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Japan tax alert

Ernst & Young Tax Co.

2022 Japan tax reform outline

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The fiscal year 2022 tax reform outline was released on 10 December 2021. 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.

Building a better working world

Corporate taxation

1) Enhancement of the tax incentives to encourage wage increases

The measures introduced to encourage companies to increase wages and distribute profits to a diverse set of stakeholders will be enhanced. A system will be established to provide companies that increase total wages paid to continuously employed persons by a specified rate with a tax credit totaling a maximum of 30% of the total year-on-year increase in the sum of wages paid to all their employees. The tax credit will be capped at 20% of the corporate tax amount for a given fiscal year, and is a temporary measure that will be implemented for a period of 2 years. In regard to small and medium-sized enterprises (SMEs), a system will be established to permit SMEs to claim a maximum tax credit of 40% of their total year-on-year increase in wages paid, provided that they have increased wages by a significant degree and concurrently increased education and training expenditures. There will additionally be enhancements to the measures which provide for a suspension of the application of special tax incentives (including the R&D tax incentives) to large enterprises that exhibit a notable unwillingness to increase both wages and investments despite growing profits.

2) Extension and enhancement of the tax incentive to promote open innovation

The tax incentive to promote open innovation, which provides a taxable income deduction of 25% of investments made in startups, will be extended by two years subsequent to revisions such as the extension of eligibility to startups within 15 years of their incorporation (c.f. the current 10 years) and the reduction of the expected period of ownership (from 5 years to 3 years).

3) Revisions to the group profit and loss sharing regime

In regard to the investment tax book value adjustment rules, a measure will be introduced to allow any group company that owns shares of a group subsidiary to, upon the withdrawal of said subsidiary from the group, add an amount corresponding to that recorded in its asset adjustment account (said amount is similar to the value of an asset adjustment account prepared in relation to a non-qualified merger) to the tax book value of the net assets of the group subsidiary; this tax book value is the amount that is treated as the book value of the shares of a subsidiary upon its withdrawal. This will address an issue that presently occurs when a subsidiary withdraws from a group, namely that takeover premiums cannot be included in the share transfer costs. The measure will also apply to subsidiaries whose consolidated tax group transitions to the profit and loss sharing regime, regardless of their status under the consolidated tax regime (i.e., as either an existing subsidiary upon the group's initial adoption of the regime or a subsidiary that entered the existing consolidated tax group).

4) Other revisions

- The calculation of deemed dividends in relation to the repayment of capital will be revised in accordance with a decision issued by the Supreme Court of Japan.
- The tax incentive to encourage investment in 5G infrastructure will be revised with the introduction of a phased reduction of the tax credit rates and subsequently extended by a period of 3 years.
- The regional center enhancement tax incentive will be revised in light of the current trends in company relocations and furthermore extended by a period of 2 years.
- The non-deductible entertainment expense rules will be extended by a period of 2 years.
- In regard to the special measure for deduction of the acquisition price of low-value depreciable assets and lump-sum depreciable assets, any such assets used for leasing (excluding that conducted as a primary business) will be excluded from the scope of assets eligible for said measure.

Individual income taxation, asset taxation and consumption taxation

1) Revisions to the housing loan tax credit

The applicable period of the measure will be extended by 4 years. Although the tax credit rate will be reduced to 0.7% of the loan balance at year end (c.f. 1% under the current rules), the credit will be made available to taxpayers for a maximum of 13 years.

2) Fixed asset taxation

In regard to burden adjustments relating to fixed asset taxes and city planning taxes levied on land, any increases in the taxable base of commercial land during FY2022 will be capped at 2.5% of the assessed value of said land (c.f. 5% under the current rules) in the interest of mitigating drastic changes.

3) Consumption taxation

The measures necessary for the enforcement of the qualified invoice retention method (invoice system) in October 2023 will be implemented (or revised as necessary). Partial revisions will also be made to the procedures required to register as a qualified invoice issuer.

4) Other revisions

- The criteria defining major shareholders will be revised. In the event that the substantial proportion of share ownership in a listed company by a given shareholder is 3% or more after taking into account shares owned through certain controlling entities, any dividends received by said shareholder from said listed company will be subject to comprehensive taxation.
- Dividends paid to certain domestic entities will be exempt from withholding taxes if paid by their wholly owned subsidiaries (those wholly owned via ownership of 100% of outstanding shares) or entities in which said domestic entities directly own more than one third of the outstanding shares on a standalone basis.

International taxation

1) Revisions to the special measure on tax book value reduction of subsidiary shares (a reform enacted in FY2020)

The measure will be revised in the interest of preventing acts of tax avoidance conducted through a combination of dividends received from subsidiaries and subsidiary share transfers. When determining whether the exemption criteria (concerning the retained earnings amount as defined in relation to the specified control date) for this measure are met, the addition of the increase in retained earnings occurring during the interim between the beginning of the fiscal year of the dividend resolution date and the date when the dividends were received (the prescribed period) to the retained earnings amount as of the end of the immediately preceding fiscal year will be permitted. In addition, a measure to prevent the avoidance of the aforementioned measure (the anti-avoidance rules) through the use of dividends through subsidiaries that fulfill the exemption criteria will also be revised. This reform will apply to eligible dividends received in fiscal years beginning on or after 1 April 2021.

2) Revisions to the earnings stripping rules

The earnings stripping rules will apply to domestic source income generated by foreign entities that do not have a permanent establishment (PE) in Japan. They will also apply to any domestic source income generated by foreign entities that do have a PE in Japan when that income is not attributable to their Japanese PE.

Tax administration

1) Safe harbor rules to facilitate a smooth transition to the electronic data retention system for transaction data pertaining to electronic transactions

In regard to the system for retaining electromagnetic records concerning transaction data pertaining to electronic transactions, safe harbor rules will be introduced for electronic transactions conducted between 1 January 2022 and 31 December 2023. To provide for situations in which the party obligated to retain such data cannot do so in accordance with the retention criteria due to reasons deemed unavoidable and said party is also able to present or submit printed versions of the electromagnetic records upon demand, transitional measures will be introduced to allow the retention of electromagnetic records via said methods irrespective of the criteria set forth in regard to their retention.

2) Measures addressing flagrantly malevolent taxpayers and taxpayers that do not fulfill their book-keeping obligations

In regard to book-keeping errors and the lack of (or non-presentation of) ledgers, a framework will be established to levy additional penalty taxes in amounts proportional to the degree of the non-execution of book-keeping obligations and in consideration of both whether the record-keeping errors were intentional and the actual ability of the taxpayer to prepare such records. A measure that treats unrecorded expenses as non-deductible in relation to necessary expenses and losses will be introduced if said unrecorded expenses, when claimed in a fiscal year in which the taxpayer has either failed to file a return or falsified or concealed facts, are not evident from their ledgers and other related documents.

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