

Japan tax newsletter

Ernst & Young Tax Co.

2021 Japan tax reform outline - Taxation related to finance and real estate

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The 2021 tax reform outline (hereinafter, "Outline") was released on 10 December 2020 by the LDP/Komeito ruling coalition.

This newsletter provides an introduction to major reforms specific to finance- and real estate-related tax rules, financial institutions and insurance companies contained in the Outline.

For a general overview of the Outline, please refer to Japan tax newsletter, "2021 Japan tax reform outline," dated 22 February 2021.

Please note that the contents of this newsletter may be revised in response to future Diet deliberations concerning the reform bill.

1. Tax measures to facilitate the development of an international financial hub

To ensure Japan's position as an international financial center, and with the aim of providing overseas investors, foreign financial business operators and highly skilled financial professionals easier access to the Japanese market, the 2021 tax reforms will establish the following tax measures.

(1) Relaxation of criteria for the deduction of performance-linked compensation provided to executive directors

The performance-linked compensation of directors of non-listed, non-closely-held corporations whose primary business is investment management services will become a deductible expense for corporate tax purposes upon fulfillment of all of the following conditions in light of circumstances where such compensation is generally subject to the scrutiny of investors and other stakeholders. This revision is predicated on the enactment of future amendments to the Financial Instruments and Exchange Act.

- ▶ The corporation which employs the executive director files blue tax returns and qualifies as a specified investment management business operator (Note 1), and pays performance-linked compensation (Note 2) to the executive director in each of the fiscal years beginning during the period from 1 April 2021 to 31 March 2026 (limited to the fiscal years which end on or after the date of the enforcement of the Act Amending the Financial Instruments and Exchange Act)
- ▶ The corporation fulfills the criteria concerning investor pre-approval (Note 3)
- ▶ Business reports prepared by the corporation in accordance with the Financial Instruments and Exchange Act are published on the internet by the Financial Services Agency Commissioner

(In the application of the rules concerning the deductibility of the performance-linked compensation of directors, said business reports are deemed equivalent to the annual securities reports (*yuho*) in which indicators of profits and other information are to be recorded.)

- ▶ Details concerning the methods by which said performance-linked compensation is calculated are listed on and submitted via the aforementioned business report promptly on or after the date on which the procedures regarding the decisions made by the compensation committee are completed; and listed on the explanatory documents stipulated by the Financial Instruments and Exchange Act and thereafter published or provided for public inspection

(In the application of the rules concerning the deductibility of the performance-linked compensation of directors, the aforementioned details concerning the methods of calculation will be treated as fulfilling the criteria for disclosure via annual securities reports.)

Note 1: The phrase specified investment management business operator refers to a corporation (excluding corporations which file annual securities reports and their wholly-owned subsidiaries) which derives 75% or more of their total revenue in the respective fiscal year from the following activities.

- (i) Investment management businesses as stipulated in concern to financial instruments business operators
- (ii) Specially permitted businesses for qualified institutional investors as stipulated in concern to parties who file notifications for specially permitted businesses
- (iii) Specially permitted businesses for overseas investors (name tentative) as stipulated in concern to parties who file notifications for specially permitted businesses for overseas investors (name tentative)
- (iv) Specially permitted transitory period businesses (name tentative) conducted during the transitory period by parties who conduct said businesses and who have submitted the requisite notification

Note 2: Performance-linked compensation refers only to objective amounts determined based on indicators concerning the profits generated through the investment of assets under management.

Note 3: Fulfillment of the "criteria concerning pre-approval by investors" refers to the fulfillment of any of the following conditions.

- (i) Disclosure of both the provision of performance-linked compensation and the calculation method pertaining thereto in the fund agreements relevant to the managed assets of the paying entity
- (ii) Furnishing of a report concerning the provision of performance-linked compensation and the calculation method pertaining thereto at a meeting of the partners of the limited partnership for the managed assets that is held prior to the commencement of the fiscal year in which the application of the provisions of these rules are sought, and the meeting minutes concerning said meeting contain no indication or record of remarks made by any such partner voicing opposition to the contents of said report

(2) Special measure concerning the levying of inheritance tax and gift tax on foreign assets in relation to highly skilled foreign professionals

In the interest of facilitating the employment of highly skilled foreign professionals in Japan, the rules concerning assets conferred by foreign persons who reside in Japan for work or other purposes through inheritance or bequest will be revised such that the foreign assets of such individuals thus acquired by other foreign persons who reside outside of Japan, or who reside in Japan for short durations of time for reasons of employment or other purposes, will not be subject to inheritance tax nor gift tax, regardless of the length of residency of the conferrer.

Specifically, foreign assets acquired through inheritance, bequest or donation by persons who either possess a status of residence permitting habitancy in Japan for a short duration of time or are foreign persons residing outside of Japan will not be subject to inheritance tax or gift tax when said assets are received from a person who possesses a status of residence permitting habitancy in Japan upon the initiation of inheritance proceedings or at the time of donation.

The phrase status of residence refers to the statuses of residence listed in the left-hand column of Appended Table 1 of the Immigration Control and Refugee Recognition Act.

Obligations to pay inheritance tax and gift tax: Overview of the tax reforms¹ (The red text below indicates revisions contained in the 2021 tax reforms)

Donor/ deceased	Donee/ heir	Residence in Japan		No residence in Japan		
		Foreign persons residing in Japan for a short duration (*1)	Has Japanese citizenship		Does not have Japanese citizenship	
			Residence within the past 10 years	No residence during the past 10 years		
Residence in Japan	Foreign persons residing in Japan for a short duration (*1) (Post-reform: Persons who have statuses of residence)					
	Residence within the past 10 years		Both domestic and foreign assets are taxable			
No residence in Japan	Foreign persons who are residing in Japan for a short duration (*2)				Only domestic assets are taxable	
	No residence during the past 10 years					

*1: Persons who have statuses of residence listed in Appended Table 1 of the Immigration Control and Refugee Recognition Act who have had a residence in Japan for a total of 10 years or less within the past 15 years.

*2: Persons who do not have Japanese citizenship and who have had a residence in Japan for a total of 10 years or less within the past 15 years.

(3) Clarification of the tax implications concerning carried interest distributed to fund managers

In concern to distributions of fund (a partnership whose business is the transfer of shares) profits received by a fund manager in excess of the proportion of their contribution to the fund (i.e., carried interest) from which said payments are received, clarification will be provided to indicate that, in certain instances (e.g. the distribution ratio has an economic rationale etc.), they are to be treated as capital gains on share transfers subject to separate taxation (to which a single tax rate is applied), rather than as compensation for services subject to comprehensive taxation (to which a marginal tax rate is applied) for individual income tax purposes. The Financial Services Agency will establish the requisite measures to ensure the convenience and accuracy of returns filed by fund managers in such circumstances.

¹ Prepared based on page 579 of the "Commentary on the FY2017 Tax Reform", the section covering the amendment of the Inheritance Tax Act, published by the Ministry of Finance.

(4) Measures concerning the special taxation for foreign partners

The following measures will be established in reference to the special taxation for foreign partners².

- (i) Revision of the criteria pertaining to the ratio of equity interest in partnership assets³ in relation to investment partnership agreements eligible for the special exemption

In the event that a foreign partner has made contributions to an investment partnership agreement eligible for the special exemption via a partnership agreement other than said investment partnership agreement eligible for the special exemption (hereafter, specified partnership agreement (*1)), the equity ratio criteria will be determined based on the ratio of equity interest to the investment partnership eligible for the special exemption held by the foreign partner and related individuals (hereinafter collectively referred to as "Foreign Partner"), i.e. the ratio that takes into consideration the aggregate equity interest directly contributed from the Foreign Partner and the equity interest contributed from the specified partnership agreement attributable to said Foreign Partner.

**1: The term specified partnership agreement refers to partnership agreements pertaining to partnerships which have directly concluded an investment partnership agreement to which the special exemption is applied (i.e., an investment partnership agreement eligible for application of the special taxation for foreign partners) and that fulfill all of the following criteria.*

- ▶ *The total ratio of equity interest in the partnership assets pertaining to said specified partnership agreement that is held by said Foreign Partner is less than 25%.
(In the event that the total ratio of equity interest in the partnership assets pertaining to a partnership agreement pertaining to a partnership which has directly concluded said specified partnership agreement that is held by the Foreign Partner is 25% or greater, parties who hold equity interest in the partnership assets pertaining to said partnership agreement (excluding said foreign partner and related individuals) will be included in the consideration of the aforementioned criteria.)*
- ▶ *The parties who hold equity interest in said investment partnership assets that are considered partnership assets pertaining to said specified partnership agreement do not perform any important duties relating to the operation of the aforementioned investment partnership agreement to which the special exemption is applied.*

The term Foreign Partner refers to a foreign partner of a partnership and any persons who have a special relationship to said foreign partner.

In brief, in the event that a partner to a partnership agreement to which the special exemption is applied that is itself a partnership based on a specified partnership agreement, the determinations made in concern to the criteria pertaining to the equity interest ratio will be measured by employing the equity interest ratio at the level of the foreign partner party to said specified partnership agreement and related individuals, rather than through the equity interest ratio held by said specified partnership agreement in the partnership agreement to which the special exemption is applied.

² A special measure which deems foreign partners (non-residents and foreign corporations party to an investment partnership agreement) who own permanent establishments (PEs) in Japan related to the business of an investment partnership to not own said PEs upon the fulfillment of established criteria (Article 41-21, paragraph (1) and Article 67-16, paragraph (1) of the Act on Special Measures Concerning Taxation (hereinafter, "ASMT")). As a result, the scope of the domestic source income subject to taxation in Japan for such foreign partners is reduced, and there are usually no filing obligations for tax returns and no tax payments required in Japan; and simultaneously profit distributions from the partnership business are exempt from paying withholding taxes in Japan.

³ A precondition is that the greater of (a) the ratio of equity interest in the partnership assets held by a foreign partner in concern to an investment partnership agreement; and (b) the profit distribution ratio enjoyed by the foreign partner, is less than 25%. The current rules stipulate that, in the event that a foreign partner which is party to an investment partnership agreement to which the special exemption is applied is itself another partnership (i.e., a fund of funds), fulfillment of the equity interest ratio criteria is to be determined based on the equity interest held by said other partnership at the fund of funds level.

Accordingly, in the event that a Foreign Partner (a foreign investor) invest in a Japanese partnership through a foreign partnership (foreign fund), said foreign investor will be treated as having fulfilled the equity interest ratio criteria if the equity interest ratio (calculated at the level of individual foreign investors) held by said foreign investor is 25% or less, even if the equity interest ratio of said foreign fund in the Japanese partnership is itself 25% or greater.

- (ii) Digitalization of the procedures to file an application for the special exemption
 - ▶ In concern to applications for the special exemption and copies of the agreements pertaining to an investment partnership agreement to which the special exemption is applied, in addition to the existing method of submitting printed records to the coordinator of profit distributions, submission of necessary data through electromagnetic methods shall also be permitted.
 - ▶ Permitted alongside the existing method whereby the coordinator of profit distributions prepares copies of the application for the special exemption and related materials and retains said copies will be the preparation and retention of electromagnetic records which record the information that must be recorded on the application for the special exemption and related materials.
- (iii) Submission of copies of applications for the special exemption and investment partnership agreements to which the special exemption is applied at the frequency of once every five years
- (iv) Other necessary measures

The tax reforms outlined above are expected to provide the following benefits.

- ▶ Extension of eligibility for the deduction of performance-linked compensation to investment management business operators that are not corporations who file annual securities reports and fulfill certain criteria, thus providing such corporations with treatment equal to that of domestic corporations who do file annual securities reports
- ▶ Exemptions from inheritance tax on foreign assets even in the case of specific categories of foreign persons who have resided in Japan for long durations (cf. current rules, which stipulate that only foreign persons who have resided in Japan for a short duration are eligible for the exemption), a change which is expected to attract highly skilled foreign professionals to Japan
- ▶ Increased entry to the Japanese market by foreign investment management business operators and inflow of foreign investor capital, enabled by the clarification of the tax implications for certain types of fund performance fees (i.e., carried interest) and partial relaxation of the criteria governing permanent establishment (PE) taxation of fund participants

However, as the reforms contain measures which rely on the revision of the Financial Instruments and Exchange Act and calls for the relevant agencies to establish the measures necessary to achieve greater clarification, parties interested in discerning the details of the reforms will be required to confirm the details of future regulations, basic circulars and other announcements.

2. Corporate taxation

(1) Reforms affecting tax incentive systems

The 2021 tax reforms will introduce a digital transformation (DX) investment promotion tax incentive and will revise the definition of experimental and research expenses under the R&D tax regime.

For details concerning the overall revisions, please reference the EY Japan tax newsletter, "2021 tax reform outline," dated 22 February 2021.

Due to the nature of financial service businesses, many financial institutions incur significant expenditures pertaining to software development and system investment on a regular basis.

Recent years have seen the cloud computing, AI and blockchain technology incorporated into both the development of financial services and the automation and sophistication of operations. Some insurance companies have even obtained DX certification from the Ministry of Economy, Trade and Industry as defined under the Act on Facilitation of Information Processing.

Parties interested will be required to confirm the details of future announcements of regulations and laws concerning the introduction of the DX investment promotion tax incentive and revision of the scope of experimental and research expenses under the R&D tax regime conducted through the 2021 tax reforms, which are expected to provide financial institutions with opportunities to consider whether their software development and system investments are eligible for the tax incentive systems provided through these reforms.

(2) Revision of the asset ownership criteria of the special tax measure for investment corporations

With regard to the asset ownership criteria⁴, which is one of the pass-through requirements of the special tax measure pertaining to investment corporations (i.e., *toushi-houjin*: investment corporations established pursuant to the Act on Investment Trusts and Investment Corporations), provisions regarding asset ratio calculations will be revised so that monetary claims pertaining to finance lease transactions will be considered to be the relevant asset being leased through the respective finance lease transaction.

Under the current rules, in the event an investment corporation acquires assets through a sale-and-lease-back transaction and said lease transaction is deemed as a finance lease transaction, then said finance lease transaction is included in specified assets as monetary claims pertaining to finance lease transactions, regardless of the type of asset that is being leased thereby. As a result of the 2021 tax reforms, calculations of asset ratios will consider any monetary claims pertaining to finance lease transactions to be investments in the underlying assets.

⁴ The requirement that the percentage of total book value of specified assets at the end of the fiscal year against the total book value of total assets at the end of the fiscal year exceeds 50%.

(3) Necessary measures due to the amendment of the Installment Sales Act

With regard to the classifications “certified comprehensive credit purchase intermediaries” and “registered small-sum comprehensive credit purchase intermediaries,” which were established under the FY2020 amendment of the Installment Sales Act, the content of said businesses is identical to those of credit card businesses carried out by comprehensive credit purchase intermediaries. Therefore, the reforms will introduce the measures deemed necessary in light of such circumstances; said measures will be based on the current tax measures applied to comprehensive credit purchase intermediaries.

(i) Measures relating to the allowance for doubtful account rules

Due to the amendment of the Installment Sales Act, entities deemed as registered small-sum comprehensive credit purchase intermediary companies under the same Act will be added to the scope of entities eligible to receive application of the allowance for doubtful account rules.

In addition, monetary claims that are eligible for the allowance for doubtful account rules related to such entities will be deemed as monetary claims related to the intermediation of comprehensive credit purchases whose payments are not yet due that were provided to designated credit bureaus as basic specified credit information prescribed by the provisions of the same Act.

(ii) Statutory provision rates for the allowance for doubtful accounts of SMEs

In regard to the special measure for the allowance for doubtful accounts of SMEs, the statutory provision rates for retail installment sales retail businesses, comprehensive credit purchase intermediary businesses and individual credit purchase intermediary businesses will be reduced to 0.7% (cf. current rules, which stipulate a rate of 1.3%).

(iii) Consumption tax exemption for intermediary fees

Fees pertaining to the intermediation of comprehensive credit purchases provided by a registered small-sum comprehensive credit purchase intermediary - which is a new classification that will be introduced by the amendment of the Installment Sales Act - shall be exempted from consumption tax.

3. International taxation

(1) Revisions of the earnings stripping rules

The following measures will be established in reference to the earnings stripping rules. These revisions will be applied to corporate taxes for fiscal years ending on or after 31 March 2021.

- (i) The following amounts will be included in the amount of non-qualified interest expenses.
 - ▶ Any amount of scheduled interest allocated to insurance premium reserves in accordance with a life insurance plan or non-life insurance plan
 - ▶ Any amount of scheduled interest allocated to refund reserves in accordance with a non-life insurance plan
- (ii) An amount equivalent to the amount of interest income received by a corporation in concern to profit distributions from a bond investment trust (i.e., the portion of profit distributions attributable to interest from government and corporate bonds) may be included in the total amount of interest income used in the calculation of the amount of qualified net interest expenses (i.e., the amount remaining after deducting the total amount of deductible interest income from the total amount of qualified interest expenses).

(2) Necessary measures pertaining to the non-deductibility of interest expenses arising from liabilities which correspond to capital attributable to PEs of foreign corporations

In concern to the amount of non-deductible interest expenses determined in accordance with the rules concerning the non-deductibility of interest expenses arising from any liabilities which correspond to capital attributable to the PE of a foreign corporation, the method for the calculation of said amounts will be revised such that the calculation is conducted by multiplying the total amount of interest expenses arising from the liabilities pertaining to the business conducted through said PE with the ratio of its own capital shortfall to the total amount of outstanding liabilities, inclusive of any liabilities which give rise to said interest expenses and any other liabilities pertaining to the procurement of funds (c.f. current rules, which utilize the total amount of liabilities which give rise to said interest expense).

Moreover, revisions will be made in an equivalent manner to the above regarding the rules concerning the non-deductibility of interest expenses arising from any liabilities which correspond to capital attributable to the foreign places of business of domestic corporations and the special tax measure for interest expenses arising from liabilities pertaining to foreign controlling shareholders (“thin capitalization rules”).

The 2021 revisions appear to clarify the circumstances in which fund procurement transactions that incur negative interest expenses and to implement countermeasures as necessary. Key points that may affect tax affairs are the calculation of income attributable to PEs, which serve as the taxable bases of corporate taxes in the event the taxpayers are foreign corporations, and foreign income calculations pursuant to the foreign tax credit rules and the amount of non-deductible interest under the thin capitalization rules in the event the taxpayers are domestic corporations. Furthermore, parties interested will be required to exercise caution concerning the impact of the added-value tax component of corporate enterprise taxes - imposed on corporations subject to pro forma standard taxation - on net interest expenses.

Parties interested will be required to confirm future announcements of regulations and laws and the effective periods thereof, and in the event that their transactions include fund procurement transactions to which negative interest rates are applied or variable interest instruments whose applied interest rate may be a negative value, will be required to review their aggregation and calculation processes in response to the above tax regimes.

(3) Extension of the tax exemption measure for interest relating to margins of over-the-counter derivative transactions

The effective period of the special measure for the taxation of interest relating to margins of over-the-counter derivative transactions of foreign financial institutions will be extended by three years (to 31 March 2024).

(4) Extension of the tax exemption measure relating to cross-border bond repurchase agreements

With regard to the special measure for the taxation of interest relating to bond repurchase agreements (*gensaki*) of foreign financial institutions, the effective period of the tax exemption measure for the interest on bond repurchase agreements concluded between specified foreign entities and specified financial institutions will be extended by two years (to 31 March 2023).

4. Consumption tax

(1) Measure concerning the commencement date of the application of the ratio stipulated as an alternative to the taxable sales ratio

Revision of rules concerning the calculations of input tax credits for consumption taxes will be conducted so that a business operator may commence the use of a ratio stipulated as an alternative to the taxable sales ratio (hereinafter as “the alternative ratio”) starting from the taxable period that includes the submission date of the relevant application for approval in the event the following conditions apply.

- (i) Said business operator submits an application for approval by the last date of the taxable period in which said business operator elects to use the alternative ratio.
- (ii) Said business operator receives approval from the district director of the tax office no later than the date when one month has passed since the date following the last date of the taxable period in which said business operator elects to use the alternative ratio.

Under the current rules, in the event a business operator elects to use the alternative ratio, said business operator must submit an application for approval and receive approval from the district director of the tax office no later than the last date of the taxable period in which said business operator elects to use said alternative ratio. Due to the 2021 tax reforms, in the event a business operator who elects to do the same submits an application for approval during the taxable period in which said business operator elects to use said alternative ratio and receives approval from the district director of the tax office no later than the date when one month has passed since the date following the last date of said taxable period, then said business operator may commence the use of the alternative ratio starting from the taxable period that includes the submission date of said application for approval.

Please note that there are no changes to the current rules regarding the requirement that a rescission notification concerning the use of an alternative ratio must be submitted no later than the last date of the taxable period in which said business operator elects to cease use of said alternative ratio.

(2) Revision of personal identification documents related to taxable purchases of gold

There are several types of personal identification documents⁵ prescribed by the Consumption Tax Act that must be preserved in order to be able to receive input tax credits for the taxable purchases of gold or platinum ingots. Of these, the requirement to preserve copies of residence cards, copies of passports of persons who do not have addresses in Japan and other similar documents will be eliminated.

This revision will apply to domestic taxable purchases conducted by business operators on or after 1 October 2021.

As a result of this revision, consumption taxes related to the purchase of gold from inbound foreign travelers will become ineligible for input tax credits.

⁵ Enforcement Regulations of the Consumption Tax Act, Article 15-4, paragraph (1).

5. Other

(1) Encouragement of the digitalization of tax procedures (NISA and cross-border transactions)

With regard to the tax procedures pertaining to NISA and cross-border transactions, for the purpose of stabilizing the financial market by facilitating the execution of cross-border transactions via encouragement of further digitalization, the submission through electromagnetic methods in place of the submission of physical forms will be permitted regarding documentation (e.g., tax exemption application forms) that must be submitted to financial institutions for the application of tax treaties or tax measures regarding income calculations concerning the transfer of listed shares, etc. contained in NISA or specified accounts, interest on domestic and foreign government and corporate bonds, interest on book-entry government bonds, and interest on bond repurchase agreements and interest relating to margins of over-the-counter derivative transactions of foreign financial institutions.

In the event of submitting said documentation in physical form, it has become difficult to obtain personal identification documents required for the application of the above tax measures and for local financial institutions to conduct documentation acceptance procedures at offices due to the spread of COVID-19. Furthermore, due to the temporary termination of international postal services, there is a possibility that the seamless processing of transactions could be inhibited by the delayed arrival of application documents.

The 2021 tax reforms are expected to expedite digitalization and the adoption of online technology by public authorities to simplify the submission of application documents, thus facilitating the execution of cross-border transactions and providing increased opportunities for parties to leverage various tax measures. Parties interested will be required to confirm future announcements of regulations and laws with regard to the details of tax procedures of regimes subject to enhanced digitalization.

(2) Expansion of requests and applications eligible to be filed through e-Tax

In concern to requests and filings submitted to the district director of a tax office through e-Tax for which data items that must be written on physical documents related to said request or filing cannot be input and sent online, the sending of electromagnetic records prepared via scanning or other methods (i.e., image data) will be permitted in place of submission of said physical documents.

Although this revision will apply to requests and applications filed on or after 1 April 2021, in practice the filing of requests or applications using the methods outlined above will be permitted even prior to the enforcement date.

(3) Establishment of methods concerning the submission of payment records via cloud services

Parties obligated to file payment records will, upon prior notification provided to the district director of a tax office, be permitted to submit payment records via methods which fulfill the following two conditions.

This revision will apply to payment records submitted on or after 1 January 2022.

- ▶ The relevant data that must be recorded in payment records are saved in a file stored in a cloud service which has been certified as meeting relevant criteria stipulated by the commissioner of the National Tax Agency
- ▶ The district director of the tax office is provided with access privileges enabling viewing and recording of data to be conducted in relation to the data of said file

The aforementioned notifications provided to the district director of the tax office and procedures related to certifications by the commissioner of the National Tax Agency may be conducted via e-Tax.

(4) Revision of the taxation methods relating to the interest and redemption proceeds of corporate bonds issued by family corporations

Interest of corporate bonds issued by family corporations received by either an individual who has a special relationship with the entities which act as the shareholders on which the determination of family corporation status are based or the relatives of said individual will be subject to comprehensive taxation (i.e. subject to a marginal tax rate).

Furthermore, redemption proceeds of corporate bonds issued by family corporations received by said individuals and their relatives will also be subject to comprehensive taxation.

The above phrase, “an individual who has a special relationship with the entities,” refers to an individual who has an outstanding share ownership relationship in excess of 50% with any of the shareholder entities.

This revision will be applied to corporate bond interest and redemption proceeds received on or after 1 April 2021.

(5) Revision of the special measure⁶ for income calculations concerning the transfer of listed shares, etc. contained in specified accounts

When calculating business income or miscellaneous income earned through the transfer of listed shares, etc. contained in specified accounts for which the levying of withholding tax has been elected, an individual taxpayer will be able to include service fees pertaining to a discretionary investment agreement paid to the financial instruments business operator that opened said withholding tax account in necessary expenses.

This reform will apply to individual income tax and individual inhabitant tax for 2022 and thereafter.

(6) Simplification of individual inhabitant tax return filing procedures pertaining to dividends on listed shares

Under the current rules concerning individual inhabitant tax, there are three methods available for taxing specified dividends and capital gains on specified share transfers, which are as follows: (i) Comprehensive self-assessment taxation; (ii) separate self-assessment taxation; and (iii) separate withholding taxation (i.e., returns need not be filed). Although the 2017 tax reforms made it possible for taxpayers to elect different taxation methods with regard to individual income tax and individual inhabitant tax, in the event different taxation methods are elected, said taxpayers are required to file income tax returns and are additionally required to file inhabitant tax returns.

To simplify procedures for filing individual inhabitant tax returns, the 2021 tax reforms will add a section for individual inhabitant tax in final tax returns so that taxpayers will generally be able to complete their tax return procedures by filing an income tax return, in the event said taxpayers elect the separate withholding taxation method (i.e., returns need not be filed) for the entire income pertaining to specified dividends and capital gains on specified share transfers.

This reform will be applied to final tax returns for 2021 or thereafter, filed on or after 1 January 2022.

(7) Burden adjustment measures⁷ for fixed asset tax and city planning tax levied on land

The taxable bases of fixed asset taxes are determined based on revaluations of land conducted once every three years, and said taxable bases are applied for the following three consecutive years. A burden adjustment measure on commercial land, etc. will be established to suppress the sudden increase of tax burdens caused by surging land prices.

⁶ ASMT, Article 37-11-3.

⁷ Supplementary Provisions of the Local Tax Act, Articles 18 and 25 (Residential Land, etc.), Articles 21 and 27-4 (Commercial Land, etc.), and Articles 21-2 and 27-4-2 (Residential Land, etc.).

The ratio derived by dividing the taxable base of the previous fiscal year (FY) (after the burden adjustment) by the taxable base of the current fiscal year (prior to the burden adjustment) will be called the burden ratio, and there will be three tiers of adjustment measures depending on the burden ratio pertaining to any such parcel of land.

Burden ratio	Land price trend	Taxable base of the current fiscal year after the burden adjustment
More than 70%	Decreasing or slightly increasing	Valuation for fixed asset taxation x 70%
60% or higher, but 70% or less*	Further increasing	Pegged to that of the previous fiscal year
Less than 60%	Surging	Taxable base of the previous FY (after the burden adjustment) + Valuation for fixed asset taxation x 5% (A minimum of 20% of the valuation amount, and a maximum of 60% of the same)

(*) 65% or less in the case of Tokyo prefecture

Based on the premise that the aforementioned framework of the burden adjustment measure under the current rules will continue to be in place from the period between FY2021 and FY2023, the following measures will be implemented during FY2021 only.

- (i) With regard to commercial land whose burden ratio is less than 60%, and with regard to residential land (that is not considered commercial land) and agricultural land whose burden ratios are less than 100%, the taxable bases for FY2021 will be set at the same taxable bases as FY2020.
- (ii) Necessary measures will be implemented regarding land on which will be applied the local municipalities' tax reduction ordinance during FY2020.

Furthermore, necessary reforms will be implemented regarding the burden adjustment measure for city planning tax on land to align them to the fixed asset tax reforms.

Tax burdens are generally expected to increase in relation to land whose prices will rise due to the revaluation of land, as is the case for the revaluation scheduled in FY2021, but due to the impact of the COVID-19 pandemic, the earning power of many industries has weakened. Therefore, this new burden adjustment measure will be implemented out of consideration for the possibility that the management environment of said industries will further worsen in the event fixed asset tax burdens were increased.

(8) Measures pertaining to real estate transaction taxes in relation to the acquisition of real estate by investment corporations and specified purpose companies (TMK)

- (i) The effective period of the measure for the reduction of tax rates in relation to the registration and license taxes⁸ levied upon registration of a transfer of ownership rights (2% in general (1.5% for land due to special provisions); reduced tax rate of 1.3%) in cases wherein investment corporations and specific purpose companies to which the period extension of the measure to reduce registration and license tax rates are applied acquire specified real estate, etc. will be extended by 2 years (until 31 March 2023).
- (ii) Extension of the effective period of the special measure for the taxable bases of real estate acquisition taxes
The effective period of the special measure for the taxable bases of real estate acquisition taxes⁹ in relation to certain real estate acquired by investment corporations, specific purpose companies, etc. (reduction of the tax base to two-fifths the original amount) will be extended by 2 years (until 31 March 2023).

⁸ ASMT, Article 83-2-2.

⁹ Supplementary Provisions of the Local Tax Act, Article 11, paragraphs (3) to (5).

(9) Extension of the measure for the reduction of registration and license taxes levied upon registrations of transfers of ownership rights of land

The effective period of the measure for the reduction of tax rates in relation to the registration and license taxes¹⁰ levied upon registrations of transfers of ownership rights of land by purchase, will be extended by two years (until 31 March 2023).

(10) Measures pertaining to real estate transaction taxes in relation to the acquisition of real estate by special enterprises prescribed by the Act on Specified Joint Real Estate Ventures

(i) The measures described below will be implemented regarding the measure for the reduction of tax rates in relation to the registration and license taxes¹¹ levied upon registration of a transfer of ownership rights (2% in general (1.5% for land due to special provisions); reduced tax rate of 1.3%) in cases wherein special enterprises acquire real estate pursuant to a specified joint real estate venture agreement, and its effective period will be extended by 2 years (until 31 March 2023).

- (a) Buildings used as nursery schools and land thereof will be added to the scope of eligible real estate.
- (b) Excluding cases wherein a building is used as housing (excluding housing for the elderly providing elderly care), warehouses or parking spaces, in the event the building area of a building is 150m² or more (in the event of a new building or a remodeled building, limited to cases wherein expenses incurred to construct said building are JPY250,000 or more per floor area of 1m²), said building will be deemed as fulfilling the building-scale criteria for new buildings constructed by special enterprises or qualified special investors.

(ii) The measures described below will be implemented regarding the special measure for the taxable bases of real estate acquisition taxes¹² in relation to certain real estate acquired by special enterprises prescribed by the Act on Specified Joint Real Estate Ventures pursuant to a specified joint real estate venture agreement (reduction of the taxable base to half the original amount), and its effective period will be extended by 2 years (until 31 March 2023).

- (a) The criteria that new housing constructed by special enterprises and qualified special investors and the land thereof be transferred within 10 years from its construction will be eliminated.
- (b) Housing built on leased land will be added to the scope of real estate acquired by eligible special enterprises and qualified special investors.
- (c) Certain types of housing will be excluded from the scope of eligibility.

(11) Measure for the reduction of registration and license taxes pertaining to the increase in capital pursuant to the Deposit Insurance Act will be made permanent

In view of the fact that the Deposit Insurance Act will be amended, the measure for the reduction of the tax rate of registration and license tax¹³ levied on the registration, etc. of the increase in capital received by financial institutions pursuant to decisions, etc. made by the Prime Minister of Japan for the purpose of conducting measures stipulated under Article 102, paragraph (1), item (i) of the same Act, will become permanently effective.

¹⁰ ASMT, Article 72.

¹¹ ASMT, Article 83-3.

¹² Supplementary Provisions of the Local Tax Act, Article 11-12.

¹³ ASMT, Article 80, paragraph (5) Due to said measure, the tax rate of registration and license tax was reduced from 0.7% to 0.35%. The FY2020 tax reforms had extended the effective period by 2 years (until 31 March 2022).

(12) Extension of tax exemption measures concerning real estate acquisition taxes levied on contracted banks¹⁴

The effective period of the tax exemption measures concerning real estate acquisition tax described below will be extended by 2 years.

- (i) Real estate acquisition tax pertaining to real estate acquired by contracted banks prescribed by the Deposit Insurance Act through the transfer of businesses of failed financial institutions, etc., mediated by the Prime Minister of Japan or through the purchase of assets based on entrustment by the Deposit Insurance Corporation of Japan as prescribed by the contract
- (ii) Real estate acquisition tax pertaining to real estate acquired by contracted banks prescribed by the Insurance Business Act through the purchase of assets of failed insurance companies, etc. based on entrustment by a policyholders protection corporation as prescribed by the contract

(13) Extension of the tax exemption measure concerning stamp duties of loan agreements in relation to special loans provided due to the COVID-19 pandemic

The effective period of the tax exemption measure concerning stamp duties of loan agreements in relation to special loans provided to enterprises whose management has been impacted by measures to prevent the spread of COVID-19¹⁵ will be extended to 31 March 2022 (cf. current rules, which stipulate that the measure expires on 31 January 2021).

(14) Further unification of financial income taxation (Expansion of the scope of financial instrument profits and losses that can be offset)

With regard to further unification of financial income taxation including income earned from derivative transactions, the Outline states that in view of developing an environment in which investors may invest in various financial instruments with relative ease while giving due consideration to the transactions individual investors conduct on comprehensive exchanges, the central government will promptly carry out discussions concerning the effectiveness of and issues surrounding mark-to-market taxation, including effective and concrete policies to prevent intentional tax avoidance acts through the deployment of various schemes, and that it will strive to obtain the understanding of related parties.

¹⁴ Supplementary Provisions of the Local Tax Act, Article 10, paragraph (1) (Contracted Banks Prescribed by the Deposit Insurance Act), and paragraph (3) (Contracted Banks Prescribed by the Insurance Business Act).

¹⁵ The Act on Special Measures to Temporarily Revise National Tax-related Acts in Response to the Impact of COVID-19, Article 11.

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