NEWS ANALYSIS

Japan's Move to Territorial Contrasts With U.S. Tax Policy

by Tom Neubig and Barbara M. Angus

Japan's recent adoption of a territorial tax system as part of a broader tax reform reduces the tax burden on the foreign-source income of Japanese multinational corporations by exempting dividends from non-Japanese subsidiaries from Japanese tax. While the tax reform package included some tighter anti-tax-haven rules, the new dividend exemption system represents a significant change in the Japanese treatment of foreign-source income. (For prior coverage of the tax reform, see *Tax Notes Int'l*, Jan. 5, 2009, p. 50, *Doc 2008-26692*, or *2008 WTD 246-1*.)

The Japanese reform is important in the context of the U.S. international tax system and President Barack Obama's budget proposal for substantial changes in the international tax area. As the table shows, most multinational corporations headquartered outside the United States are subject to territorial tax rules on their foreign operations.

Before the Japanese tax reform, 18 of the 33 Fortune Global 50 non-U.S. companies were headquartered in countries with territorial tax regimes. Now 22 of those companies are headquartered in territorial tax countries. With the U.K. budget that was released April 22 confirming a similar change, soon a majority of the largest multinational corporations will be operating under territorial tax systems.

Before the Japanese reform, the two largest economies had both high corporate income tax rates and worldwide tax systems. Now the United States not only has the second-highest corporate income tax rate of the OECD countries, it is also one of the few that still have a general worldwide tax system. The other headquarter countries with worldwide tax systems have corporate income tax rates below 30 percent. Moreover, the Obama administration's budget blueprint includes an as-yet-unspecified proposal for a $210 billion tax increase in the U.S. international sector, including changes to ''reform deferral.''

The Japanese corporate tax reform is part of a global trend toward reduced taxation of corporate income, which often takes the form of a significantly reduced corporate tax rate but also is reflected through reduced taxation of foreign-source income.

Fortune Global 50 Companies by Country of Headquarters and Tax Treatment of Foreign-Source Income

Headquarters Country	Number of Companies	Percent of Companies	Percent of Revenues	2009 Statutory Corporate Tax Rate	Taxation of Foreign-Source Income
United States	17	34	37	39.5	Worldwide with credit
France	6	12	11	34.4	Territorial
Germany	5	10	9	33.0	Territorial
United Kingdom	4	8	9	28.0	Transitioning to territorial
Netherlands	2	4	7	25.5	Territorial
Japan	4	8	7	41.3	Just enacted territorial
China	3	6	6	25.5	Worldwide with credit
Belgium	2	4	4	34.0	Territorial
Italy	2	4	3	30.3	Territorial
Switzerland	1	2	2	24.7	Territorial
South Korea	1	2	1	22.0	Worldwide with credit
Luxembourg	1	2	1	28.6	Territorial
Mexico	1	2	1	28.0	Worldwide with credit
Russia	1	2	1	28.0	Worldwide with credit
Total/Average	50	100%	100%	30.9% for non-U.S.	

Source: Fortune Global 500, calculations by Ernst & Young LLP.

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The details of the president's budget proposal to reform deferral are expected in the coming weeks. As we await the specifics, it is clear that the direction of the proposal runs counter to this strong current of global corporate tax reform with lower overall corporate tax rates and reductions in domestic taxation of foreign-source income.

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U.K. Releases 2009 Budget

by Kristen A. Parillo

The U.K. government on April 22 released its 2009 budget, which contains a number of tax measures aimed at businesses and individuals, including details on the implementation of the new foreign profit taxation measures, the launch of a second offshore tax amnesty, and the introduction of a new top income tax rate.

The foreign profits reform package will take effect this year. Starting July 1, 2009, foreign dividends received by U.K. companies will be exempt from U.K. corporate income tax. The exemption will be accompanied by a worldwide debt cap on interest, under which finance expenses payable by U.K. members of a group of companies will be subject to a cap equal to the consolidated gross finance expense of that group. The debt cap rules will apply to finance expenses payable in accounting periods beginning on or after January 1, 2010. (For prior coverage of the foreign profit tax reform, see *Doc 2009-7970* or *2009 WTD 65-22*.)

As part of the reform package, the Treasury Consents rules (which require companies to get approval from HM Treasury before they undertake certain transactions involving subsidiaries that reside outside the U.K.) will be repealed and replaced by a posttransaction information reporting requirement, which will apply to transactions undertaken on or after July 1, 2009.

Because of the new foreign dividend exemption, the exemption for superior and nonlocal holding companies and the acceptable distribution policy exemption will be removed from the controlled foreign companies rules. The changes to the CFC regime will take effect for accounting periods starting on or after July 1, 2009, though a two-year transition period will be available for some holding companies.

The budget also contains several measures designed to help companies with cash flow problems, including an extension by one year of the enhanced loss relief measures announced in the 2008 prebudget report; an expansion of HM Revenue & Customs' Business Payment Support Service; the introduction of a ''top-up'' trade credit insurance scheme to help businesses maintain their finances, under which the government will offer to match private-sector trade credit provisions for a temporary period if insurers reduce coverage to any U.K. business; and the launch of a consultation, to begin in June, on measures to help companies in financial difficulties.

To spur economic growth and increase the competitiveness of U.K. businesses, the government also called for an increase in capital allowances for new investment to 40 percent for one year; the development of a £750 million Strategic Investment Fund to support advanced industrial projects of ''strategic importance,'' of

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