primary advantages of an RLT are that assets held by the RLT pass outside of the probate process, the RLT maximizes use of a couple’s applicable exclusion amounts for U.S. estate tax purposes and, as with using a Will, the settlor can control the management and distribution of trust assets after his death. An RLT does not avoid debts, taxes, or in many States, a surviving spouse’s elective share rights.

   c. **Testamentary Trust.** A trust created in a Will which will take effect upon the death of the settlor. A Qualified Domestic Trust (QDOT) set up in a Will or RLT is a type of testamentary trust, which is used to defer U.S. estate tax on property passing to a surviving spouse who is not a U.S. citizen.

   d. **Irrevocable Life Insurance Trust (ILIT).** A vehicle for leveraging assets through life insurance and passing such assets to beneficiaries free of estate tax. A trust is set up to hold life
insurance policies for the benefit of spouse and/or children. Settlor gifts the insurance proceeds to the beneficiaries, who in turn fund the trust. Upon death, the insurance proceeds are not subject to estate tax because the trust assets are not assets of the settlor.

5. **Surviving Spouse’s Elective Share.** A surviving spouse may elect to override provisions of a Will, RLT joint-ownership and beneficiary-designated property (depending on applicable State law), taking instead a share of the decedent’s assets as provided by law. Generally, the amount varies depending on the length of marriage (in some states, the greater of $50,000, or a certain percentage of the assets, up to 50% if married more than 15 years). Unlike Japan law, such forced heirship rights are not available to descendents (children) or ascendants.

V. **Japanese Inheritance Tax (Souzokuzei).** The tax is levied on the heir/beneficiary of an inheritance, rather than on the decedent or estate of the decedent (under e.g., U.S. gift and estate tax rules).

A. **Scope of Inheritance Tax and Gift Tax.** Japanese gift and inheritance taxes apply to:

1. **Japan Situs Property** – regardless of the residency/nationality of the transferor or transferee.

2. **Japan Resident Donees and Heirs** – persons domiciled in Japan who receive property (located anywhere in the world) by gift or inheritance. *Non-Japanese nationals, resident (domiciled) in Japan, are subject to tax on any gifts or inheritances received, regardless of the location of the asset or nationality/residence of the person from whom it was received.*

3. **Japan Nationals Not Resident in Japan (“5-Year Rule”)** – continue to be subject to tax on non-Japan property received by gift or inheritance for 5 years after leaving Japan (or indefinitely if received from a transferor, whether or not a Japanese national, who had a domicile in Japan within 5 years before the gift or death). *Under the 5-Year Rule, Japanese nationals (even if dual citizens) are subject to Japan gift and inheritance tax for at least 5 years after leaving Japan on gifts or inheritances received, including from a non-Japan national spouse/parent.*

4. **Japan Resident Donors and Decedents** – Beginning April 1, 2013, any gift or inheritance received from a donor or decedent domiciled in Japan at the time of the gift or death is subject to gift or inheritance tax no matter the residence/nationality of the donee or heir, or the location of the asset gifted or inherited.

B. **Calculation of Inheritance Tax (Souzokuzei).**

1. Allocate assets subject to tax and deductions to each successor.
2. Determine total taxable amount.

3. Deduct Basic Exemption.

4. Allocate total taxable inheritance to each successor.

5. Apply tax rate (10%-50%; 55% from 2015) to each successor’s taxable inheritance.

6. Determine total tax.

7. Allocate total tax to each successor in proportion to the assets actually received.

8. Deduct any applicable tax credit.

C. Assets Subject to Tax.

1. Cash, deposit accounts, stocks and bonds, real estate, tangible property.

2. Deemed Inherited Property.
   a. Life insurance proceeds on the life of the decedent to the extent the decedent paid the premiums on the policy (or certain small amount short-term policies), to the extent the proceeds exceed an amount equal to JPY5 million x number of statutory heirs. However, life insurance proceeds received on the life of another is not treated as deemed inherited property, but rather is generally treated as Occasional Income (50% of which is excluded, after a basic deduction of JPY500,000) subject to income tax.
   b. Retirement allowance, meritorious service award, distributions from qualified pension plans, etc.
   c. Annuity or periodic payment contract to extent paid for by decedent.
   d. Other economic benefits provided by decedent to beneficiaries (debt forgiveness, trust interests, interest-free loans, etc.).

3. Trust Interests. The taxation of trust interests under the Trust Law, is described below (except that transfers in trust subject to Gift Tax will instead be treated as being subject to Inheritance Tax) for trusts that are effective (generally, when the trust agreement is entered into) on or after September 30, 2007. For trusts that became effective prior to the implementation of the new Trust Law, assets transferred to a trust are treated as still owned by the settlor, unless the beneficiary is deemed to receive a gift of the assets placed in trust (see below). If the settlor is deemed to own the trust assets at his death, then the beneficiaries are generally deemed to receive an inheritance of the trust assets. If no
beneficiaries of the trust are specified, then the trust assets are deemed to be inherited by the settlor’s statutory heirs.

4. Property received within three years of death.

D. Valuation of Certain Assets. Generally, assets are valued at their fair market value. However, certain special valuation rules apply, including:

1. **Land.** Generally, based on the Road Tax (Rosenka) value for land in Japan, as set by the Japanese tax authorities. Special deductions may apply for property used as the primary residence of the decedent and/or heirs.

2. **Real Property Improvements.** Based on the same value as that used for the annual Fixed Asset Tax and set by the local government.

3. **Listed Shares.** For listed shares, the value is the lower of: (a) the closing price on the date of death; or (b) the lowest of the monthly average price of the stock during the three months ending with the month of the date of death.

E. Valuation of Unlisted Stock. For unlisted stock, the valuation is based on a specific formula which in turn is based on one or more of the followings: size of shareholding being valued, type and scale of the company, value of net assets, stated capital and capital surplus, dividends, and comparable figures of similar companies.

1. **Valuation of a Minority Shareholding.** A Minority Shareholding is generally valued based on the Actual Dividends method, except with respect to certain Specified Companies (companies starting up or dormant), in which case the Net Asset Value method is used.

2. **Valuation of a Controlling Shareholding.** In valuing a Controlling Shareholding of a:

   a. **Large Scale Company**, either the Comparable or Net Asset Value method may be used.

   b. **Medium Scale Company**, either the Combination or Net Asset Value method may be used.

   c. **Small Scale Company**, either the Combination or Net Asset Value method may be used.

   d. **Specified Company**, such as a company with only one comparable (Combination method may be elected), a share holding company (alternatively, all assets other than subsidiary shares may be valued based on the methods provided for Large, Medium, and Small Scale Companies above), real estate holding company, companies with less than three years old, companies starting up, dormant, or winding down, generally the Net Asset value method is used (except as provided).
3. **Size of Shareholding.** Shareholdings are classified as either Controlling or Minority.

a. **Controlling Shareholding.** A Controlling Shareholding with respect to a company is any shareholding in the company which is not a Minority Shareholding.

b. **Minority Shareholding.** In the case of a Company *with* Family Shareholders, a Minority Shareholding is shares held by

- any shareholder who is not a Family Shareholder; or

- where there is at least one Major Family Shareholder, any shareholder who: (i) is a Family Shareholder, (ii) is not a Major Family Shareholder, (iii) owns directly less than 5% of the voting rights, and (iv) is not a Major Officer.

In the case of a Company *without* Family Shareholders, a Minority Shareholding is shares held by:

- any shareholder who holds, directly or through a “specified relationship,” less than 15% of the voting rights; or

- where there is at least one Major Shareholder, any shareholder who: (i) who holds, directly or through a “specified relationship,” 15% or more of the voting rights, (ii) owns directly less than 5% of the voting rights, and (iv) is not a Major Officer.

c. **Family Shareholder.** A Family Shareholder is any shareholder who, directly or through a “specified relationship,” holds 30% or more of the voting rights in a company.

d. **Major Family Shareholder.** A Major Family Shareholder is a shareholder who, together with any spouse, direct descendant/ancestor, or brother-sister (and one degree by marriage), holds 25% or more of the voting rights.

e. **Major Shareholder.** A Major Shareholder is a shareholder who holds, directly or through a “specified relationship,” 15% or more of the voting rights and directly holds 10% or more of the voting rights.

f. **Specified Relationship.** A shareholder is deemed to have a specified relationship with respect to Related Individuals and Controlled Companies.

(i) **Related Individual.** A Related Individual is any relative within six degrees of relationship (three degrees by marriage), a common law spouse, an employee of an individual shareholder, other individuals economically supported by the shareholder, a relative (within six degrees of relationship (three degrees by
marriage)) of any of the foregoing individuals who live together with any such foregoing individual.

(ii) **Controlled Company.** A Controlled Company is any company with respect to which the shareholder and any Related Individuals hold, directly or indirectly, more than 50% of the total amount of shares or voting rights; or comprise more than 50% of the shareholders/members of such company.

g. **Major Officer.** A company president, director, vice president representative director, executive director, executive officer, liquidator, auditor or whip.

4. **Scale of the Company.**

a. **Large Scale.** A large scale company is any company that has: (i) 100 or more employees; (ii) fifty or more employees and total assets with a book value of JP¥1 billion (JP¥2 billion for a wholesaler) or more; or (iii) annual gross income of JP¥2 billion (JP¥8 billion for a wholesaler) or more.

b. **Small Scale.** A small scale company is any company that has less than 100 employees which satisfies the following: (i) less than five employees or total assets with a book value of less than JP¥50 million (JP¥70 million for a wholesaler, JP¥40 million for a retail or service company); and (ii) annual gross income of less than JP¥80 million (JP¥200 million for a wholesaler, JP¥60 million for a retail or services company).

c. **Medium Scale.** A company which is classified as neither a large nor small scale company is classified as a medium scale company.

5. **Valuation Methods.**

a. **Comparable.** A method based on a comparison of certain factors with those of another company, which is listed, in the same or similar business. The value is computed as follows:

\[
A \times \frac{B'}{B} + 3 \times \frac{C'}{C} + \frac{D'}{D} \times E
\]

A - Share price of comparable companies  
B - Average dividend per share of the company  
B' - Average dividend per share of comparable companies  
C - Average net profit per share of the company  
C' - Average net profit per share of similar comparable companies
D - Book value of net assets per share of the company
D' - Average historical value of net assets per share of comparable companies
E - Applicable ratio (0.5, 0.6, and 0.7 for Small, Medium, and Large Scale companies, respectively)

b. **Net Asset Value.** A method based generally on the inheritance tax value of the company for all assets and liabilities. The per share value is computed as follows:

\[ \frac{A - (A - B) \times 42\% \ast}{C} \]

A - Value of net assets of the company calculated based generally on the inheritance tax value of the company for all assets and liabilities
B - Book value of net assets
C - Number of issued and outstanding shares of the company
\ast - 42\% is the approximate tax rate applicable on the net appreciation in the company’s assets

c. **Combination.** Under the this method, the value is based on the value determined under both the Comparable and Net Asset Value methods, with weighting based on the type and size/scale of the company. The value of the company is computed as follows:

\[ A \times B + C \times (1 - B) \]

A - Value based on the Comparable method
B - Ratio defined as the larger of X or Y (as determined below)
C - Value based on the Net Asset Value method

X is the ratio under the following applicable category:

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Book Value of Total Assets at the End of the Preceding Tax Year and Number of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale</td>
<td>≥ JP¥70 million, but &lt; JP¥700 million (excluding a company which has less than 5 employees )</td>
</tr>
</tbody>
</table>

-16-
<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Gross Income of the Preceding Tax Year</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale</td>
<td>≥ JPY400 million, but &lt; JPY700 million</td>
<td>0.60</td>
</tr>
<tr>
<td>Retail and Service</td>
<td>≥ JPY40 million, but &lt; JPY60 million</td>
<td>0.75</td>
</tr>
<tr>
<td>Other than above</td>
<td>≥ JPY500 million, but &lt; JPY800 million</td>
<td>0.90</td>
</tr>
</tbody>
</table>

Y is the ratio under the following applicable category:

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Gross Income of the Preceding Tax Year</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale</td>
<td>≥ JPY200 million, but &lt; JPY2.5 billion</td>
<td>0.60</td>
</tr>
<tr>
<td>Retail and Service</td>
<td>≥ JPY60 million, but &lt; JPY600 million</td>
<td>0.75</td>
</tr>
<tr>
<td>Other than above</td>
<td>≥ JPY80 million, but &lt; JPY700 million</td>
<td>0.90</td>
</tr>
</tbody>
</table>

d. **Actual Dividends.** Based on the capitalized value (10%) of the average of the actual annual dividends of the company during the three years prior to the year of death.

F. **Deductions.**

1. Debts, funeral expenses – Generally, allocated to the successor assuming the debt.
2. Estate administration – Not deductible.
3. Charitable gifts – Allocated to the charitable successor. Only charities qualifying as such under Japan law are eligible.
4. Life insurance proceeds (¥5 million × number of statutory successors) – Allocated to each beneficiary receiving insurance proceeds.
5. Retirement allowances, etc. (¥5 million × number of statutory successors) – Allocated to each beneficiary receiving the benefits.

G. **Basic Exemption.** ¥50 million, plus ¥10 million for each statutory successor. For example, the exemption for a decedent survived by a spouse and two children is ¥80 million (¥50 million, plus ¥10 million × 3 statutory successors). From 2015, the basic exemption will be reduced to ¥30 million, plus ¥6 million for each statutory heir.
H. **Tax Rates.** Note that the marginal tax rates are applied to each successor’s inheritance, rather than to the decedent’s estate as a whole. Thus, the more successors, the lower the overall tax.

<table>
<thead>
<tr>
<th>INHERITANCE TAX ON TAXABLE AMOUNTS -</th>
<th>OVER</th>
<th>BUT NOT OVER</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥ 0</td>
<td>¥ 10,000,000</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>10,000,000</td>
<td>30,000,000</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>30,000,000</td>
<td>50,000,000</td>
<td>20%</td>
<td></td>
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<tr>
<td>50,000,000</td>
<td>100,000,000</td>
<td>30%</td>
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<tr>
<td>100,000,000</td>
<td>300,000,000</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td>300,000,000</td>
<td>-</td>
<td>50%</td>
<td></td>
</tr>
</tbody>
</table>

From 2015, the top marginal rate will increase to 55% on amounts over JPY600 million, the 40% rate will apply up to JPY200 million, a new 45% rate will apply up to JPY300 million, and the 50% rate will apply up to JPY600 million.

I. **Surtax on Certain Inheritances (Sozoukuzeigaku no Kasan).** A surtax of 20% on amounts inherited by persons other than the deceased’s spouse, parents by blood, and children by blood.

J. **Tax Credits.**

1. Spousal. Generally, equal to the greater of the first ¥160 million of net taxable assets (before the Basic Exemption), or the total inheritance tax times the spouse’s statutory share (usually 50%).

2. Minor Child. ¥60,000 times the number of years until the child reaches age 20.

3. Handicapped Person. ¥60,000 times the number of years until the person reached age 70.


5. Transfers from a Prior Decedent Within 10 Years.

6. Foreign Tax Credit. Credit for inheritance, estate, and similar taxes paid to foreign governments on property subject to inheritance tax is permitted subject to certain limitations.

K. **Tax Basis of Inherited Assets.** Heirs take a carryover adjusted tax basis in property received by inheritance (the same tax basis that the decedent had at death). Unlike U.S. tax rules, the tax basis does not step-up (step-down) to the fair market value at the date of death. However, if the inherited property is sold or otherwise disposed of within three years of the due date of the inheritance tax return, the portion of inheritance tax attributable to the property is deductible in computing gain or loss on the sale or other disposition.
L. **Tax Deferral for Succession of Unlisted Family Companies.** Effective for inheritances of certain shares received from October 1, 2008, a Principal Heir may defer payment of inheritance tax on up to 80% of the taxable value of up to two-thirds of the issued and outstanding voting shares held by a Qualifying Decedent in a Qualifying Company and received by way of inheritance until the death of the Principal Heir; provided certain requirements for providing collateral are met. Similarly, an heir of the Principal Heir may upon the death of the Principal Heir also defer the tax under the same conditions, such that the tax deferral becomes permanent.

1. **Qualifying Company.** Any Small or Medium Enterprise (“SME”), the shares of which have been certified by the Minister of Economy, Trade and Industry, other than one that: is publicly-listed, involved in adult entertainment, asset management company (70% or more of the assets consists of real estate, securities, cash, commodities, etc., based on the book value, or at least 75% of its revenue is from such passive assets), has no revenue in the tax year immediately before the year of death, or has no employees at the date of death.

2. **Small or Medium Enterprise (“SME”).** Depending on the industrial classification (wholesale, services, retail, rubber products manufacturing, software, hotel and hospitality, and others), an SME is any company with not more than a maximum of 900 employees and JPY300 million in stated capital (*shihonkin*).

3. **Principal Heir.** Any family member of the decedent who is a representative of the company and who holds the most voting rights among all family members (who together must hold more than 50% of the voting rights in the company). A family member is any individual who is within six degrees of relationship by blood (or three by marriage).

4. **Qualifying Decedent.** Any representative of the company who at the date of death held, together with his or her family, more than 50% of the total voting rights in the company and who, excluding the Principal Heir, held the most voting rights.

5. **Collateral to Secure Payment of Tax.** The Principal Heir must pledge to the shares of the company, or provide some other collateral, to the government to secure any future payment of the inheritance tax.

6. **Period of Deferral.** The inheritance tax continues as long as the Principal Heir holds the shares in the Qualifying Company, the company continues to meet the requirements for a Qualifying Company, etc.

M. **Inheritance Tax Return.**

1. Joint Return. Successors may choose to file jointly, or separately.

2. Tax and Return Due – 10 months after date of death.
3. Extension of Return. Generally not permitted; but certain exceptions may apply.

4. Payment in Kind (Butsu Nou). Instead of paying the tax in cash, certain property may be transferred in lieu of cash.

5. Penalties for failure to timely pay tax may apply (10%-40%).

VI. Japanese Gift Tax (Zoyozei). The tax is imposed on the donee on donative transfers made during life, rather than on the donor. The gift tax applies only to transfers between individual persons.

A. Scope of Gift Tax. (see above).

B. Gifts in Trust (From September 30, 2007). Under the current law, the taxation of trusts is divided into three main categories:

1. Beneficiary-Taxed (General) Trust. If there is a current beneficiary and the trust does not satisfy the requirements for the special rules for integrated trusts or corporation-taxed trusts explained below, the beneficiary is treated as if he owns all of the trust property for most taxation purposes (the "beneficiary-taxed trust").

2. Integrated Trust. Generally, these types of trusts, typically investment trusts and pension trusts, have many beneficiaries and/or the beneficial entitlements can be bought and sold frequently. As it is impossible to tax the beneficiaries as if they own the trust property itself, it is convenient and even appropriate to tax them on the actual receipt of the income, subject to some measures which prevent the tax deferral from being too large. Thus, beneficiaries of an integrated trust are taxed when they actually receive income from the trust.

3. Corporation-Taxed Trust. The third scheme applies to trusts which are treated as if they were an independent corporation. As compared to an actual corporation, the difference is that the trustee, rather than the trust itself, is liable for tax because a trust has no legal personality under the Japanese civil laws. It should be noted that the trustee of a corporation-taxed trust is generally treated as a corporation for most taxation purposes, even if the trustee is an individual. This type of trust is divided into of three groups:

a. Securitized Beneficial Entitlements. These consist of trusts with securitized beneficial entitlements other than integrated investment trusts, pension trusts, and certified public trusts. Because the beneficial entitlements are securitized, it would be difficult to tax the trust income in the hands of the beneficiaries as if they own the trust property itself. On the other hand, without some measure against large tax deferrals it would not be appropriate from the viewpoint of equity to tax only the actual receipts of the beneficiaries. This group, therefore, is taxed in the same way as corporations.
b. Corporation Tax Avoidance. These consist of trusts which are deemed to be used for corporation tax avoidance and are generally taxed as corporations, including:

   (i) a trust, the grantor of which is a corporation, the trust property of which is the whole or an important part of the business of the grantor corporation and more than 50% of the beneficial entitlements in which is given to the shareholders of the grantor corporation;

   (ii) a trust created by a corporate grantor if the trustee is the grantor or a special related person of the grantor, as specified in the relevant Cabinet Order, and the trust term is more than 20 years (unless the trust property is of only one kind and it will likely take more than 20 years to control or manage that property); and

   (iii) a trust created by a corporate grantor if the trustee is the grantor or a special related person of the grantor, as specified in the relevant Cabinet Order, if the beneficiaries are also a special related person of the grantor and the trustee has the right to alter the ratio of the distributions to the beneficiaries. As these trusts have current beneficiaries they would, without special rules, be treated as beneficiary-taxed trusts. It is, however, thought to be inequitable to treat them in that way, because in that case the substantial corporate income of the grantor would be taxed only in the hands of the beneficiary and the corporation tax would be avoided.

c. No Current Beneficiary. These consist of trusts which have no current beneficiaries.

C. Trusts Used for Estate Planning. The taxation of trusts used in estate planning are as follows for trusts that are effective (generally, when the trust agreement is entered into) on or after the implementation of the new Trust Law (Shintaku Hou) on September 30, 2007:

1. No [Specified] Beneficiary, Etc. Trust (Jyuekisha Tou Ga Sonshinai Shintaku). A trust is a No Beneficiary Trust if no beneficiary, or other person (who can receive trust assets) with the power to amend the terms of the trust so as to violate the purpose of the trust, is specified. Upon the transfer of property into such trust:

   a. the settlor/transferor is deemed to have sold the property (and thus, may be subject to income tax on any gain on the deemed sale);

   b. the trustee is deemed to have received a donation (which is treated as donation income), as if the trustee were a corporation under the Corporation Tax Law; and

   c. if a beneficiary is related to the settlor, the trustee is also deemed to have received a gift as if the trustee were a Japanese
national under the Gift Tax Law (however, any corporation tax in (b) is creditable against the gift tax).

In the future, the trustee is deemed the owner of the trust assets as if the trustee was a corporation for corporation and income tax purposes. In addition, beneficiaries are deemed to be the shareholders of such deemed corporation. If a beneficiary of a No Beneficiary Trust is determined, then such trust ceases to be a No Beneficiary Trust and thus, the trust assets are deemed to be transferred to the beneficiary at their adjusted tax basis and the beneficiary is not subject to income tax on the deemed receipt of such assets; provided that, the beneficiary is in being at the time the trust came into effect. A beneficiary not in being at such time is subject to Gift Tax on such distribution.

2. **Sequential Beneficiary Trust** (*Jyukisha Renzokugata Shintaku*). A sequential beneficiary trust is a trust the terms of which:

   a. provide that the beneficial right expires on the beneficiary’s death and another person becomes the new beneficiary in sequence;

   b. provide that the beneficial right expires upon the beneficiary’s death or upon the happening of other circumstances, at which time another person will obtain new beneficial rights;

   c. provide that the beneficial right will be transferred to another person upon the beneficiary’s death or upon the happening of other circumstances;

   d. provide that a person has the right to change or name beneficiaries; or

   e. are similar to the above.

For Gift Tax purposes, the initial beneficiary is deemed to receive a gift from the settlor upon the establishment of the trust, and the subsequent beneficiary is deemed to receive a gift upon succeeding to or receiving the subsequent beneficial interest.

3. **General Trust.** A general trust is a trust which is not one of the above (or other enumerated types of business trusts, collective investment trust, pension trust). A beneficiary of a general trust is deemed to receive a gift, unless the settlor is also the beneficiary (in which case there are no tax consequences to the settlor or trustee).

4. **Foreign Asset Reporting Requirement.** From 2013, permanent resident income taxpayers with foreign assets in excess of JPY50 million as of December 31 must file a disclosure statement reporting such overseas assets, including interests in foreign trusts, whether or not such taxpayer is obligated to file an income tax return for that year. Failure to file the statement can result in a fine of up to JPY500,000 or imprisonment of up to one year. In addition, the penalty tax on
underpayment of income tax (generally, 20%) is increased by 5% if such underpayment is due to an understatement of income from unreported overseas asset, and decreased by 5% if such underpayment is due to an understatement of income from overseas assets properly disclosed in such statement.

D. **Gifts in Trust (Before September 30, 2007).** For trusts which became effective (generally, when the trust agreement is entered into) before September 30, 2007, a beneficiary of a trust is deemed to have received a gift when a:

1. Beneficiary other than the settlor is named at the time the trust is created;
2. New beneficiary is added to a trust where the settlor was formerly the only beneficiary;
3. Beneficiary confirms the intention to accept an interest in a trust where it was not previously clear that the beneficiary would do so;
4. Beneficiary is specified in a trust which previously did not specify a beneficiary;
5. Designated beneficiary did not previously exist and the beneficiary comes into existence;
6. Beneficial interest is received upon satisfaction of a condition precedent; or
7. Person other than the settlor receives a distribution of the trust assets due to the termination of the trust before the occurrence of the above described circumstances.

It is not clear whether a gift in trust is deemed made where a beneficiary is specifically named, but the amount that such beneficiary is entitled to is not fixed (for example, a discretionary trust). Depending on the facts and circumstances, it is possible to take the position that no gift is made until it is determined that a specific beneficiary will receive a specified amount from the trust. If no gift is deemed made, then the settlor is generally still deemed to own the trust property.

E. **Valuation.** The valuation of assets is based on the same methods as for Inheritance Tax as discussed above.

F. **Basic Exemption.** ¥1.1 million per year on all gifts received from all sources.

G. **Spousal Allowance.** Up to ¥20 million on a one-time gift of certain residential property to be used by a spouse married for more than 20 years.

H. **Gifts to Lineal Descendants.** In addition, donors aged 65 or older may utilize a special gift tax regime for certain gifts to lineal descendants aged 20 or older. In lieu of the JP¥1.1 million basic exemption, such gifts are allowed a
one-time JP¥25 million exemption, after which gifts are tentatively taxed at a flat 20% rate. Upon the death of the donor, the gift is taxed at the lower inheritance tax marginal rate scale, rather than at the higher gift tax rate scale (a credit may be claimed for the initial 20% tax paid at the time the gift was made).

I. **Tax Rates.** Note that the gift tax marginal rates are imposed at a lower amount of gift as compared to the inheritance tax. For example, the maximum 50% rate applies on gifts over JP¥10 million, but only applies to inheritances over JP¥300 million. However, no Surtax applies on gifts to persons other than the donor’s spouse, parents, or children.

<table>
<thead>
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</tr>
<tr>
<td>10,000,000</td>
<td></td>
<td>-</td>
<td>50%</td>
</tr>
</tbody>
</table>

From 2015, the top marginal rate will increase to 55% on amounts over JP¥30 million, a new 45% rate will apply up to JP¥15 million, and the 50% rate will apply up to JP¥30 million, from 2015.

J. **Foreign Tax Credit.** Credit for gift taxes paid to foreign governments on property subject to gift tax is permitted subject to certain limitations.

K. **Tax Basis of Gifted Assets.** Donees take a carryover adjusted tax basis in property received by gift (the same tax basis that the decedent had as of the date of the gift).

L. **Gift Tax Return.**

1. **Tax and Return Due** – March 15 following the year in which the gift was made (unless the donee terminates his Japanese domicile and does not appoint an agent to file his tax return, in which case the return is due immediately upon the date of such termination).

2. **Extension of Return.** Generally not permitted; but certain exceptions may apply.

3. **Payment in Kind (Butsu Nou).** Instead of paying the tax in cash, certain property may be transferred in lieu of cash.

4. **Penalties for failure to timely pay tax may apply** (10%-40%).

M. **Tax Deferral for Succession of Unlisted Family Companies.** Effective for gifts of certain shares received from April 1, 2009, a Principal Donee may defer payment of gift tax on up to two-thirds of the issued and outstanding
voting shares (including shares already held by the Principal Donee) in a Qualifying Company received by way of gift from a Qualifying Donor; provided certain requirements for providing collateral are met.

1. **Qualifying Company.** Any Small or Medium Enterprise (“SME”), the shares of which have been certified by the Minister of Economy, Trade and Industry, other than one that: is publicly-listed, involved in adult entertainment, asset management company (70% or more of the assets consists of real estate, securities, cash, commodities, etc., based on the book value, or at least 75% of its revenue is from such passive assets), has no revenue in the tax year immediately before the year of the gift, or has no employees at the date of the gift.

2. **Small or Medium Enterprise (“SME”).** Depending on the industrial classification (wholesale, services, retail, rubber products manufacturing, software, hotel and hospitality, and others), an SME is any company with not more than a maximum of 900 employees and JP¥300 million in stated capital (shihonkin).

3. **Principal Donee.** Any family member of the decedent who is a representative of the company, over 20 years old, must have served as an officer of the company for over three years, and who holds the most voting rights among all family members (who together must hold more than 50% of the voting rights in the company). A family member is any individual who is within six degrees of relationship by blood (or three by marriage).

4. **Qualifying Donor.** Any representative of the company who resigns as an officer of the company prior to the gift, who holds, together with his or her family, more than 50% of the total voting rights in the company, and who, excluding the Principal Heir, held the most voting rights.

5. **Collateral to Secure Payment of Tax.** The Principal Donee must pledge to the shares of the company, or provide some other collateral, to the government to secure any future payment of the inheritance tax.

6. **Period of Deferral.** The deferral of gift tax continues as long as the Principal Donee holds the shares in the Qualifying Company, the company continues to meet the requirements for a Qualifying Company, etc.

N. **Japan-US Estate, Inheritance and Gift Tax Treaty.** Japan has in force only one estate, inheritance, and gift tax treaty, which is with the US. The treaty provides various rules on determining the situs (location) of assets. For example, debt, including bank deposits, is located where the debtor resides (which may result in overriding the general US situs rules which treat certain debt as non-US situs assets for US gift and estate tax purposes). In addition, the treaty permits Japanese nationals to claim a proportionate share the US applicable credit amount.
VII. Techniques and Strategies.

A. Information List. In the event of death or an emergency, it is important for family members to be able to collect important information and relevant documents quickly and easily (to speed up the process of accessing the decedent’s accounts to pay bills, maintaining and ensuring proper collection of income from decedent’s assets, cancel unneeded services, etc.).

1. List of Assets and Updated Values.
2. List of Account/Policy Numbers.
3. Access to Internet Account/Mobile Phone.
4. Contact Information. (phone/fax numbers/e-mail and mailing address for broker, securities agent, insurance agent, employer’s personnel office).
5. Location of Important Documents. Wills, trusts, bank and brokerage statements, insurance policies, safe deposit box key, etc.

B. Japan Will vs. Home Country Will. For expatriates, a home country Will can generally be used in Japan if properly prepared and executed (signed). A Japan Will can also be used, especially if a U.S. expatriate has no “home” state (a state to which he has close connections). However, the Japan situs assets (and in certain cases, non-Japan personal property) will generally be subject to Japanese Succession Law (including forced heirship rights of any surviving spouse, children, etc.). In addition, it is important to make sure that multiple (Japan and home country) Wills are coordinated, so that they do not adversely affect (invalidate) one over the other, or each other.

C. Avoiding Japan’s Forced Heirship and Other Succession Laws. Generally, if there is no dispute among the heirs, a decedent’s assets will pass according to his estate plan (by Will or under an RLT, etc.). However, in the case of second-marriages/children from prior partner or where there may be a dispute among heirs, the assets of an expatriate (if domiciled in Japan) may be subject to the Japan’s forced heirship or other succession laws. Thus, an expatriate may want to ensure that his assets are governed by the law of a State or other jurisdiction which does not impose such restrictions and thus, will give him maximum control over disposition. In this case, it is necessary to restructure the assets to assure that Japan law will not be applied to their disposition.

1. Choice of Law. Certain states, such as New York or Florida, generally provide that its own state succession law will be applied to personal property located or managed in the state and where the decedent requests that state’s law to apply. Personal property should be moved to accounts in the state chosen or trustees located in that state should be selected to hold the personal property. In addition, a Will or trust in which it is declared that that state’s law should apply should be set up.
2. **Real Property.** Generally, real property is governed by the law of the place where the real property is located. Thus, Japan real property will be subject to the Japan succession law. One way to avoid this is to transfer Japan real property to a non-Japan corporation or other entity, so that the owner will hold stock instead of a real property interest. Stock is personal property and thus, can be transferred with other personal property to the chosen state and governed by that state’s succession law. However, transferring Japan real estate to an entity is generally subject to Japan income tax on any gain, as well as significant title transfer registration taxes and thus, the tax costs of such restructuring should also be evaluated.

D. **Coordination of Marital Transfers (Japan and U.S.).** Generally, both Japan and the U.S. provide preferential treatment for assets passing to a surviving spouse. However, the treatment is not the same and may give rise to double taxation if not handled properly. The relevant exemptions are:

1. **Japan.** Generally, the greater of ¥160 million or 50% of inheritance assets (where a spouse and children survive) can pass to a surviving spouse free of tax (or at a minimal amount).

2. **U.S.** An unlimited amount can pass to a U.S. citizen spouse. With respect to a non-U.S. citizen spouse, an unlimited amount can pass if the assets are held in a qualified domestic trust (QDOT).

3. **Life Insurance.** Purchasing life insurance may help to cover the cost of the tax, especially if exposure to the tax is only for a temporary period (for example, with respect to Japanese national heirs subject to the 5-Year Rule).

4. **Lifetime Giving.** Equalizing the assets of both spouses will help to reduce the taxable estate of the first spouse to die. Thus, a lifetime giving plan in which the wealthier spouse makes gifts to the other. Currently, up to $145,000 (in 2014) can be gifted annually to a non-citizen spouse (unlimited amounts can be gifted to U.S. citizen spouses) free of U.S. gift tax. However, if also subject to Japan gift tax, then such gifts cannot exceed ¥1.1 million annually before becoming subject to tax. Such gifts can be leveraged by gifting assets which to have higher appreciation potential (stocks, real estate, business interests), rather than conservative investments (cash, CDs).

E. **Qualified Domestic Trust (QDOT).** When a surviving spouse is not a U.S. citizen, then the unlimited marital deduction is only available if assets pass into a QDOT. The QDOT is basically a device which defers the estate tax until the surviving spouse’s death and assures that the U.S. will be able to collect the tax. The general requirements for a QDOT are:

1. QDOT treatment must be elected on the U.S. estate tax return.

2. The QDOT must be governed by U.S. law.
3. The Trustee controlling distributions must be a U.S. person.

4. QDOT must distribute all income to the surviving spouse at least annually (the spouse is subject to U.S. income tax on such income, but the distribution is not subject to U.S. estate tax).

5. QDOT assets distributed to the surviving spouse, either during life or at death, will be subject to U.S. estate tax (except in certain hardship cases) at the first decedent spouse’s marginal tax rate.

6. If the surviving spouse becomes a U.S. citizen, the QDOT assets can be distributed to him/her tax-free.

F. QDOT Planning. Because of QDOT restrictions, it may make sense to avoid transferring assets to a QDOT (and pay the estate tax on such assets). Life insurance can be purchased to cover the estate tax.

1. Give the Surviving Spouse the Power to Make the QDOT Election.

2. Under Japanese tax law, the surviving spouse is only entitled to receive the greater of ¥160 million or 50% of the expatriate’s assets tax-free (thus, 50% of the assets above ¥160 million will be subject to Japanese inheritance tax). Under U.S. tax law, the surviving spouse receives all the assets tax-free, if the assets pass into a QDOT.

3. Generally, a QDOT should be used only if the surviving spouse will not be subject to Japanese tax on the QDOT assets (otherwise tax will have to be paid in Japan, upon the death of the first spouse, and again in the U.S. on the QDOT assets). Thus, with respect to the portion of assets that will be subject to Japanese tax, such portion should not be placed in a QDOT. Because it may be difficult to determine exactly what portion will be subject to Japan tax at the time the estate plan is created, the surviving spouse should be given the power to decide how much of the assets should go into the QDOT.

G. Term Life Insurance. If exposed to Japanese tax for a limited time (while residing in Japan or, with respect to Japanese nationals, for at least 5 years after leaving Japan), consider purchasing term life insurance to help cover the temporary exposure to Japanese tax. Term life insurance can generally be acquired for a reasonable annual premium, and the policy can be cancelled when it is no longer needed.


1. Tax Deferral for Succession of Unlisted Family Companies. Recent provisions reduce the gift and inheritance tax burden on small and medium size, family-owned companies, where the principal successor continues to own and manage the company. The requirements to obtain the deferral are detailed in Sections V.L and VI.M, above. As these incentives are relatively new and the requirements are somewhat
complex, it is unclear whether they will have a significant impact on succession planning.

2. **Valuation of Company Shares.** Traditionally, inheritance tax planning has involved restructuring the family company to qualify for a preferable valuation method, in terms of number of employees, type of business, increasing or decreasing sales or book value of assets, restricting dividends, etc. As compared to the Net Asset Value Method, the Comparable Method generally produces the lowest value because it is based on dividends, net income, and book value of net assets, which is relatively low for most Japanese companies. Thus, a family company is often restructured to meet the requirements to qualify using the Comparable Method or, if not, the Combined Method formula which is most heavily weighted to the Comparable Method.

3. **Planning for Family Holding Companies.** Previously, it was common for the founder of a business to set up a holding company (usually, a limited company, *Yugen Kaisha*) to own the shares in the family company (which often became a publicly-listed company). Under prior law, the potential corporate-level tax (currently, ≈37%) on appreciated assets, including the shares in the family company, could be taken into account in valuing both the holding company and family company. Thus, by setting up a holding company, the value for inheritance tax purposes could potentially be significantly reduced by taking into account two levels of corporation tax.

However, current valuation rules do not permit reducing the family company’s value by the corporate-level tax. Many families continue to hold their family company shares through such holding companies. This is because it is difficult to eliminate the holding company without triggering capital gains tax at the corporate level, shareholder level, or both.

4. **Transfers Through Trusts.** Trusts have not traditionally been used as an estate planning tool in Japan. Indeed, the concept of another person (the trustee) holding legal title to assets is often disconcerting to many Japanese. The new Trust Law and trust taxation rules have only been in effect since September 30, 2007 and thus, it remains to be seen whether Japanese will embrace such structures.