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Japan tax alert

Ernst & Young Tax Co.

2023 Japan tax reform outline

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The fiscal year 2023 tax reform outline was released on 16 December 2022. 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.

Contents

Building a better working world

Corporate tax

1) Revision of R&D tax incentives

In an effort to bolster incentives which facilitate increased investment activity, the credit rate curve for the general R&D tax credit will be revised. The applicable period of the special tax measure designating a maximum credit rate of 14% (c.f. the general rate of 10%) will be extended by 3 years after reducing the minimum credit rate to 1% (2% under the current rules). As a means of providing further incentives to companies that have reached the maximum credit amount (currently 25% of corporate tax liability), a mechanism will be introduced which allows for a variable credit ceiling dependent on the degree of change in annual E&R spending. In regard to the open innovation activity-based credit, the definition of R&D-based startups will be revised and expanded. A tax incentive will also be introduced for corporations which leverage advanced degree holders and other highly skilled professionals in R&D activities. Provisions governing E&R expenses related to the development of services will also be revised, such as the addition of instances in which existing big data is used in research activities.

2) Revision of tax incentive to promote open innovation

This tax incentive allows for companies to claim an income deduction for 25% of share purchase amounts in startups provided certain conditions are met. In addition to the acquisition of newly issued shares, the incentive will now also be applicable to acquisitions of existing shares that do not involve additional funding. To stimulate even greater growth in startups, tax reduction benefits will be provided for an extended duration upon fulfilling certain growth criteria (increasing sales by 1.7x and sales reaching JPY3.3 billion or more, among others) within 5 years of shares acquired under this newly added provision.

3) Other

- Among crypto assets held at the end of a period by a company, those crypto assets which were issued and held since issuance by the same company will no longer be subject to corporate taxation on net unrealized capital gains based on mark-to-market valuation.
- Spin-off tax rules will be expanded. The revisions will allow for companies that spin-off a wholly-owned subsidiary while still maintaining some equity in the entity (less than 20%) to be eligible for benefits provided certain conditions are met.
- Excluded from the special regime for tax deferral on share deliveries will be instances in which the share-granting parent company is considered a family corporation after the share delivery.
- The criteria of the DX investment promotion tax incentive will be revised and extended by 2 years.
- The special measure for taxation of the replacement of specified assets will be revised and extended by 3 years.
- The special measure for the reduction of the corporate tax rate of SMEs will be extended by 2 years.

International taxation

1) Introduction of global minimum tax

The OECD/G20 Inclusive Framework on BEPS 2.0 includes the provision of new taxing rights to market jurisdictions (Pillar 1) and a global minimum tax (Pillar 2). Japan has now decided to move forward with the implementation of Pillar 2. The 2023 tax reform will include legislation for the income inclusion rule (“IIR”) while accounting for the latest discussions on the topic within the international community, as well as developments in other countries engaged in the same process. Upon its legislation, measures will be introduced to reduce the administrative burden on those companies in scope of the IIR. In light of the need to monitor critical developments in other countries implementing the IIR, as well as to afford affected companies ample time to prepare for new administrative procedures, the IIR in Japan will apply to fiscal years beginning on 1 April 2024 or after. Items expected to be discussed by the OECD in detail beginning from next year, such as the undertaxed profits rule (“UTPR”) and the qualified domestic minimum top-up tax (“QDMTT”) , are being considered for legislation in the 2024 tax reform at the earliest. Opinions and feedback from the international community on these topics will again play a major role in any future deliberations.

2) Revision of foreign subsidiary income inclusion tax rules (JCFC)

The foreign subsidiary income inclusion tax rules of Japan (JCFC) will coexist alongside Pillar 2’s global minimum tax. To reduce any additional administrative burdens stemming from the implementation of Pillar 2 placed on applicable companies, current JCFC rules will be revised. Should the tax burden rate of a specified foreign related company’s fiscal year be 27% or higher (currently 30% or higher), the foreign related company will be exempt from the application of entity-basis income inclusion. In addition, certain documents related to a foreign related company partially subject to CFC rules which were required to be included with tax return filings will now be excluded, and only the requirement to preserve such documents will remain. These revisions will go into effect for fiscal years starting on or after 1 April 2024 to coincide with the implementation of Pillar 2.

Individual income taxation, asset taxation and consumption taxation

1) Expansion of NISA scope and duration

In an effort to achieve the Doubling Asset-based Incomes Plan touted by the Kishida Cabinet, the NISA investment scheme will be drastically expanded beginning from January of 2024. NISA itself will be made permanent and its tax-free holding periods will become indefinite. The annual maximum investment amount will also be raised to JPY3.6 million (a combination of a JPY1.2 million limit for accumulation-type investments such as investment trusts and a JPY2.4 million limit for growth-type investments such as stocks). As a means of ensuring the NISA does not act as a vehicle for unlimited tax benefits for high-income earners, the tax-free lifetime investment limit will be set at JPY18 million. Of this JPY18 million limit, a maximum of JPY12 million will be allotted for growth-type investments.

2) Creation of tax incentive to spur re-investment in startups

An incentive has been created in which any gain on transfer of stock-trading proceeds will be tax-exempt provided a business founder uses such proceeds to create a business or to reinvest in a startup. The limit of this incentive has been set at JPY2 billion.

3) Revision of inheritance tax

The need has arisen for Japanese inheritance and gift taxation to be conducted under a system which is neutral to the timing selected for asset transfers. Accordingly, a standard deduction (JPY1.1 million) equivalent to that of the calendar-year taxation system will be created in an effort to improve the usability of the taxation system for settlement at the time of inheritance. In addition, while the current system calls for gifts received within 3 years prior to the start of inheritance to be added to the inherited property, this period will be extended to 7 years.

4) Revision of qualified invoice system

The qualified invoice system (qualified invoice retention method) will go into effect from October of 2023. Tax measures will be enacted to ensure companies have a smooth transition to the new system, as well as to reduce any additional administrative burden that may be incurred. To reduce any radical impact on tax liabilities for businesses which were exempt from consumption taxes in the past but will now become invoice-issuing businesses with the new system, a measure will be implemented which reduces the tax liability amount to 20% of the output tax amount for a three-year period. The administrative burden should be significantly lightened as a result of this provision, even more so than under the application of the simplified taxation rules for consumption tax. A measure will also be implemented to reduce the administrative burden on businesses below a certain size for a 6-year period by allowing them to take an input tax deduction for book-purposes only for small-amount transactions (payment amounts below JPY10,000). This measure is designed to allow the new system to settle into place and provide businesses time to gradually adapt. Lastly, the obligation to issue refund invoices for small-amount transactions will be eliminated in order to reduce the administrative burden for instances when items such as bank transfer fees are discounted.

5) Other

- Taxation on the income of high-net-worth individuals will be strengthened. A new measured will be implemented for instances in which the amount of income calculated by deducting JPY330 million yen from an individual's income and multiplying that amount by 22.5% exceeds the amount of income tax liability for the year. Such instances will have an additional income tax imposed equal to the excess amount.
- The exercise period within the stock option rules will be extended from 10 to 15 years for certain startups.
- Angel investor tax rules will have their requirements relaxed.

Tax administration and other items

1) Revision of the electronic book preservation act (e-retention) rules

In regard to the system for retaining electromagnetic records concerning transaction data pertaining to electronic transactions, a new grace will be introduced for businesses that have reasonable grounds for their inability to comply with the rules in a timely manner. In regard to the scanned document preservation rules, current provisions will be further relaxed to facilitate easier compliance with the rules. Furthermore, in an effort to further aid the transition to highly reliable electronic books, the scope of electronic books eligible for the reduction of penalties imposed due to understated tax will be streamlined and clarified.

2) Revision of penalties

Necessary measures will be implemented to provide for instances in which a taxpayer has failed to file a tax return and although penalties for acts of deceit or concealment do not necessarily apply, it can still be concluded that the taxpayer was not unaware of their obligation to file a tax return. Additional measures for failure to file penalties will be introduced for instances in which undeclared amounts are especially high.

3) Tax rules and measures to secure funds for national defense build-up

Corporate, income, and tobacco taxes were selected for tax hikes in order to secure the funding required to bolster the nation's defense capabilities. In regard to corporate tax, a new surtax ranging from 4% to 4.5% on corporate tax liability amounts will be adopted. To limit the impact on SMEs, a JPY5 million deduction from the taxable base of corporate taxes will also be provided. In regard to income tax, a new 1% surtax on income tax liability amounts will be implemented. The reconstruction income tax will be lowered by 1%, and its duration will be extended. In regard to tobacco tax, an increase of three yen per cigarette will be rolled out in stages. The implementation of the above measures is expected to occur at a suitable date in 2024 or later.

4) Other

Eco-car tax incentives will remain in their current form until the end of 2023.

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