

# Japan tax alert

Ernst & Young Tax Co.

## 2021 Japan tax reform outline

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The fiscal year 2021 tax reform outline was released on 10 December 2020. In this alert, we provide an overview of the major reforms and revised provisions contained in the outline. Please note that provisions may be revised, deleted or added during Diet deliberations regarding the reform bill.

## Corporate taxation

### 1. Revisions to the general R&D tax incentive

The maximum tax credit available to companies that have increased investment in research and development (R&D) investments despite a decrease in sales above a certain level will increase from 25% to 30% of corporate tax liability. (Accordingly, the maximum credit available under the two existing R&D tax incentives will increase from the present 45% to 50%.) This will be a temporary measure lasting 2 years. Furthermore, to encourage software R&D, the expenses which comprise the acquisition costs of in-house software will be added to the list of items eligible for application of this R&D tax incentive.

### 2. Introduction of a digital transformation (DX) investment promotion tax incentive

A new tax incentive will be introduced to permit companies that conduct cloud system implementations, etc. which constitute digital capital investments to transform a business pursuant to a business plan that has been approved by the national government to choose between a 30% special depreciation or a 3% tax credit (5% if sharing data with a non-group company) of the relevant acquisition costs. (This will be a temporary measure lasting 2 years.) The maximum capital investment eligible for this tax incentive will be JPY30 billion.

### **3. Introduction of a tax incentive to promote carbon neutrality investments**

A new tax incentive will be introduced to permit companies that invest in facilities and equipment that contribute to the reduction of greenhouse gas emissions pursuant to a business plan that has been approved by the national government to choose between a 50% special depreciation or a 5% tax credit (10% if fulfilling certain requirements) of the relevant acquisition costs. (This will be a temporary measure lasting 3 years.) However, if this tax credit is used together with the tax credit offered by the DX investment promotion tax incentive, the total tax credit will be capped at 20% of corporate tax liability for a given fiscal year. The maximum facility or equipment investment amount eligible for this tax incentive will be JPY50 billion.

### **4. Special measure concerning the deduction limit of net operating losses (NOLs)**

A temporary measure will be introduced to allow companies that have incurred NOLs for two consecutive years a maximum 100% NOL deduction against the income of the following fiscal years within the limits of investment amounts made pertaining to business reconstructions or reorganizations, such as DX and carbon neutrality investments, conducted pursuant to business plans that have been approved by the national government.

### **5. Introduction of a tax measure to encourage M&As compensated through the utilization of shares**

A new measure will be introduced to allow entities that transfer shares they own and receive shares issued by the acquiring parent entity as consideration pursuant to the share issuance regime set forth by the Companies Act to defer the recognition of the capital gains or losses arising from said share transfer. Even if cash, etc. is paid alongside shares issued by the acquiring parent entity, so long as the value of said shares comprises 80% or more of total consideration, the deferral of the recognition of the capital gains or losses arising from said share transfer will be permitted for the portion corresponding to said shares.

### **6. Revision of the tax incentives to encourage wage increases and investments**

The tax incentives to encourage wage increases and investments for large enterprises will be revised to focus on increases made by enterprises on the wages paid to newly-hired employees and education and training expenses.

### **7. Introduction of a tax incentive to help SMEs with the consolidation of their managerial resources**

A measure will be introduced to allow small and medium-sized enterprises (SMEs) that have received approval for plans to enhance productivity by consolidating their managerial resources to record a reserve fund, which comprises a certain percentage of the acquisition costs of SME shares in preparation for post-facto risks after the acquisition of SME shares, and to deduct such reserve amounts at once. After five years have elapsed from the year of deduction, the reserve amount must be added to taxable income equally over the subsequent five-year period.

### **8. Other**

- ▶ The special measure for the reduction of the corporate tax rate of SMEs (15%) will be extended by two years.
- ▶ The measure which disallows large enterprises the application of R&D tax incentives and other tax credit provisions related to the enhancement of productivity will be revised, and the application period thereof will be extended for three years.

## **Individual taxation and asset taxation**

### **1. Tax rules related to housing**

The special measure that extends the period individuals can receive housing loan tax credits from a 10-year period to a 13-year period will be extended for two more years. The minimum square footage requirements which apply to housing eligible for this tax credit will also be relaxed. The current tax measure exempting gift taxes up to a maximum of JPY15 million in gifts given by an individual to their children or grandchildren as housing purchase funds will be kept in force until December 2021.

### **2. Fixed asset tax**

For FY2021 only, a special measure to peg the same land taxes as the previous fiscal year (imposed on all land, including commercial-use and residential-use land) will be introduced with regard to land whose tax amounts are to increase as prescribed by the burden adjustment measure, etc.

The lesser of the two amounts will be applied to land subject to decreased tax liability.

### 3. Other

- ▶ The 50% tax rate imposed on retirement benefits (equalization measure) provided to employees with short tenures will be revised.
- ▶ Measures which provide tax exemption to lump-sum gifts of education funds and gifts of wedding and childcare funds will be revised and extended by two years.

## Tax administration

### 1. Revision of the electronic books maintenance rules

Procedures to be taken for electronically preserving books and documents related to national taxes will fundamentally be revised. The system requiring prior approvals will be eliminated. In addition to electronic books that fulfill the strict criteria that are currently in place, the storage of other electronic books or electronic data as-is will be permitted if certain requirements are met. With regard to the scanned document storage rules, procedures and requirements will be significantly relaxed. Measures also will be introduced to ensure that fraudulent acts, such as the falsification of electronic data, are prevented.

### 2. Revision of obligations to affix seal impressions on tax-related documents

Obligations to affix seal impressions on tax-related documents under the current rules will be abolished, excluding cases where registered seal impressions or attachments of seal registration certificates are required.

### 3. Other

- ▶ As countermeasures against international tax avoidance acts, the scope of parties deemed guilty of evading disposition for delinquent tax and parties obliged to pay secondary tax liabilities will be revised.
- ▶ As the economic activities of non-residents and foreign entities that are not based in Japan increase, measures to ensure that tax managers are appropriately appointed will be introduced to enable the tax authorities to carry out effective tax audits, etc.

## Other

### 1. Tax measures to facilitate the development of international financial hubs

The performance-linked compensation of directors of non-listed companies whose primary business is investment management services will become deductible expenses for corporate tax purposes, provided certain conditions are met. Foreign persons who live in Japan and who possess certain residence statuses such as work permits will not be subject to inheritance taxation in regard to the foreign property they own, regardless of their length of residency. Revisions will be made to make clear the fact that, in certain cases, remuneration of fund managers (carried interest distributed from the profits of a fund) will become subject to separate taxation under the Income Tax Act.

### 2. Revision of the treatment of taxes withheld in foreign countries in relation to dividends distributed by foreign subsidiaries

The treatment of the deductibility of expenses of taxes withheld in foreign countries and the application of foreign tax credits in relation to dividends distributed by foreign subsidiaries will be revised, focusing on amounts that are subject to adjustments for double taxation under Japanese anti-tax haven (CFC) rules.

### 3. Other

- ▶ The fuel economy standards of the eco-car tax reduction, which reduces automobile weight tax, will be revised and extended for two years lasting until March 2023.
- ▶ Discussions on the general framework of integrated resort (IR) related tax rules were conducted. Materialization of the discussions will be conducted in the tax reforms for FY2022 or thereafter.



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Japan Tax SCORE 2021218

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