

Japan tax newsletter

Ernst & Young Tax Co.

2023 Japan tax reform outline

EY Japan Tax Alerts and Newsletters

You may access past alerts from the link below.

https://www.ey.com/ja_jp/ey-japan-tax-library/tax-alerts

Contents

▶ Corporate taxation	2
1. Revision of R&D tax rules	
2. Revision of tax incentive to promote open innovation	
3. Revision of spin-off tax rules	
4. Revision of crypto asset mark-to-market valuation methodology	
5. Other	
▶ International taxation	8
1. Introduction of global minimum tax	
2. Revision of foreign subsidiary income inclusion tax rules (JCFC)	
3. Other	
▶ Individual income taxation, asset taxation and consumption taxation	15
1. Expansion of NISA scope and duration	
2. Revision of inheritance tax and gift tax	
3. Revision of qualified invoice system	
4. Creation of tax incentive to spur re-investment in startups	
5. Extension of exercise period within stock option rules	
6. Strengthened taxation on the income of high-net-worth individuals	
7. Other	
▶ Tax administration and other items	19
1. Revision of the electronic book preservation act (e-retention) rules	
2. Revision of penalties	
3. Tax rules and measures to secure funds for national defense build-up	
4. Eco-car tax incentives	
5. Other topics	

The ruling parties (a coalition comprised of the Liberal Democratic Party and Komeito) released an outline of the 2023 tax reforms (hereinafter, "Outline") on 16 December 2022. This newsletter provides an overview of the major amendments and revisions contained in the Outline

The 2023 tax reform signals a clear commitment from the Japanese government to unleash and ignite the latent potential of individuals, businesses, and local regions of Japan via the intentions embedded in this year's revisions to tax frameworks. In order to ensure this "virtuous cycle of growth and distribution" continues to flourish, a tax system which encourages investment in the growth of markets, industries, and people must be strengthened across the board, and wide-ranging income redistribution policies must be enacted both in and outside of the tax arena.

The NISA investment scheme will be drastically expanded in scope and duration in an effort to achieve the Double Asset-based Incomes Plan for citizens. New tax incentives will be created, and existing tax incentives will be revised in order to significantly elevate the startup ecosystem and promote the creation and development of new industries. Revisions to R&D incentives will also facilitate an increase in investment activities. Lastly, Pillar 2's global minimum tax ("GMT") agreed upon in the OECD/G20 Inclusive Framework on BEPS will come into effect on 1 April 2024.

Please note that the content of this newsletter may be partially revised, deleted, or supplemented in response to future Diet deliberations on the reform bill.

Corporate taxation

1. Revision of R&D tax rules

While R&D expenditure by private companies in Japan maintains a high level and ranks third in the world in actual spending, it is still characterized as stagnant. Furthermore, open innovation between startups and the hiring of advanced degree-holders lags in comparison to Europe and the US. In order to maintain and enhance Japan's international competitiveness, various revisions will be made to existing R&D tax incentives as a means of encouraging increased and high-quality investment activities in the private R&D space.

(1) General R&D tax credit

In regard to the general R&D tax credit, the below figures show the revisions to the tax credit rates and maximum tax credit amounts with respect to the ratio of increase/decrease in experiment and research spending ("E&R ratio"). The applicable period of this tax measure will also be extended by 3 years. 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 annual E&R ratio.

(Maximum tax credit)

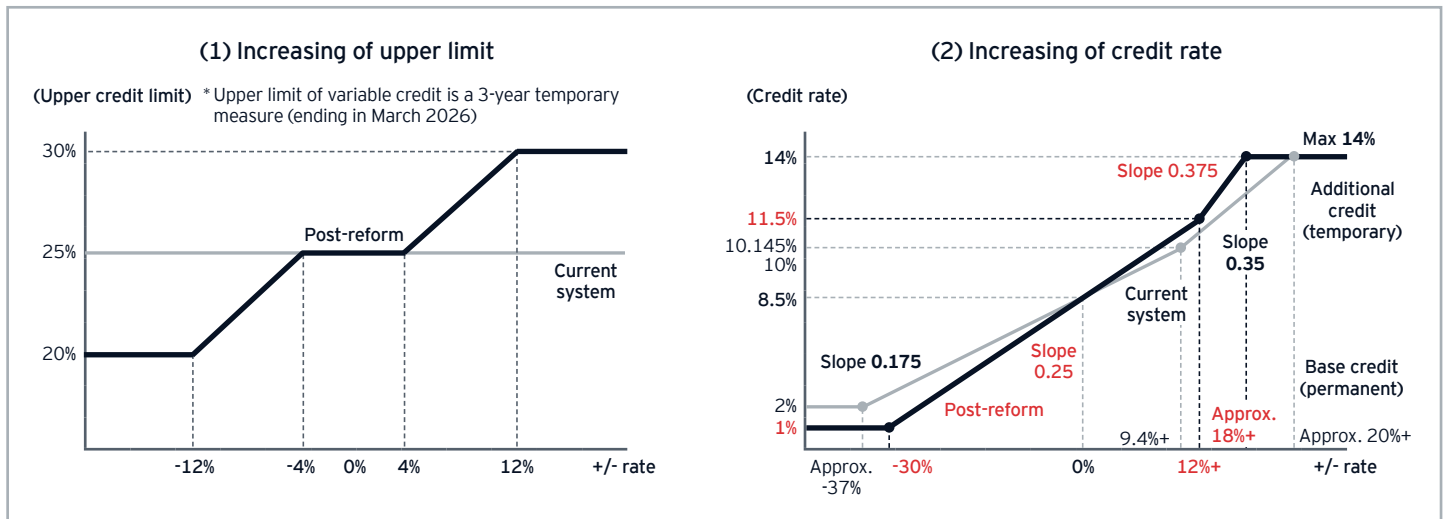
Special measure tax credit (*)	More than 4%	Less than -4%
	$(\text{E\&R ratio} - 4\%) \times 0.625$ (upper limit 5%) addition	$(-\text{E\&R ratio} - 4\%) \times 0.625$ (upper limit 5%) subtraction

(*) Applicable to fiscal years beginning between 1 April 2023 and 31 March 2026.

(Tax credit rate)

E&R ratio more than 12%	E&R ratio of 12% or less
$11.5\% + (\text{E\&R ratio} - 12\%) \times 0.375$	$11.5\% - (12\% - \text{E\&R ratio}) \times 0.25$

(*) Lower limit of credit rate reduced from current 2% to 1%, upper limit set to 14% (currently 10%)



Source: "2023 tax reform discussions for economies and industries" published by the Ministry of Economy, Trade, and Industry https://www.meti.go.jp/main/zeisei/zeisei_fy2023/zeisei_k/pdf/zeiseikaisei.pdf (Accessed 10 January 2023)

The applicable period of the special tax measure that grants special tax credit rates and the special measure that grants additional tax credits in the event E&R expenses exceed 10% of average sales will be extended by 3 years. In addition, in the event E&R spending exceeds 10% of average sales and the special measure that grants additional tax credits as a result is also applicable, the resulting maximum tax credit will be compared with the maximum tax credit afforded by the new E&R ratio special tax measure and the larger maximum tax credit will be applied. In regard to other measures, the special tax measure which provided additional tax credits to companies whose sales reduction rate against the sales of their base fiscal year was 2% or more will be abolished at the conclusion of its applicable period.

For the incentive tax credit limit currently set at 25% of corporate tax liability, a new variable mechanism will be introduced which will range between 20% and 30% depending on the E&R ratio. Companies that have been unable to increase their tax credits due to being at the tax credit ceiling are expected to see a significant increase in their tax credits.

On the other hand, with the tax credit range affected by the E&R ratio being so wide, more effort than ever before will be required for keeping track of and understanding actual E&R spending.

In addition, whichever resulting tax credit is larger between the variable E&R special measure and the 10% of average sales special measure will be the tax credit that is applied.

Revisions to the scope of E&R expenses will allow for improving the quality of R&D investments and urging businesses towards discontinuous innovation. Specifically, the scope of applicable big data will be expanded with regard to E&R expenses related to the development of new services by making use of existing big data also applicable (currently only big data that is newly collected and which is used in the development of new services is applicable for treatment as E&R expenses). In contrast, expenses related to designs and prototypes stemming from the development process which are deemed to be costs that are clearly not intended to improve the performance of the relevant product will be excluded from the scope of E&R expenses.

(2) Open innovation tax credits (tax credit rules pertaining to specified E&R expenses)

As with general E&R expenses, specified E&R expense incentives will be revised to promote further innovation. The scope of R&D-based startups will be expanded, and joint or consigned research activities conducted with specified businesses developing new businesses (Note 1) will also be eligible for a tax credit (25%). In addition, the scope of such joint or consigned research will be the same as the current scope of joint and consigned research with R&D-based venture companies.

(Note 1) Specified businesses developing new businesses are businesses stipulated in the Industrial Competitiveness Enhancement Act that meet the following criteria:

- ▶ Companies already engaged in business that contributes to specified business activities under the Act
- ▶ Entities receiving funding from certain investment limited partnerships or from a national research and development agencies (certification of the investor is not required)
- ▶ Entities established for less than 15 years and with a ratio of R&D expenses to sales of 10% or more
- ▶ Management resources must be used for conducting businesses that are expected to be highly productive, or for developing new businesses.
- ▶ Entities who fulfill other criteria than those above with the approval of the Minister of Economy, Trade, and Industry

While companies will need to remain vigilant toward the years of establishment and R&D to sales ratio of eligible investment partners, open innovation with startups is expected to greatly accelerate due the scope of eligible entities greatly increasing (from 200 to over 2000 according to METI documents) as a result of funding from such investors not requiring any certifications.

Similarly, in order to promote the utilization of highly skilled professionals such as advanced degree holders, a new preferential measure will be introduced for certain E&R expenses that satisfy all of the requirements described below. Specifically, certain E&R expenses which are labor expenses related to new highly skilled professionals (Note 2) can be included in specified E&R expenses, and the relevant credit rate will be set to 20%.

- ▶ Research that is conducted by new highly skilled professionals to whom labor expenses are paid
- ▶ The ratio of labor expenses for new highly skilled professionals (Note 3) in the current period / the same ratio from prior period is ≥ 1.03
- ▶ E&R that falls under any of the following categories
 - a Details of the proposed research activities were advertised to the general public or to employees of that company
 - b Details of the research activities were proposed by the new highly skilled professional engaged in the research activities
 - c Persons engaged in the research activities are recruited from the general public or from the officers/employees of that company, and the new highly skilled professional engaged in the research activities was hired via that recruitment

(Note 2) New highly skilled professionals are individuals that fall under any of the following categories.

- a An individual who has been granted a doctoral degree and 5 years have not elapsed since the date that degree was granted
- b An individual who has been exclusively engaged in research work for 10 or more years as an officer or employee of a third-party (excluding those individuals or entities with certain capital relationships with the relevant company) and 5 years have not elapsed since the individual became an officer or employee of the relevant company (including those individuals or entities with certain capital relationships with the relevant company).

(Note 3)

New highly skilled professional labor expense ratio =

$$\frac{\text{Certain E\&R expenses which are labor expenses paid to the new highly skilled professional}}{\text{E\&R expenses which are labor expenses paid to officers and employees of that company}}$$

This is not a general R&D measure but rather an open innovation measure. Examinations required for joint research with universities are likely unnecessary. As the incentive for labor expenses related to new highly skilled professionals is applicable for up to 5 years, it may be possible to cover all of the initial year's labor expenses with the total tax credit amount.

2. Revision of tax incentive to promote open innovation

The tax incentive to promote open innovation, which was introduced in 2020, encourages companies to invest their funds, technology, sales channels, and other management resources into startup companies and engage in business restructuring activities by allowing such companies to deduct from their taxable income their investment amount (equivalent to 25%) in startups.

The acquisition of issued shares was not eligible for this incentive under the current system, but this year's reforms make acquisitions of shares from an individual or entity other than the original issuer, such as a specified business developing new businesses, eligible for the incentive provided a majority of voting rights results from the acquisition, and also sets the upper limit of the acquisition costs at JPY20 billion.

However, this incentive requires meeting certain other requirements, some of which differ from those criteria required by the current system (Note 4). In addition, in the event 5 years have passed since the acquisition of the specified shares, the amount recorded in the specified account will be reversed and included in taxable income. However, this shall not apply if certain requirements are met, such as the sales amount in any fiscal year within 5 years of the acquisition date increases by 1.7x AND reaches JPY3.3 billion or more.

Lastly, the upper limit of the eligible acquisition costs for specified shares acquired via direct capital investments will be reduced to JPY5 billion (currently JPY10 billion).

(Note 4)

- ▶ The minimum expected period of ownership required for specified shares and the period for continuing specified business activities as required for certifications related to specified business activities will be set at 5 years.
- ▶ The acquisition cost requirement will be JPY500 million or more.
- ▶ Specified businesses developing new businesses must be domestic companies.
- ▶ Additional acquisitions via direct capital investments made on or after 1 April 2023 and after the application of this incentive will not be eligible.

As of 1 April 2022, this system has 152 certified cases on record (the total amount of certified investments is approximately JPY42.7 billion). As noted above, the current system did not allow for the acquisition of issued shares, making it a non-factor in the M&A scene. However, it is now possible to take advantage of this tax break provided certain conditions are met. Note that in the event the sales amount in any fiscal year within 5 years of the acquisition date does not increase by 1.7x AND does not reach JPY3.3 billion or more, the acquisition amount must be included in taxable income (leading only to a deferral of taxes rather than an income deduction).

3. Revision of spin-off tax rules

For the period between 1 April 2023 to 31 March 2024, in the event a company that has received approval for a business restructuring plan as stipulated by the Industrial Competitiveness Enhancement Act makes a distribution-in-kind conducted as a specified dividend of surplus wherein shares of a wholly-owned subsidiary are transferred, that distribution will be treated as a share distribution. In addition, such distribution-in-kind will be treated as a qualified share distribution provided the following conditions are met.

- (1) Only shares of the subsidiary are issued, according to the number of shares held by the shareholders in the company which executes the distribution-in-kind
- (2) The number of shares in the wholly-owned subsidiary held immediately after by the company executing the distribution-in-kind are less than 20% of total issued shares
- (3) 90% or more of directors and employees of the wholly-owned subsidiary are expected to continue working there after the distribution
- (4) Criteria required by the qualified share distribution rules are also met, such as the non-controlling relationship requirement and the primary business continuity requirement
- (5) Other conditions are met, such as the grant of stock options or expectation to grant stock options to specified managing directors or officers of related business operators or foreign related companies

The current system required the original parent company to distribute all of its shares in a wholly-owned subsidiary. The new measures will allow for the parent company to retain a portion of shares in the company (less than 20%) and still apply the qualified share distribution measure provided certain requirements are satisfied. However, the relevant plan must be certified between the period of 1 April 2023 to 31 March 2024.

Spin-offs conducted after the relevant period will still be eligible for the measure provided certification was obtained during the relevant period. As this measure is temporary and requires prior certification to be applied, it is important to stay up-to-date on future tax reforms that may extend or relax these measures for 2024 onwards.

4. Revision of crypto asset mark-to-market valuation methodology

Until now, crypto assets held at the end of a period by a company were subject to taxes based on mark-to-market valuation. However, mark-to-market valuation will no longer be required for the below crypto assets that are expected to be held long-term.

- A) Crypto assets issued by the company itself which are held continuously since issuance, or;
- B) Crypto assets held continuously since issuance which are subject to transfer restrictions due to technical measures or certain trusts

In addition, in the event that a corporation transfers crypto assets borrowed from a party other than a crypto asset exchange service provider and does not repurchase crypto assets of the same type as those borrowed by the end of the fiscal year in which the date of transfer occurs, the repurchase of those crypto assets will be deemed to have occurred and an amount equivalent to the calculated gain or loss must be recorded.

The mark-to-market valuation of crypto assets at the end of a period has been called out as a major hindrance to entrepreneurship and business development in blockchain technology. This new measure will exclude those crypto assets held continuously by companies and encourage the expansion of business opportunities in the blockchain industry.

5. Other

► Donations made to the establishment of educational institutions

Donations made to certain newly established higher education institutions that meet all of the following requirements are fully deductible as designated contributions.

- (1) Expenditures made between the date the higher education institution submits its application to the Minister of Finance until 31 March 2028
- (2) Donations made upon confirmation that the establishment of the higher education institution has been approved prior to its establishment, and such a donation was allotted to cover costs associated with the establishment
- (3) A provision also exists in the program guidelines which allows for the remaining balance of the donation to be donated to a national or local government in the event approval for establishment of the institution is not acquired within a specified period of time

This measure encourages companies to employ their management resources for educational purposes and is in response to the realization that strengthening productivity within Japan requires further reforms in educational settings tasked with developing a work force that can successfully contribute to society.

► Special measure for transfer of shares treated as consideration

In regard to the special measure for calculating income relating to the transfer of shares in which the shares are treated as consideration, instances in which the share-granting parent company is considered a family corporation (excluding certain family corporations) after a share issuance that takes place on or after 1 October 2024 will be excluded.

This measure imposes certain restrictions on consolidating shares in an asset management company by owner companies that make use of the share issuance regime.

▶ **Digital transformation (DX) investment promotion tax incentive**

The 2021 tax reforms introduced a measure that allows for special depreciation or a tax credit to be taken for acquisitions of software used in accordance with a certified business plan for the creation of certain digital technologies. This measure will be extended for 2 years and revised as detailed below.

Requirements	Proposed reforms
Criteria for business information	The overseas sales ratio of the eligible entity is expected to exceed a specified ratio
Criteria for productivity improvement or development of new demand	The sales of the eligible entity are expected to increase 10% or more

These requirements will not be applicable to assets acquired on or after 1 April 2023 in relation to business adaptation plans that were submitted for certification before the same date.

DX certification will continue to be required in order to have business adaptation plans certified. In addition, new requirements regarding the development and hiring of personnel for digital activities have been added to the DX certification requirements in accordance with amendments to the Digital Governance Code. Companies aiming to receive DX certification should be aware of these new requirements.

▶ **Extension of special measure on replacement of specified assets**

The special measure for taxation of the replacement of specified assets will be revised and extended by 3 years.

▶ **Extension of special measure for SME corporate tax reduction**

The special measure for the reduction of the corporate tax rate of SMEs (15% of annual income of JPY8 million or less) will be extended by 2 years. In addition, the investment tax incentive, SME business enhancement tax rules, and other measures will be extended by 2 years upon the revision of certain application requirements.

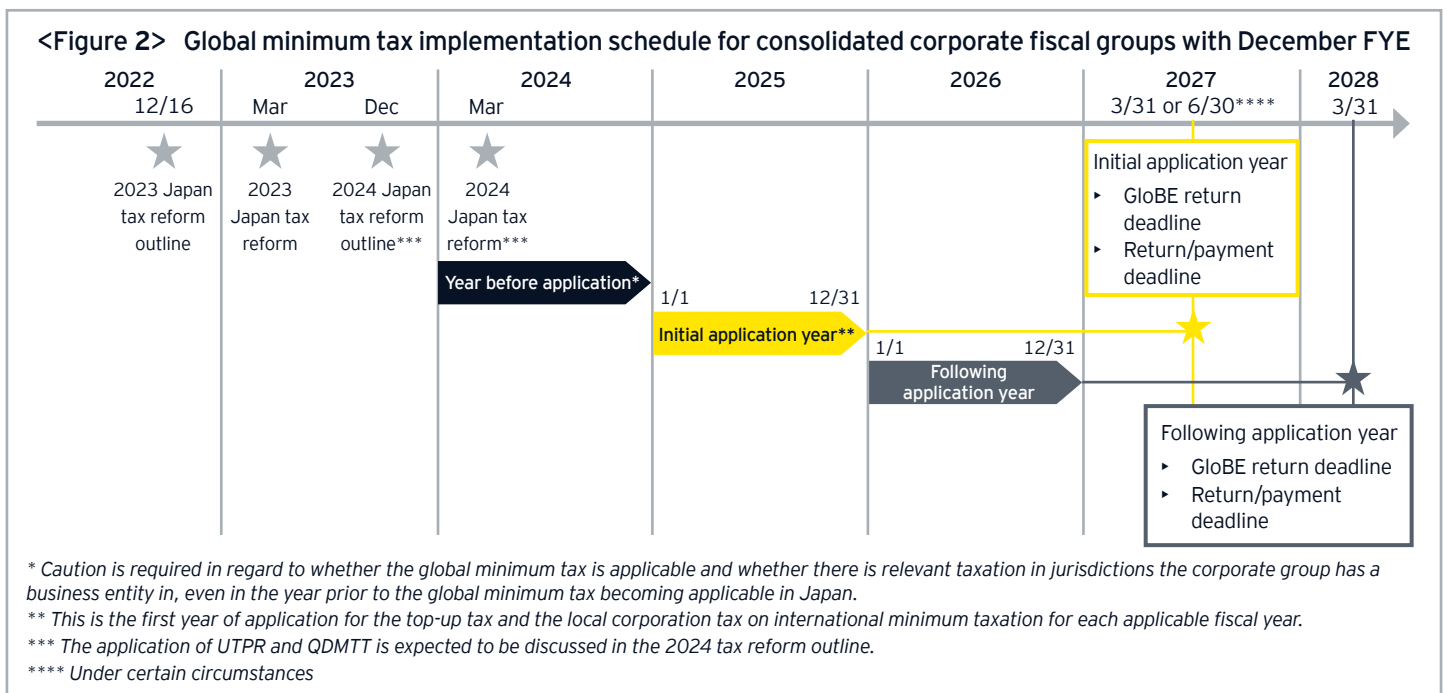
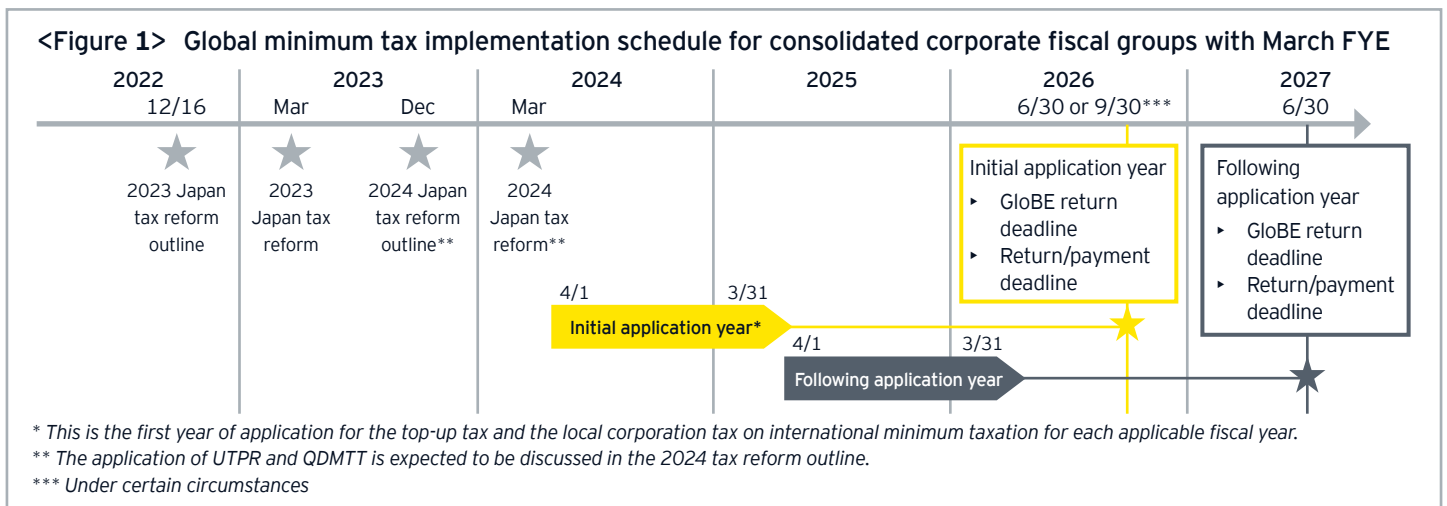
▶ **Tax incentive to enhance SMEs' technology infrastructure**

In regard to the tax incentive to enhance SMEs' technological infrastructure, certain revisions will be implemented, and its duration will be extended by 3 years. However, the special measure which allows for increasing the upper limit of the deductible amount in cases where a company's sales reduction rate against the sales of their base fiscal year equals 2% or more will be abolished at the end of the measure's duration.

International taxation

1. Introduction of global minimum tax

In October of 2021, an international agreement was made based on the OECD/G20 Inclusive Framework on BEPS in an effort to tackle the tax challenges posed by the digitalization of the economy. This international agreement consisted of two pillars - the provision of new taxing rights to market jurisdictions (Pillar 1) and a global minimum tax (Pillar 2). The 2023 tax reform introduces legislation for the Income Inclusion Rule (“IIR”) of Pillar 2, while taking into account the latest discussions on the topic within the international community, as well as the trends of other countries engaged in the same process. 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 be applicable to fiscal years beginning on or after 1 April 2024. Please refer to figures 1 and 2 for the application schedules of fiscal years ending in March and December, respectively.



(1) Establishment of assessment of top-up tax for each applicable fiscal year (national taxes)

New measures will be established for the assessment of a top-up tax assumed as corporate tax (national tax) for each applicable fiscal year (hereinafter “corporate top-up tax”).

Domestic corporations that belong to multinational enterprise groups (“Specified MNE Groups”) with annual gross revenue equivalent to EUR750 million or more in at least two of the four most recent applicable fiscal years immediately preceding an applicable fiscal year will be subject to a corporate top-up tax. Public interest corporations will be excluded from this obligation.

The global minimum tax is a tax mechanism based on the income earned by corporations located in foreign countries. Local taxes such as corporate inhabitant tax and corporate enterprise tax (including specified corporate enterprise tax) are not assessed as benefits from administrative services of local government agencies are not received in relation to being subject to such taxes. Based on current tax rates, the global minimum tax rate shall be set so that the tax amount assessed for corporate tax and local corporate tax will equal a ratio of 907:93. The corporate top-up tax is calculated by multiplying the taxable base by a tax rate of 90.7/100.

The filing and payment deadline of top-up tax is within 1 year and 3 months (1 year and 6 months in certain cases) from the day following the end of each applicable fiscal year. However, relevant filings are unnecessary if there is no top-up tax in the applicable year. Specific electronic filing measures, inquiries, and relevant penalties will apply in the same manner as corporate tax.

(2) Top-up tax (taxable base)

The top-up tax is the amount derived from multiplying the attribution ratio calculated from the ownership interest of domestic companies against the top-up taxes by company of the Specified MNE Group which are top-up taxes of the JV group and top-up taxes other than the amount of the JV group. Joint venture companies are equity-method companies on the consolidated financials of the ultimate parent company and entities which the ultimate parent company directly or indirectly holds at least 50% of ownership interest in, consolidated entities for such entities, and permanent establishments of such entities.

① Calculation of group top-up tax

The group top-up tax is the sum of the top-up tax (other than the amount of JV group) and the top-up tax amount of the JV group. In addition, the latter calculation is essentially identical to the former calculation.

Please refer to Figure 3 for the calculation of top-up tax (other than the amount of JV group)

In the event the effective tax rate (ETR) for a jurisdiction, which is the ratio of the sum of the adjusted covered taxes of each constituent entity located in the jurisdiction and the net GloBE income in the jurisdiction, falls below the minimum tax rate of 15%, the top-up tax will be derived by adding the three amounts (A+B+C) described below and deducting from that sum the qualified domestic minimum top-up tax: The amount derived from subtracting the substance-based income inclusion (5% of certain payroll and other expenses and 5% of certain tangible and other assets: transitional measures exist for the relevant ratio) (Figure 4) from the net GloBE income of the jurisdiction and multiplying the resulting amount with the amount derived from subtracting the ETR for a jurisdiction (Note) from the minimum tax rate of 15% (A); the recalculated top-up tax for a jurisdiction in the event recalculation is required (B); the international minimum tax on undistributed income in the event the taxable distribution method is applied to an investment entity (C).

Investment entities refers to insurance investment companies, investment companies, real estate investment companies, and certain companies that are directly or indirectly owned by investment companies or real estate companies.

Note: The ratio of the adjusted covered taxes of each constituent entity located in the jurisdiction contained within the net GloBE income of the jurisdiction.

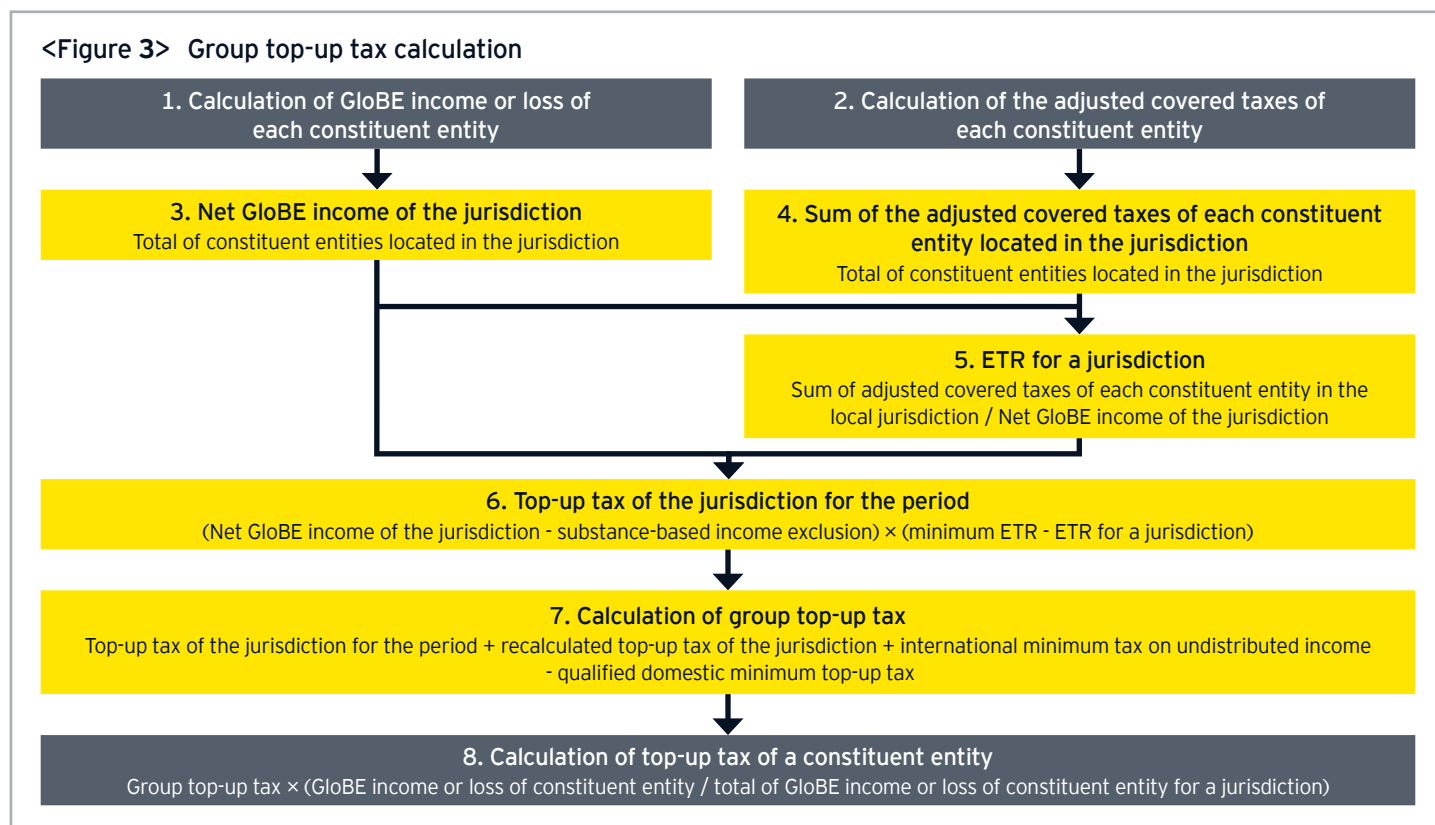


Figure 4: Ratios used in calculation of substance-based income exclusion (transitional measures)

	Certain amount of payroll and other expenses	Certain amount of tangible and other assets in tangible fixed assets
Fiscal years beginning between 1 April 2024 and 31 December 2024	9.8%	7.8%
Fiscal years beginning in 2025	9.6%	7.6%
Fiscal years beginning in 2026	9.4%	7.4%
Fiscal years beginning in 2027	9.2%	7.2%
Fiscal years beginning in 2028	9.0%	7.0%
Fiscal years beginning in 2029	8.2%	6.6%
Fiscal years beginning in 2030	7.4%	6.2%
Fiscal years beginning in 2031	6.6%	5.8%
Fiscal years beginning in 2032	5.8%	5.4%
Fiscal years beginning from or after 2033 (post-transitional measures)	5%	5%

Calculations are done for each constituent entity, including minority-owned constituent entities, minority-owned parent entities, minority-owned subsidiaries, and investment entities of which the ultimate parent entity holds at least 30% ownership interest in. Calculations are also done for each stateless constituent entity among the constituent entities, but the substance-based income exclusion is not applicable to such entities.

② **Calculation of the top-up tax of a constituent entity**

The top-up tax of a constituent entity is calculated by multiplying the group top-up tax by the percentage it holds out of the total amount of GloBE income or loss for all constituent entities located in the same jurisdiction as the constituent entity.

③ **Top-up tax calculation**

The top-up tax is calculated by multiplying the top-up tax of a constituent entity by an attribution rate derived from the direct or indirect ownership ratio of an ultimate parent company, intermediate parent company (not owned by an ultimate parent company subject to a tax equivalent to the top-up tax), or partially owned parent company. A partially owned parent company is defined as a constituent company in which an entity other than the constituent company directly or indirectly holds a certain percentage of ownership interest exceeding 20%.

④ **Calculation of GloBE income or loss of a constituent entity**

The GloBE income or loss of a constituent entity is calculated by determining the amount to be attributed to the permanent establishment from the net income or loss of the constituent entity which is used to prepare the consolidated financial statements of the ultimate parent company, adjusted to exclude the amount of dividends received in relation to the ownership interests held by the constituent entity for 1 or more years or for other ownership interests of a certain percentage or international shipping income earned.

Permanent establishment refers to a location where a company's business is conducted which is located in a jurisdiction other than the jurisdiction in which the company is domiciled ("other country"). This includes the following locations:

- 1) A location where business is conducted and income derived from the business of such permanent establishment is assessed tax by the other country in accordance with a tax treaty.
- 2) A location where business is conducted and income derived from the business is assessed tax by the other country in absence of a tax treaty.
- 3) In the event corporate tax is not assessed by the other country and all or a portion of the income derived from the business falls under the income attributable to a permanent establishment as described by Article 7 of the OECD Model Tax Convention, a location where the business is conducted under the category of permanent establishments as described in Article 5 of the OECD Model Tax Convention.
- 4) In the event a location in the other country where business is conducted does not fall under the above three criteria and when the country in which the company is domiciled does not assess tax on income derived from such business conducted, a location in the other country where such business is conducted.

⑤ **Calculation of the adjusted covered taxes of each constituent entity**

The sum of the adjusted covered taxes of each constituent entity is the base tax that should be used to calculate the ETR for a jurisdiction. The adjusted covered taxes are determined by calculating the covered tax on the net income or loss for the period (corporate tax and other certain taxes) and the adjustments to the covered taxes derived from the application of accounting for income taxes with adjustment of covered taxes on the net income or loss for the periods which are attributable to the permanent establishment and allocation of the taxes imposed on the constituent entity's income by CFC inclusion rules or other equivalent tax rules to the constituent entity.

⑥ **Exemptions**

In the event the average jurisdictional revenue for the applicable fiscal year and the two applicable fiscal years immediately prior to that year is calculated to be less than EUR10 million, AND the average profit or loss for those same years is calculated to be less than EUR1 million, the jurisdictional top-up tax for the country in which the constituent entity is domiciled will be treated as 0.

⑦ **Safe harbor for CbCR reporting items**

Transitional exemption criteria using certain information for CbCR reporting will be established.

⑧ **Other**

The top-up tax for each applicable year will not be subject to the blue-form tax return regime. However, it will be subject to a statement of reasons for corrections but will not be subject to presumptive taxation. Inquiries and penalties will apply to the income of each fiscal year in the same manner as corporate tax, and other necessary measures will be established.

(3) Establishment of local corporate tax on international minimum taxation (national tax)

A local corporate tax on international minimum taxation (hereinafter "local tax on IMT") will be established to coincide with the implementation of the top-up tax.

The top-up tax amount for each applicable fiscal year of a domestic company belonging to a Specified MNE Group will be used as the specific corporate tax basis and will be assessed a local corporate tax. The local tax on IMT is calculated by multiplying the specific corporate tax basis from each applicable fiscal year (taxable base) by 93/907. Furthermore, the corporate tax amount used to calculate corporate inhabitant tax will not include any top-up taxes.

The filing and payment of local tax on IMT is within 1 year and 3 months (1 year and 6 months in certain cases) from the day following the end of each applicable fiscal year. The special measure for electronic filing will apply in the same manner as local corporate tax.

(4) Establishment of GloBE information return regime

① Outline

A domestic company that is a constituent entity belonging to a Specified MNE Group must submit via e-Tax an information return on the Specified MNE Group, which includes required information such as names of constituent entities in the same group, jurisdictional ETRs by entity, group top-up taxes, requests for the application of exemptions, etc., to the director of the competent tax office within 1 year and 3 months (1 year and 6 months in certain cases) from the day following the end of each applicable fiscal year.

The return must be prepared in English and may be submitted by one entity on behalf of multiple entities obligated to submit the return. Penalties will apply for failure to submit or fraudulent submissions.

② Exemption from submission obligation

A domestic company will be exempt from the obligation to submit the information return of the Specified MNE Group provided the tax authority of the foreign country in which the ultimate parent company or company designated as the ultimate parent company is domiciled can provide the Japanese tax authorities with the information return.

However, a domestic company exempted in this manner will be required to submit via e-Tax the notification of information regarding the ultimate parent company to the tax director of the competent tax office within 1 year and 3 months (1 year and 6 months in certain cases) from the day following the end of each applicable fiscal year.

Items for consideration in 2024 tax reform or after

Items expected to be discussed by the OECD in detail during 2023, such as the qualified domestic minimum top-up tax (QDMTT) and the undertaxed profits rule (UTPR), are being considered for legislation in the 2024 tax reform at the earliest.

The following items are being considered for the handling of national and local taxes once Pillar 2 is implemented.

The IIR and UTPR are tax mechanisms based on the income taxes assessed on corporations located in foreign countries. Local taxes such as corporate inhabitant tax and corporate enterprise tax (including specified corporate enterprise tax) are not assessed as benefits from administrative services of local government agencies are not received in relation to being subject to such taxes. Based on current tax rates, the global minimum tax shall be set so that the tax amount assessed for corporate tax and local corporate tax will equal a ratio of 907:93.

The QDMTT is a tax mechanism based on income earned by domestic companies. As benefits from administrative services of local government agencies are received in relation to being subject to taxes, the QDMTT will be implemented based on the ratio of national and local taxes (a breakdown of the 29.74% statutory corporate effective tax rate). In an effort to simplify the system, the amount of corporate inhabitant and enterprise taxes imposed by the QDMTT will be included in local corporate tax and assessed/collected by the national government. It is then expected to be distributed to local governments via local tax allocations. In light of this, the ratio of corporate tax to local corporate tax will be set to 753:247.

In accordance with the goal of having a multilateral convention related to Pillar 1 agreed upon by the first half of 2023, various items are expected to be considered in the future, such as how taxation should be handled for taxing rights allocated to Japan as a market jurisdiction, how taxation should be handled when taxation rights are provisioned to local government agencies, and how double taxation should be exempted under relevant treaties.

2. Revision of foreign subsidiary income inclusion tax rules (CFC rules)

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. These revisions will go into effect for fiscal years starting on or after 1 April 2024 to coincide with the implementation of Pillar 2.

(1) Reduction of trigger tax rate of a specified CFC

Under current rules, a specified CFC (paper company, cash box, black-listed company) would be excluded from full income inclusion provided its tax burden rate was 30% or more. This tax burden rate (trigger rate) of 30% will be lowered to 27% or more with the reform.

(2) Relaxation of documentation related to foreign related companies required for filings

Domestic entities must attach financial statements or other documentation of certain foreign related companies to their final tax returns. Documentation related to the following foreign related companies partially subject to CFC rules will no longer be required to be attached to filings and will now only be required to be retained.

- 1) Foreign related companies partially subject to CFC rules without partial income inclusion amounts
- 2) Foreign related companies excluded from the CFC rules as a result of meeting certain criteria, such as having partial income inclusion amounts of JPY20 million or less

In regard to the information, such as direct or indirect shareholder information, that is to be included in the documents related to a foreign related companies which must be attached to tax filings, such information can now be represented in whole or in part by diagrams and figures which systemically show the relationships between foreign related companies and shareholders.

(3) Other

Other necessary measures in addition to the above will also be established.

(4) Application

These revisions will apply to fiscal years beginning on or after 1 April 2024.

The reduction of the tax burden rate will lighten the administrative burden of companies related to the confirmation of applicable countries. In addition, paper companies located in jurisdictions where the statutory tax rate is 27% or higher, such as the United States (California and other states) and Germany, may be excluded from being subject to entity-basis income inclusion.

However, entities located in jurisdictions in which they are subject to consolidated or pass-through taxation will need to prepare calculations under the assumption that these tax rules do not apply. In particular, extra caution should be paid to US state taxes as state tax calculations can be complex.

These revisions were also implemented with the aim of reducing any additional administrative burdens stemming from the implementation of Pillar 2 placed on applicable companies. Accordingly, these measures will commence at the same time as the IIR and will apply to fiscal years beginning on or after 1 April 2024 for domestic corporations (note that these reforms are based on the fiscal year of domestic corporations, whereas the revisions to CFC rules in previous years were often based on the fiscal years of foreign the related companies).

As noted on pages 7 to 9 of Japan's ruling coalition party's reform outline, further reforms which coincide with the enactment of Pillar 2 are likely to be considered in the future. As such, it is important to keep an eye on future developments in this space.

3. Other

A temporary measure exists which provides tax exemption rules for the special measure for interest related to a bond repurchase agreement-related transactions between a specified foreign company and a specified financial institution. As the duration of these rules will expire on 31 March 2023, this reform will extend the effective period for 3 years.

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. Specific details are as described below.

- (1) The ordinary NISA account from the prior system will be replaced by a growth-type investment framework, and the accumulation NISA account will be replaced by an accumulation-type investment framework. The prior system did not allow the use of both NISA account types, but the new system will allow individuals to use both the growth-type investment framework and the accumulation-type investment framework simultaneously.
- (2) The prior system had a deadline of 2023 for the ordinary NISA account and 2042 for the accumulation NISA account. The new system will make NISA itself permanent.
- (3) The prior system had tax-free holding periods that expired in 5 years for the ordinary NISA account and 20 years for the accumulation NISA account. The new system will make the tax-free holding period indefinite.
- (4) The annual maximum investment amount will be raised to JPY1.2 million for accumulation-type investments and JPY2.4 million for growth-type investments. The two accounts can be held simultaneously with a combined annual maximum investment amount of JPY3.6 million.
- (5) The prior system had a tax-free lifetime investment limit of JPY6 million for the ordinary NISA account and JPY8 million for the accumulation NISA account. The new system will set the limit to JPY18 million, of which JPY12 million will be allotted for growth-type investments. The lifetime investment limit will also be managed using the total of acquisition costs.
- (6) Amounts invested under the prior system until the end of 2023 will not be included in the tax-free lifetime investment limit under the new system and will continue to be subject to treatment under the prior system.

Item	Prior System		New System	
	Ordinary NISA	Accumulation NISA	Accumulation-type framework	Growth-type framework
Maximum annual investment amount	JPY1.2 million	JPY400,000	JPY1.2 million	JPY2.4 million
Tax-free lifetime limit	JPY6 million	JPY8 million	JPY18 million (JPY12 million of growth-type investments)	
Tax-free holding period	5 years from opening account	20 years from opening account	Indefinite	Indefinite
Investment period	Max 5 years	Max 20 years	Indefinite	Indefinite
Choice of accounts	None (only one account)		Yes (both accounts simultaneously)	



In an effort to achieve the Doubling Asset-based Incomes Plan and accelerate the transition from savings to investments, these reforms center around middle-income taxpayers and foster an environment in which they are encouraged to participate in many aspects of the capital market and can enjoy the benefits of their investments.

2. Revision of inheritance tax and gift tax

Revisions to both inheritance and gift tax will be implemented.

(1) Taxation system for settlement at the time of inheritance

In regard to the gift tax for the year in which assets were gifted from a specified gift-giver to an individual subject to the taxation system for settlement at the time of inheritance, a standard deduction of JPY1.1 million will now also be available in addition to the JPY25 million standard deduction which exists under the current inheritance settlement system. Under this revision, gift tax filings will not be necessary for gifts valuing JPY1.1 million or less.

Note: The above reforms will be applied to inheritance or gift tax assessed on assets received as gifts on or after 1 January 2024.

(2) Add-back for gifts prior to death

Currently, heirs of a decedent who received gifts from the decedent within 3 years prior to the death must add the value of such gifts back to the taxable estate for inheritance purposes. This 3-year period will be extended to a 7-year period with the current revisions.

Note: The above reforms will be applied to inheritance tax assessed on assets received as gifts on or after 1 January 2024.

(3) Other

In regard to the tax breaks for lump-sum gifts of educational funds, wedding gifts, and child-rearing funds, certain improvements will be made and applicable periods extended.

It is necessary to create tax regimes that support the neutral timing of asset transfers and promote early asset transfers across generations while reinforcing an asset's primary function of being redistributable. These revisions aim to accomplish this goal.

3. Revision of qualified invoice system

The qualified invoice system (qualified invoice retention method) for consumption tax will go into effect from October of 2023. The below tax measures will be enacted to ensure companies have a smooth transition to the new system and to reduce any additional administrative burden that may be incurred.

(1) Transitional measures for small-scale enterprises who become qualified invoice issuers (20% special measure)

In the event a tax-exempt enterprise becomes a qualified invoice issuer or submits an election to forfeit tax-exempt status during the tax period which includes the dates between 1 October 2023 and 30 September 2026, such enterprise will be allowed to treat the amount to be deducted from the consumption tax levied on the taxable base of that period as equal to 80% of the total consumption tax levied on the taxable base, thereby allowing the consumption tax liability to be set at 20% of the consumption tax on the taxable base.

(2) Reduction measure for administrative burdens incurred by small and medium enterprises with less than JPY10,000 of sales

For enterprises with JPY100 million or less in sales during the base period (or JPY50 million or less during the specified period), this measure would allow such enterprises to take a deduction for the input taxes related to purchases occurring within Japan of less than JPY10,000 during the period between 1 October 2023 and 30 September 2029, while only being required to retain accounting books that contain certain details.

Acquisition and retention of invoices for sales less than JPY10,000 during the relevant period would not be necessary.

(3) Revision of obligation to issue refund invoices

The obligation to issue a qualified refund invoice will be discontinued for refunds of sales of less than JPY10,000.

This revision will apply to refunds of sales of all taxable transfers of assets on or after 1 October 2023.

(4) Revision of qualified invoice issuer registration system

Revisions will be implemented for the transitional measures applied to registrations related to registering as a qualified invoice issuer or requesting cancellation of registration.

In light of the goals of the above revisions, enterprises that attempt to register as qualified invoice issuers from 1 October 2023 and write "difficult circumstances" on a registration application submitted after the deadline will not be requested again to include such reason even if such reason was not originally included.

4. Creation of tax incentive to spur re-investment in startups

A special measure will be established to allow certain residents who acquired shares (specified shares) issued at the time of the establishment by an incorporated company that met certain requirements in the year which contains the date of its establishment to deduct the total amount required for the acquisition of the specified shares from the gain on transfer resulting from the transfer of shares in the year of acquisition (limited to the total amount of gain on transfer for the relevant year). The acquisition cost of the acquired specified shares will be the amount derived from deducting the amount that exceeds JPY2 billion after the relevant deduction from the amount required for the acquisition.

Note: This special measure is applied as an option under the angel investor tax rules.

5. Extension of the exercise period within stock option rules

In regard to the exemption from taxation of economic benefits relating to the acquisition of shares via the execution of share acquisition rights received by a specified director (stock option rules) and in addition to other necessary measures, a measure will be implemented that changes the requirement that the exercise of relevant stock acquisition rights must take place no later than 10 years after the date of the resolution granting such stock acquisition rights, which is a requirement stipulated in applicable contracts relating to stock acquisition rights, to a requirement that the stock acquisition rights granted by certain incorporated companies must be exercised no later than 15 years after the date of the resolution granting such stock acquisition rights.

In addition to "4. Creation of tax incentive to spur re-investment in startups" and "5. Extension of the exercise period within stock option rules," the latest revision includes relaxation measures for requirements of the angel investor tax rules. These measures aim to stimulate the growth in the establishment and business development of startups. The "Startup Development Five-Year Plan" was formulated with the goal of increasing the scale of investments in startups to JPY10 trillion yen in five years by FY2027, and tax measures are also mentioned in the plan.

Cabinet Secretariat Startup Development Five-Year Plan https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugij/kaigi/dai13/shiryoku1.pdf (accessed 10 January 2023)

Cabinet Secretariat Startup Development Five-Year Plan Roadmap

https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugij/kaigi/dai13/shiryoku2.pdf?fbclid=IwAR2wmuTjolBCIn7dIM2ZtjXxJM-ixt-AGbuTtqmCarhMPT7E5UxHY8jxQA (accessed 10 January 2023)

In regard to section 5. above, page 13 of the "2023 tax reform discussions for economies and industries" published by the Ministry of Economy, Trade, and Industry in December of 2022 states that, in addition to the extension of exercise periods, revisions to entrustment of custody requirements are also being considered and are expected to apply to unlisted companies as well.

6. Strengthened taxation on the income of high-net-worth individuals

In order to optimize the tax burden of high-net-worth individuals, a new measure will be implemented for instances in which the amount of income calculated by deducting JPY330 million from an individual's standard taxable income for the year 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. This reform will apply to individual income taxes from 2025.

7. Other

(1) Consumption tax related to duty-free shops

In regard to the consumption tax exemption rules for foreign tourists (duty-free shop system), in the event of tax-exempt purchase of goods takes place without the approval of the district director of the tax office, the transferee of such transferred goods will be jointly and severally obligated to pay the exempted taxes along with the transferor.

(2) Revision of exit tax rules

In regard to the tax grace period in the event an individual is subject to the special measures concerning capital gains upon departure from Japan (exit tax), if such individual wishes to apply for the tax grace period by providing unlisted shares or other items as collateral that satisfy the requirement of there being no established pledge on the collateral, and such individual submits certain documents to the district director of the tax office, the collateral may be provided without the issuance of share certificates.

| Tax administration and other items

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

(1) Revision of the scope of eligible electronic books

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 taxes will be streamlined and clarified.

Prior to these revisions, all books preserved under this tax law were required to meet the requirements of books eligible for the reduction of penalties. With these new revisions, the scope of books that must meet these requirements will be limited. For corporate tax purposes, wage ledgers and other certain items are no longer required to be included in the records relating to purchases and other expenses or costs.

This reform will be applied in concern to national taxes for which the statutory filing due date arrives on or after 1 January 2024.

(2) Relaxation of scanned document preservation rules

Scanned document preservation rules for national taxes have been revised as follows.

- 1) Abolishment of information retention requirements related to resolution, gradation, and size of scanned documents related to national taxes
- 2) Abolishment of the requirement to confirm information about the individual who records information related to national taxes
- 3) Limitation of the inter-relationship requirement (to only important documents such as agreements and receipts) regarding the ability to confirm the inter-relationship of items recorded related to national taxes recorded in books related to national taxes

Note: The above revisions will apply to documents that are preserved on or after 1 January 2024.

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

- 1) The following measures will be implemented for the requirements of electronic book preservation.
 - a) In regard to the measure that makes the search requirements unnecessary for individuals obligated to preserve electronic books who can download electronic books upon request from a national tax employee in conjunction with an audit or inquiry, the applicable scope will include the following.
 - i) Sales are JPY50 million or less in the determination period (Currently JPY10 million or less)
 - ii) Individuals obligated to preserve electronic books who present or provide paper documents of electronic records upon request (limited to documents exported in a clear manner and organized by transaction dates, parties, etc.)
 - b) The requirements to confirm information of the individual that retains electronic books will be abolished.
- 2) As a safe harbor measure for an individual obligated to preserve electronic books but unable to do so in accordance with the requirements of the electronic book preservation requirements due to reasonable grounds, such individual will be able to preserve electronic books of electronic transactions related to income and corporate tax regardless of said requirements, provided a competent tax office affirms the reasonable grounds for failure to preserve electronic books related to transaction information, and such individual can download electronic books and can present or provide paper documents (exported in a clear and organized manner) upon request in conjunction with an inquiry or audit.

3) The safe harbor measure implemented to ensure the smooth transition to electronic book preservation will be abolished at the end of its duration.

Note: The above revisions will apply to information related to electronic transactions which are electronically preserved on or after 1 January 2024.

In regard to the abolishment of the measure for paper retention of information related to electronic transactions, the safe harbor measures introduced in 2022 will expire as of 31 December 2023. In its place a new safe harbor measure will be implemented for individuals that are unable to comply with the electronic book preservation system under reasonable grounds. These revisions intend to clarify that safe harbor measures can be applied flexibly to individuals who were unable to comply with the system and enjoyed the previous safe harbor measure, regardless of whether there are "unavoidable circumstances."

The new safe harbor measure includes requirements for paper retention as well as the ability to respond to requests for downloading of the records.

Appropriate data retention locations and methods must be reconsidered in order to reliably respond to tax examinations requests for the presentation and provision of relevant data. Alongside revisions to the scope of eligible electronic books and the relaxation of scanned document preservation rules, these revisions to retention rules will likely increase the number of new companies that use these tax regimes.

2. Revision of penalties

The failure to file additional tax rate (currently 15% (20% for the portion of tax liabilities exceeding JPY500,000)) will be raised to 30% for the portion of tax liabilities exceeding JPY3,000,000. Furthermore, for taxpayers who are subject to additional taxes for failure to file or heavy additional taxes (penalties) for fraudulent or deceptive tax filings in relation to national taxes for the prior year and the year prior to that year, a measure will be established that assesses an additional tax of 10% on the current year's additional taxes or fraud penalties.

Note: The above reform will be applied in concern to national taxes for which the statutory filing due date arrives on or after 1 January 2024.

The above measures will be implemented for instances in which a taxpayer has failed to file a tax return and penalties for acts of disguise or concealment do not necessarily apply, but it can be concluded that the taxpayer was not unaware of their obligation to file a tax return.

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

A new surtax ranging from 4% to 4.5% on corporate tax liability amounts will be introduced in order to reliably secure the funding required to bolster the nation's defense capabilities. In regard to income tax, a new 1% surtax on income tax liability amounts will be assessed for the time being. The reconstruction income tax will be lowered by 1%, but its duration will be extended. In addition, a measure with certain tax increases on tobacco will be put in place.

Note: The implementation of these above measures is expected to be at an appropriate time in 2024 or later.

4. Eco-car tax incentives

The current eco-car tax incentives will stay in place until 31 December 2023, after which certain revisions will be implemented and its duration will be extended to 30 April 2026.

5. Other topics

- ▶ In regard to enterprise taxes from business scale taxation, as a result of capital reductions and company reorganizations, there have been problematic reductions in the number of companies subject to the tax and the overall scope of the tax's application.
 - The Outline notes that the government will continue to carefully consider what the ideal scope and application of the business scale taxation is in the future, while taking into consideration its impact on regional economies and corporate management.
- ▶ In regard to the valuation of condominiums for inheritance tax, optimizations are being considered in light of discrepancies between the market valuation principle used in inheritance tax law and actual market prices.



@Japan_EY

Follow us for the latest tax news.

Comments or general inquiries regarding this tax newsletter may be directed to our Brand, Marketing and Communications team at tax.marketing@jp.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

About EY's Tax services

EY's tax professionals in Japan provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. Our highly regarded tax professionals operate in four major cities in Japan. Our talented people, consistent methodologies and unwavering commitment to quality service help you to build the strong compliance and reporting foundations and sustainable tax strategies that help your business succeed. For more information, please visit ey.com/en_jp/people/ey-tax.

©2023 Ernst & Young Tax Co.
All Rights Reserved.

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com/en_jp