16 December 2020

Global Tax Alert

Japan releases 2021 tax reform outline

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Executive summary

On 10 December 2020, Japan's coalition leading parties released the 2021 tax reform outline (the Outline). A tax reform bill (the Bill) will be prepared based on the Outline. The Bill will be submitted to the Diet[1] and is expected to be enacted by the end of March 2021.

This Alert summarizes the key provisions relevant to multinational corporate taxpayers.

Detailed discussion

Digital transformation investment incentives

Digital transformation-related investment under a certified business adaptation plan made by 31 March 2023 up to JPY30 billion (US$300 million) will be eligible for 30% special depreciation or a 3% to 5% tax credit (capped at 20% of corporate income tax payable together with the carbon-neutral investment incentives). Digital transformation-related investment includes software, machinery and equipment that contributes to improved productivity and marketing development.

Building a better working world

Research and Development (R&D) tax credit

- Under the existing law, qualified R&D expenditures are eligible for a 6% to 14% tax credit. The 2021 reform will amend the creditable ratio to 2% to 14% (generally capped at 25% of corporate income tax payable).
- If gross sales in a year beginning between 1 April 2021 and 31 March 2023 decreases by 2% or more as compared to the latest year ended before 1 February 2020, and qualified R&D expenditures for the year are greater than the amount spent in that latest year, an additional creditable amount of 5% will be provided.
- The additional credit measures, available under the current law if qualified R&D expenditures exceeds 10% of the average gross sales, will be extended for two years.
- The existing measures for certain small and medium-sized enterprises (SMEs) and for special R&D expenditures will be refined.

Increased employee compensation credit

The existing increased employee compensation credit will be refined to encourage businesses to hire new employees such that if compensation paid to newly hired employees in the current year increases by 2% or more as compared to compensation paid to newly hired employees in the previous year, the compensation paid to newly hired employees in the current year is eligible for a 15% to 20% tax credit subject to certain conditions (capped at 20% of corporate income tax payable).

Increased limit for net operating loss (NOLs) deductions

Under the existing law, NOLs carried-forward can only shelter up to 50% of the current year's taxable income (except for certain SMEs). Under the 2021 reform, an increased NOL limit will be provided for eligible NOLs, which is up to the "outstanding amount of accumulated qualified investment" for the applicable fiscal years. This measure is intended to stimulate new investment associated with digital transformation, carbon neutrality and business restructuring.

- Eligible NOLs are NOLs incurred in fiscal years that include any date between 1 April 2020 and 1 April 2021 (in certain circumstances, a fiscal year ended between 1 February 2020 and 31 March 2020 and the following fiscal year).
- The "outstanding amount of accumulated qualified investment" is the amount of investment made under a business adaptation plan certified within a year of the enactment of the revised *Act on Strengthening Industrial Competitiveness*, reduced by the amount of such investment that was already eligible for this regime.
- The applicable fiscal years are fiscal years that meet all of the following:
  - Fiscal years beginning within five years since the first day of the "basis year." The "basis year" is the earliest profitable fiscal year after the fiscal year during which the eligible NOLs are incurred
  - Fiscal years that include the business adaptation plan period
  - Fiscal years beginning before 1 April 2026

Tax treatment of share-for-share acquisitions

Certain share-for-share acquisitions will qualify for tax neutral (i.e., tax deferred) treatment for existing shareholders, subject to certain conditions including that 80% or more of the acquisition consideration must be the acquirer's shares.

Incentives to attract foreign financial services companies and fund managers

- Profit-linked directors' compensation (that is generally non-deductible except for certain public companies) paid by specified investment management companies will be deductible subject to certain conditions including an approval by investors and certain public disclosure.
- Carried interest (excess distributions from investment partnerships) earned by fund managers will be taxed as capital gain, which is subject to a flat tax rate of approximately 20%, and not as income that is subject to progressive tax rates.
- No inheritance tax or gift tax will be imposed on property outside of Japan acquired by certain non-Japanese nationals.

Carbon neutral investment incentives

Carbon neutral-related investment under a certified environment adaptation plan made by 31 March 2024 up to JPY50 billion (US$500 million) will be eligible for 50% special depreciation or a 5% to 10% tax credit (capped at 20%

of corporate income tax payable together with the digital transformation investment incentives). Carbon neutral-related investment includes equipment that contributes to reduced greenhouse gas emissions.

Digitalization of tax compliance

- The majority of tax-related documentations (including tax returns) will no longer need to be physically stamped.
- The electronic data and documentation retention regime will be refined, including abolishing the tax authorities' pre-approval for the electronic retention.
- Certain tax compliance for cross-border transactions (including applications for an exemption of qualified bond interest withholding tax and forms for tax treaty benefits) will be accepted via electronic filing subject to certain conditions.

Endnote

1. Japanese bicameral legislature.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Tax Co., Tokyo

- Koichi Sekiya koichi.sekiya@jp.ey.com

Ernst & Young LLP (United States), Japanese Tax Desk, New York

- Hiroaki Ito hiroaki.ito1@ey.com
- Ryuta Tosaki ryuta.tosaki1@ey.com

Ernst & Young LLP (United States), Asia Pacific Business Group, New York

- Chris Finnerty chris.finnerty1@ey.com
- Bee-Khun Yap bee-khun.yap@ey.com
- Dhara Sampat dhara.sampat2@ey.com

EYG no. 008725-20Gbl

1508-1600216 NY
ED None