11 March 2024

Japan tax newsletter

Ernst & Young Tax Co.

2024 Japan tax reform outline

- translation of Japan tax newsletter which was issued on 16 Jan 2024

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On 14 December 2023, Japan's ruling party (a coalition comprised of the Liberal Democratic Party and Komeito) released the 2024 Tax Reform Outline (below "the outline"). This newsletter provides an overview of the major amendments and revisions contained in the outline.

The 2024 tax reform has labeled the challenge of sustaining wage growth in a manner that outpaces inflation as one of its key priorities. To achieve this crucial task, this year's reform proposes a one-time fixed amount reduction of individual income and inhabitant tax, as well as the strengthening of incentives which encourage companies to increase wages. Another goal of this year's reform is the strengthening of supply capacity through promoting the accumulation of capital and further improving productivity. On these fronts, measures such as a tax credit regime to promote domestic production in strategic industries and an "Innovation Box" regime will be introduced. Also, measures to significantly enhance the startup ecosystem will be implemented.

Furthermore, tax revisions will be introduced to increase the public's trust in Japan's tax system and to address the economic and social structural changes affecting Japan and the international community, including declining populations and economic globalization. The government is actively implementing a host of initiatives to combat the declining birthrate, with various measures designed to aid taxpayers who are parents also being implemented across the tax system. Finally, in an effort to respond to the issue of globalization, the global minimum tax ("GMT") will be gradually legislated upon, and new systems such as platform taxation will also be introduced.

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

EY

Building a better working world

Corporate taxation

1. Tax incentives encouraging wage increases

In order to achieve wage increases that can outpace inflation, large enterprises, medium-sized enterprises, and SMEs will be divided into three categories for tax incentives encouraging wage increases, and revisions and enhancements to credits and other incentives will be implemented for each category. The proposed reforms would apply for each fiscal year beginning within the period from 1 April 2024 to 31 March 2027.

(1) Tax incentives encouraging wage increases for large enterprises

Eligible corporations: Stated capital of over JPY100 million and more than 2,000 regular employees, etc.

Item			Pre-reform	Post-reform
Business category			Large enterprises	Large enterprises
Eligibility criteria			The amount of wages and other payments paid to employees has increased over the previous fiscal year	
			Wages of continuously employed persons have increase 3% or more over the previous fiscal year	
Entities required to disclose their multi-stakeholder policies			Only for corporations with stated capital of JPY1 billion or more and 1,000 or more regular employees	▸ Corporations with stated capital of JPY1 billion or more and 1,000 or more regular employees ▸ Corporations with stated capital over JPY100 million but less than JPY1 billion, and more than 2,000 regular employees
Tax credit rate	Wage increase ratio	3% or higher	15%	10%
		4% or higher	25%	15%
		5% or higher		20%
		7% or higher		25%
	Added on top (1) Increase in education and training expenses		If education and training expenses have increased by 20% or more over the previous fiscal year, 5% is added to the normal credit rate	If education and training expenses have increased by 10% or more over the previous fiscal year and the education and training expenses are more than 0.05% or more of the wages and other payments paid to employees, 5% is added to the normal credit rate
	Added on top (2) Support for women/ raising children		—	5% is added to the normal credit rate if either of the below certifications apply. ▸ Platinum Kurumin Certification *Support for raising children ▸ Platinum Eruboshi Certification *Support for women's activities
	Max credit rate		30%	35%
Max credit amount			Credit capped at 20% of corporate tax amount	
Carryforward of excess credit			Cannot be carried forward	Cannot be carried forward

Created by EY using LDP「2024 Tax Reform Outline」as reference

In addition to the expansion of corporations subject to disclosing their multi-stakeholder policies, the contents of the policies will also be clarified, such as including consumption tax-exempt businesses as business partners in items such as "policies to increase wages" and "policies to build appropriate relationships with business partners and other matters". Accordingly, the contents to include in multi-stakeholder policies will require further consideration.

(2) Tax incentives encouraging wage increases for medium-sized enterprises

Eligible corporations: Stated capital of over JPY100 million and 2,000 regular employees or less, etc.

**Corporations where the total number of regular employees exceeds 10,000, when combined with corporations with which they have a controlling relationship, are excluded from the category of medium-sized enterprises and instead fall under the category of large enterprises.*

Item			Pre-reform	Post-reform
Business category			Large enterprises	Medium-sized enterprises
Eligibility criteria			The amount of wages and other payments paid to employees has increased over the previous fiscal year	
			Wages of continuously employed persons have increase 3% or more over the previous fiscal year	
Entities required to disclose their multi-stakeholder policies			Corporations with stated capital of JPY1 billion or more and 1,000 or more regular employees	Corporations with stated capital of JPY1 billion or more and 1,000 or more regular employees
Tax credit rate	Wage increase ratio	3% or higher	15%	10%
		4% or higher	25%	25%
	Added on top (1) Increase in education and training expenses		If education and training expenses have increased by more than 20% over the previous fiscal year, 5% is added to the normal credit rate	If education and training expenses have increased by 10% or more over the previous fiscal year and the education and training expenses are more than 0.05% or more of the wages and other payments paid to employees, 5% is added to the normal credit rate
	Added on top (2) Support for women/ raising children		—	5% is added to the normal credit rate if either of the below certifications apply. ▸ Platinum Kurumin Certification *Support for raising children ▸ Platinum Eruboshi Certification *Support for women's activities ▸ Eruboshi Certification (3rd stage) *Support for women's activities
	Max credit rate		30%	35%
Max credit amount			Credit capped at 20% of corporate tax amount	
Carryforward of excess credit			Cannot be carried forward	Cannot be carried forward

**Created by EY using LDP「2024 Tax Reform Outline」as reference*

If the number of employees at an entity exceeds 10,000 after including affiliated subsidiaries, it will be excluded from the category of medium-sized enterprises and will fall under the category of large enterprises. As such, it will be necessary to keep accurate employee headcounts of group companies.

(3) Tax incentives encouraging wage increases for SMEs (Small and Medium enterprises)

Eligible corporations: small and medium enterprises

<table>
<tr><th colspan="3">Item</th><th>Pre-reform</th><th>Post-reform</th></tr>
<tr><td colspan="3">Business category</td><td>SMEs</td><td>SMEs</td></tr>
<tr><td colspan="3">Eligibility criteria</td><td colspan="2">The amount of wages and other payments paid to employees has increased 1.5% or more over the previous fiscal year</td></tr>
<tr><td colspan="3">Entities required to disclose their multi-stakeholder policies</td><td>N/A</td><td>N/A</td></tr>
<tr><td rowspan="5">Tax credit rate</td><td rowspan="2">Wage increase ratio</td><td>1.5% or higher</td><td>15%</td><td>15%</td></tr>
<tr><td>2.5% or higher</td><td>30%</td><td>30%</td></tr>
<tr><td colspan="2">Added on top (1)
Increase in education and training expenses</td><td>If education and training expenses have increased by 10% or more over the previous fiscal year, 10% is added to the normal credit rate</td><td>If education and training expenses have increased by 5% or more over the previous fiscal year and the education and training expenses are more than 0.05% or more of the wages and other payments paid to employees, 10% is added to the normal credit rate</td></tr>
<tr><td colspan="2">Added on top (2)
Support for women/ raising children</td><td>—</td><td>5% is added to the normal credit rate if either of the below certifications apply.
- Platinum Kurumin Certification *Support for raising children
- Kurumin Certification *Support for raising children
- Platinum Eruboshi Certification *Support for women's activities
- Eruboshi Certification (2nd stage or above) *Support for women's activities</td></tr>
<tr><td colspan="2">Max credit rate</td><td>40%</td><td>45%</td></tr>
<tr><td colspan="3">Max credit amount</td><td colspan="2">Credit capped at 20% of corporate tax amount</td></tr>
<tr><td colspan="3">Carryforward of excess credit</td><td>Cannot be carried forward</td><td>5 years carryforward possible
(Limited to when the amount of wages paid in the fiscal year the carryforward credit is taken exceeds the previous year's reference wages paid)</td></tr>
</table>

**Created by EY using LDP* 「2024 Tax Reform Outline」 *as reference*

As in the past, it is important to note that ineligible businesses (corporations with average annual income in excess of JPY1.5 billion for each fiscal year that ended within three years before the start date of the relevant fiscal year) cannot apply the wage increase incentive system for SMEs.

2. Creation of tax credit to promote domestic production in strategic industries

Amid intensifying competition across the globe for investment in strategic industries, a new tax credit to promote domestic production in strategic industries has been established as a new investment promotion measure to stimulate domestic investment at businesses - particularly those with high costs at the production stage. Specifically, a 10-year tax credit proportional to production/sales volumes will be implemented for electric vehicles, green steel, green chemicals, sustainable aviation fuel (SAF), and semiconductors (microcontrollers/analog), among other items.

Use of this regime will require a business adaptation plan as set out in the Industrial Competitiveness Enhancement Act to be certified between the enforcement date of the amended Industrial Competitiveness Enhancement Act and 31 March 2027.

For those fiscal years within 10 years from the certification date, a tax credit can be taken for the lesser of the amount corresponding to the volume of designated goods sold or the amount corresponding to the acquisition cost of assets used to produce such goods (excluding amounts that have already enjoyed a tax credit from this system).

The maximum credit is set at 40% (20% for assets related to producing semiconductors) of the relevant period's corporate tax liability, in total with any tax credits from the digital transformation investment promotion tax incentive and the carbon neutral investment promotion tax incentive. Any excess credit amounts can be carried forward for 4 years (3 years for assets related to producing semiconductors).

Please also note that in the event income has increased over the prior period, there will be limitations based on wages paid to employees and capital investments, and tax credits from this regime (excluding tax credits for assets related to producing semiconductors) will not be deductible from the local corporate income tax base.

Criteria for the application of eligibility restrictions
Upon satisfaction of all of the following conditions
(1) Amount of income in the previous fiscal period < amount of income in the current fiscal period
(2) Increase in amount of wages paid to continuously employed persons compared to prior fiscal period is < 1%
(3) Domestic capital investments ≦ Total depreciation cost in current fiscal period X 40%

3. Creation of the "Innovation Box" regime

As international competition for innovation continues to build up, the "Innovation Box" regime will be established to apply tax breaks to income generated from intellectual property ("IP") such as patents and software. The overall goal of this regime will include solidifying Japan as a competitive location for R&D activities, as well as spurring further investment in intangible assets by Japanese private-sector companies.

If a corporation that files a blue return has conducted transactions such as the transfer of specified patent rights (Note 1), 30% of the smaller amount of either (1) or (2) below can be included in deductible expenses in the relevant fiscal year.

(1) The amount obtained by multiplying the amount set forth in (a) below by the ratio of how much of the amount set forth in (c) below is included in the amount set forth in (b) below, for each transaction of specified patent right transfers or similar transactions conducted in the fiscal year

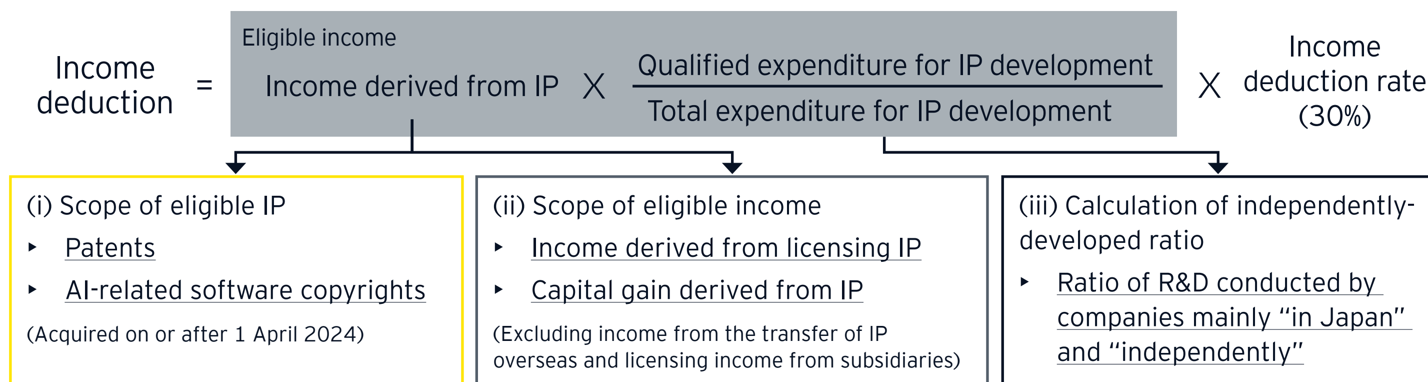
(a) The amount of income pertaining to the transfer of specified patent rights or similar transactions

(b) Of the amount of R&D expenses incurred during the current fiscal year and previous years (limited to the fiscal years starting on or after 1 April 2025) (Note 5), the total amount pertaining to R&D directly related to specified patent rights involved in transactions such as the transfer of specified patent rights

(c) The amount of qualified R&D expenses (Note 6) included in the amount in (b) above

(2) Income for the relevant period

(Calculation of the income deduction)



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(Note 1) "Transactions related to the transfer of specified patent rights" above refers to the transfer of specified patent rights (Note 3) to a resident or a domestic corporation (excluding those who are related parties (Note 2)) or the lending of specified patent rights (Note 4) to other persons (excluding those who are affiliated persons).

(Note 2) The above "related parties" will be determined based on the same criteria as those for related parties under the transfer pricing taxation system.

(Note 3) "Specified patent rights" above refers to certain patent rights and copyrights of programs utilizing AI-related technology acquired or produced on or after 1 April 2024.

(Note 4) The lending of specified patent rights includes the establishment of rights pertaining to the specified patent rights and other acts to allow other persons to use the specified patent rights.

(Note 5) The above "amount of R&D expenses" refers to the amount of R&D expenses under accounting standards for R&D expenses to which a certain adjustment has been added.

(Note 6) The above "amount of qualified R&D expenses" refers to R&D expenses other than acquisition costs of specified patent rights, paid license fees, contracted E&R expenses to foreign related parties, and R&D expenses pertaining to business conducted through overseas business locations.

(Note 7) For fiscal years starting before 1 April 2027, if there are specified patent rights involved in specified patent right transfers or similar transactions conducted in the relevant period which are directly related to R&D activities commenced before the beginning date of the first fiscal year starting on or after 1 April 2025, the amount of (1) above will be the amount obtained by multiplying the amount of (a) below by the ratio of how much of the amount of (c) below is included in the amount of (b) below.

(a) Total amount of income pertaining to the transfer of specified patent rights or similar transactions in the relevant period

(b) Total amount of R&D expenses incurred in the relevant period, the previous period, and the period before the previous period

(c) Total amount of qualified R&D expenses included in the amount of (b) above

Application period

The applicable years will be each fiscal year beginning within the period from 1 April 2025 to 31 March 2032.

Tax benefits equivalent to a corporate tax rate of approximately 7% will be available for eligible income.

During the request period for draft revisions, gains on the sale of products incorporating eligible IP were included in the scope of eligible income for this revision, but they were not included in the text of the tax reform outline. In addition, income from the transfer of IP overseas and license income from subsidiaries were excluded.

4. Revision of R&D tax rules

The R&D tax regime which partially overlaps with the Innovation Box tax regime in terms of its objectives, will be revised to further enhance incentives to increase investment by lowering the deduction rate when experiment and research (E&R) expenditures decrease.

(1) Revision of scope of E&R expenses

The amount of E&R expenses pertaining to business conducted through overseas business locations of a Japanese corporation will be excluded from the amount of E&R expenses eligible under the rules.

(2) Revision of the credit rate of the general R&D tax credit

For fiscal years in which the ratio of increase/decrease in E&R spending is less than zero, the tax credit rate will be revised as follows, and the lower limit of the tax credit rate (currently 1%) will be abolished.

Eligible fiscal year	Tax credit rate
For fiscal years beginning from 1 April 2026 to 31 March 2029	8.5% + increase/decrease in the ratio of E&R expenses X 8.5/30
For fiscal years beginning from 1 April 2029 to 31 March 2031	8.5%+ increase/decrease in the ratio of E&R expenses X 8.5/27.5
For fiscal years beginning on or after 1 April 2031	8.5% + increase/decrease in the ratio of E&R expenses X 8.5/25

5. Revision of size-based enterprise taxation

(1) Measures to address capital reduction (applicable to fiscal years starting on or after 1 April 2025)

The current criteria for corporations subject to size-based enterprise taxation under the corporate enterprise tax (stated capital of more than JPY100 million) will be maintained, but supplementary criteria will be added.

(a) For the time being, even if a corporation that was subject to size-based enterprise taxation in the previous fiscal year reduces its stated capital to JPY100 million or less in the relevant fiscal year, it will be subject to size-based enterprise taxation if the total amount of its stated capital and capital surplus exceeds JPY1 billion.

(b) For fiscal years starting on or after the enforcement date of this measure (1 April 2025) and notwithstanding (a) above, corporations that were subject to size-based enterprise taxation in the fiscal year preceding the fiscal year in which this measure was promulgated(*), whose stated capital is JPY100 million or less, and whose total amount of stated capital and capital surplus exceeds JPY1 billion in the first fiscal year starting on or after the enforcement date, will remain subject to size-based enterprise taxation.

(*) *In cases where the amount of stated capital is JPY100 million or less on the day immediately preceding the date this measure was promulgated, the first fiscal year ending on or after the promulgation date.*

(2) Measures for wholly owned subsidiaries (applicable to fiscal years beginning on or after 1 April 2026)

A wholly-owned subsidiary of a corporation whose total amount of stated capital and capital surplus exceeds JPY5 billion (excluding cases in which the corporation is a corporation or other person that is tax-exempt or taxable on income base only) will be subject to sized-based enterprise taxation if such subsidiary's stated capital is JPY100 million or less as of the end of the relevant fiscal year and whose total amount of stated capital and capital surplus (*) exceeds JPY200 million.

(*) *In cases where the relevant wholly owned subsidiary pays dividends to its controlling parent entity from capital surplus on or after the promulgation date, the total amount will be determined by adding the amount equivalent to said dividends*

An easing measure will be established for corporations that are newly subject to size-based enterprise taxation due to the above revisions. The measure will allow the following prescribed amounts to be deducted from the amount of the corporate enterprise tax in the relevant fiscal year.

- Fiscal years beginning between 1 April 2026 and 31 March 2027
  Of the amount that exceeds the tax amount calculated under the conventional taxation method, the amount obtained by multiplying the excess amount by 2/3
- Fiscal years beginning between 1 April 2027 and 31 March 2028
  Of the amount that exceeds the tax amount calculated under the conventional taxation method, the amount obtained by multiplying the excess amount by 1/3

In light of expected revisions of the Industrial Competitiveness Enhancement Act, if a certified special business restructuring plan (tentative name) under the same Act is certified by 31 March 2027, wholly owned subsidiaries or other entities acquired through certain M&A or other transactions conducted by the certified special restructuring enterprise (tentative name) in accordance with the certified plan will be exempted from the size-based enterprise taxation for five years.

Size-based enterprise taxation was introduced in 2004 for large corporations with stated capital exceeding JPY100 million. It was intended to ensure stable tax revenues by collecting taxes according to the amount of capital of a corporation rather than its income. However, the number of corporations subject to the tax has decreased to approximately 2/3 of the number at the time of its introduction, mainly due to corporations reducing stated capital to JPY100 million or less. Although the scope of corporations subject to the tax will be expanded by these revisions, the outline notes that the government will continue to carefully consider what the ideal scope and application of the size-based enterprise tax is in the future, while taking into consideration its impact on regional economies and corporate management.

6. Other

- **Revision of crypto asset mark-to-market valuation methodology**

The fair value at the end of the fiscal year of "crypto assets with restrictions on transfer and other conditions" (Note 1) which are held as a part of the market crypto assets owned by a corporation will have their amounts calculated using one of the following valuation methods selected by the corporation (Note 2).

(1) Cost method

(2) Market value method

(Note 1)

- *"Crypto assets with restrictions on transfer and other conditions" refers to crypto assets that meet the following requirements.*
  - *(a) Certain restrictions are imposed on the transfer of the crypto assets, such as technical measures taken to prevent the transfer to other persons.*
  - *(b) In order to have the Certified Association for Payment Service Providers publicize the fact that the restrictions set forth in (a) above have been imposed, the person who holds the crypto assets has notified the crypto asset exchange service provider that the restrictions set forth in (a) above have been imposed.*

(Note 2)

- *Self-issued crypto assets that are held continuously since issuance are valued by the cost method (valuation method in (1) above).*
- *The valuation method must be selected for each type of crypto asset with restrictions on transfer and other conditions and must be reported to the competent district director of the relevant tax jurisdiction office by the deadline for filing a final return for the fiscal year containing the day on which the crypto asset was acquired.*
- *If a valuation method is not selected, the amount calculated by the cost method (valuation method in (1) above) will be the valuation amount of the crypto asset at the end of the period.*

Crypto assets held continuously by a third party other than the issuer are not subject to taxes based on mark-to-market valuation at the end of the period under certain conditions.

This revision is expected to advance the development of an environment that supports further adoption of Web3.0, as well as promote entrepreneurship involving blockchain technology.

- **Extension/revision of partial spin-off tax rules**

The spin-off tax rules in which partial spin-offs are treated as qualified share distribution will be revised and extended by four years.

(1) Disclosure timing of certified business restructuring plan

The timing for disclosure of the content of the certified business restructuring plan will be from the date of certification until the date the restructuring outlined in the plan is conducted (currently: the date of certification)

(2) Additional eligibility criteria

A requirement will be added to the requirements for a certified share distribution to qualify as a qualified share distribution, requiring the wholly owned subsidiary to which the certified share distribution pertains to conduct new business activities as its principal business.

- **Extension of tax incentive to promote open innovation**

The applicable period of the tax incentive to promote open innovation will be extended by two years.

The tax incentive to promote open innovation was introduced under the 2020 Tax Reform. It provides a tax deduction equivalent to 25% of the acquisition cost for investments in startup companies.

- **Revision of rules on reserves for investment losses on SME business restructuring**

With regard to the rules on reserves for investment losses on SME business restructuring, a measure has been added which allows for the reserve set aside for investment losses on SME business restructuring, which is the amount equal to or less than the amount obtained by multiplying the acquisition cost of shares by each of the following ratios in accordance with the category of shares (*), to be included in deductible expenses in the relevant fiscal year provided certain conditions are met. The application period has also been extended by three years.

- In light of expected revisions of the Industrial Competitiveness Enhancement Act, individuals or enterprises that are certified special restructuring enterprises (tentative name) and that have a certified special business restructuring plan (tentative name), and;
- Which acquire shares or other securities of another corporation (limited to acquisition by purchase) in accordance with the certified special business restructuring plan, and;
- Where the holder continues to hold such security until the end of the fiscal year that includes the date of acquisition (excluding cases where the acquisition price of the securities exceeds JPY10 billion or is less than JPY100 million, and cases where the holder has concluded certain warranty and indemnity insurance contracts)

(*)

Shares or securities acquired for the first time in accordance with the certified special business restructuring plan	90%
Shares or securities other than those listed above	100%

This reserve is to be reversed when all or part of the shares or securities are no longer held, or when the book value of the shares or securities are reduced. The reserve amount is reversed equally over five years from the fiscal year that includes the day on which ten years (current: five years) have elapsed from the day following the last day of the fiscal year in which the reserve was accumulated. The reversed amount of each year is included in taxable income for each year.

In order to stimulate SMEs with growth potential to acquire multiple SMEs as subsidiaries and grow on the whole as a group, measures have been introduced to expand the reserve ratio from the current 70% to a maximum of 100% and to extend the grace period from the current five years to ten years in the case of multiple M&As. Such measures are expected to ensure the smooth movement of labor to growth sectors, while also ensuring the employment of personnel at SMEs.

▸ Revision of non-applicability measures of specified tax credit rules

The requirements for measures to disallow specified tax credit rules for large corporations will be made more stringent, and the applicable period will be extended by three years.

The requirement of "if the number of regular employees exceeds 2,000 and the amount of income for the previous business year exceeds zero" will be added to the additional measures for the requirements which set forth "the case where the amount of stated capital is JPY1 billion or more and the number of regular employees is 1,000 or more, and the case where the amount of income for the previous business year exceeds zero." Also, the requirement for domestic capital investment will require the amount of domestic capital investment to exceed 40% (current: 30%) of the total amount of depreciation for the relevant period.

Specified tax credit rules subject to non-applicability measures.
R&D tax incentives
Investment promotion tax incentive in the promotion zone of regional economy advancement projects
Tax incentive for 5G implementation
Digital transformation investment promotion tax incentive and carbon neutral investment promotion tax incentive

In an effort to encourage companies with large internal reserves that are reluctant to raise wages or conduct domestic investments to make use of their reserves, the requirements for measures to disqualify specific tax credit provisions will be strengthened.

▸ Extension of entertainment expense rules and food and beverage expenses up to JPY10,000

The exclusion of entertainment expenses from deductible expenses will be extended for three years (until fiscal years beginning on or before 31 March 2027) and the below measures will be established.

(1) The standard amount for certain food and beverage expenses that are excluded from the scope of entertainment expenses will be increased from the current JPY5,000 or less per person to JPY10,000 or less.

(2) The applicable period for special deduction for entertainment and hospitality expenses and the special deduction for SMEs will be extended by three years.

** The above (1) will apply to food and beverage expenses incurred on or after 1 April 2024.*

The taxation of entertainment expenses is being reviewed and revised with the intention of stimulating the economic activities of SMEs, which play a vital role in revitalizing local economies, and dispelling the deflationary mindset regarding food and beverage expenses - a mindset further inflamed by Japan earning the reputation of "cheap Japan "in recent years.

International taxation

1. Revision of top-up tax assumed as corporate tax

As a response to new international tax rules, Japan has been working to implement the international agreement on addressing tax challenges arising from the digitalization of the economy, which was collectively acknowledged by member countries in the OECD/G20 "Inclusive Framework on BEPS" in October 2021. The internationally agreed upon BEPS2.0 consists of the provision of new taxing rights to market jurisdictions (Pillar 1) and a global minimum tax (Pillar 2). In the 2024 tax reform, legislation on Pillar 2 is being enacted in accordance with international agreements and following up on the progress made in the 2023 tax reform.

Under Pillar 2, the effective tax rate ("ETR") will be calculated for each jurisdiction where the MNE Group has branches or subsidiaries, based on the profit and tax expense reported using financial accounting. The portion of that ETR that is less than the internationally agreed upon minimum ETR of 15% will be subject to additional taxation.

There are three methods of taxation: (1) QDMTT (Qualified domestic Minimum Top-up Tax), which preemptively applies tax in jurisdictions where less than the minimum 15% ETR has been reached; (2) Income Inclusion Rule (IIR), which imposes taxation on the parent company when QDMTT has not been introduced in jurisdictions where less than the minimum 15% ETR has been reached, or when QDMTT has been introduced but there is a portion that cannot be taxed under QDMTT; and (3) UTPR (Undertaxed Payment Rule), which imposes taxation in a separate jurisdiction when IIR has not been introduced in jurisdictions where the parent company is located or when less than the minimum 15% ETR has been reached in the parent company's jurisdiction.

Currently in Japan, only (2) IIR has been implemented based on the ETR level of Japan and how discussions within the Inclusive Framework on BEPS have so far progressed. (1) QDMTT and (3) UTPR will be discussed further in and after the 2025 tax reform.

In regard to Pillar 2, further legislation is being considered for after the 2025 tax reform based on the progress of international discussions on relevant topics. In regard to Pillar 1, actively contributing to international discussions in order to advance the early signing of multilateral treaties has been highlighted as an integral task and the ideal form of Japan's tax system will be considered further based on the provisions of future multilateral treaties it enters into.

Jurisdictions implementing Pillar 2 are required to follow the rules developed in the Inclusive Framework on BEPS (common approach). Currently, Administrative Guidance on Pillar 2 is constantly being formulated within the Inclusive Framework, meaning Japan should also be constantly reviewing and revising its tax system in order to align with those developments.

The major revisions in the 2024 tax reform relating to Pillar 2 are as follows.

(1) The introduction of a set of standards (the QDMTT Safe Harbor) which, when all requirements are met, will reduce the group top-up taxes for the jurisdiction where the constituent entity is located to zero in the case where a constituent entity is required to impose a tax on the qualified domestic minimum top-up tax which satisfies certain requirements in the jurisdiction where the constituent entity is located

This is considered to reflect the content of the Administrative Guidance compiled in the Inclusive Framework on BEPS in July 2023. Specifically, only in cases where QDMTT has been introduced in a jurisdiction where less than the minimum 15% ETR has been reached, and where it is expected that sufficient taxation will be imposed on the portion under QDMTT that is less than the 15% ETR, the Group's top-up tax for the relevant jurisdiction will be deemed to be zero and no calculation will be required under the Japanese IIR.

(2) Revision of the foreign tax credit

In regard to whether taxes imposed under QDMTT, IIR, and UTPR in other countries are subject to the foreign tax credit in Japan, it has been determined that taxes imposed under QDMTT in other countries will be subject to the foreign tax credit in Japan, while taxes imposed under IIR and UTPR in other countries will not be subject to the foreign tax credit in Japan.

IIR and UTPR have likely been excluded from the foreign tax credit system in Japan as they are in nature a final level of taxation in which the ETR is calculated based on the tax expense after taking into account all taxation on foreign branch income in the jurisdiction of the head office, as well as the CFC (controlled foreign company) tax rules in other countries.

On the other hand, unlike IIR and UTPR, QDMTT is required to calculate the ETR without considering taxation on foreign branch income in the jurisdiction where the head office is located and the CFC tax systems in other countries. Accordingly, there was a concern that such foreign branch income taxation and CFC taxation could be imposed in duplicate with taxation under QDMTT depending on the circumstances. As a result of these revisions, the Japan foreign tax credit will likely take into account taxes imposed under QDMTT.

(3) Revision of local taxes

The amount of corporate tax to be used as the basis for the calculation of the corporate inhabitant tax will not include the amount of top-up taxes assumed as corporate tax in each applicable fiscal year.

These measures have been implemented in accordance with the conclusions of the 2023 tax reform. More specifically, 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.

In addition, if the QDMTT is implemented in the future, it will be a tax mechanism based on income earned by domestic companies. As benefits from administrative services of local government agencies can be considered as received in relation to being subject to taxes, the QDMTT will be implemented based on the ratio of national and local taxes. Additionally, in an effort to simplify the system, the amount of corporate and local inhabitant taxes imposed by the QDMTT will be included in local corporate tax and assessed/collected by the national government. It will then be distributed to local governments via local tax allocations.

(4) Other

In addition, the following revisions were included in the 2024 tax reform.

- In cases where a stateless constituent entity is subject to a tax pertaining to its domestic top-up tax, the amount of such tax will be deducted in the calculation of the group top-up tax.
- In regard to the exclusion amount of gains or losses on the fair value valuation of certain ownership interests that are excluded from GloBE income or loss, the amount will be included in GloBE income or loss based on the selection of the jurisdiction of the MNE Group
- In regard to the amount of tax credit that can be taken by holding an equity interest in a conduit company (limited to the amount that satisfies certain requirements), the amount will be included in adjusted covered based on the selection of the jurisdiction of the MNE Group
- In regard to the system for the provision of matters to be reported by specified MNE groups, necessary matters to be reported will be reviewed based on the categorization of the entity obligated to submit the report
- Other necessary measures will also be established.

Separately, additional Administrative Guidance was collected and published under the Inclusive Framework on BEPS in December 2023. The content of these guidelines is also expected to be addressed as a part of the items above or as necessary in the future.

The above revisions apply to top-up taxes assumed as corporate tax of domestic corporations for the applicable fiscal years beginning on or after 1 April 2024.

2. Revision of qualified capital contributions in kind

The following revisions will be made to the requirements for qualified contributions in kind.

(1) Expansion of the scope of assets that are not considered qualified contributions in kind among contributions in kind to foreign corporations

A contribution in kind in which a domestic corporation transfers intangible assets to the head office of a foreign corporation is excluded from being a qualified capital contribution in kind.

(Note) "Intangible assets" above refers to the following assets for which consideration should be paid if they are transferred or lent between independent business operators in accordance with the terms and conditions of ordinary transactions.

(a) industrial property rights or other rights concerning technology, production methods involving special technology, or any other equivalent rights or methods (including the right to use these rights);

(b) copyrights (including publication rights, neighboring rights and any other equivalent rights)

In light of the fact that intangible assets can be easily separated from the place where the asset value is formed, and that a part of the creation of said value takes place in Japan even if the assets belong to a business outside of Japan, contributions in kind that transfer intangible assets will be excluded from the scope of qualified contributions in kind to prevent adverse effects on taxation caused by the removal of unrealized asset gains of domestic corporations from Japan, and also to ensure the right of taxation in Japan.

(2) Revision of the domestic/foreign determination of whether a transaction is eligible as a qualified contribution in kind

In determining whether a transaction is a qualified contribution in kind, the domestic/foreign determination of an asset to be transferred by a contribution in kind (excluding domestic real estate) will now be based on whether the asset falls under the category of assets pertaining to business conducted through the head office of a domestic corporation or a permanent establishment of a foreign corporation, or the category of assets pertaining to business conducted through the overseas business location of a domestic corporation or the head office of a foreign corporation.

(Note) "Overseas business location" above refers to a permanent establishment located outside Japan.

In regard to the domestic/foreign determination of an asset to be transferred by a contribution in kind, "head office of a corporation" and "permanent establishment (PE)" as used in the foreign tax credit rules and domestic source income taxation will be used instead of "place of business" for the determination. This approach ensures stability for how foreign/domestic determinations are made and is consistent with determining whether foreign corporations are subject to the taxation rights of Japan.

The revisions above will apply to the contributions in kind made on or after 1 October 2024.

3. Revision of Japanese Controlled Foreign Company ("JCFC") rules

(1) Revision of the income ratio requirements pertaining to the special measure for paper companies in the determination of specified foreign affiliated companies

In regard to the income ratio requirements pertaining to the special measure for paper companies in the determination of specified foreign affiliated companies as stipulated in the special measures for taxation of income relating to foreign related parties of domestic entities (the Japanese Controlled Foreign Company ("JCFC") rules),if there is no income in fiscal year of the foreign related company, it is not necessary to determine the income ratio requirement for said fiscal year.

In regard to the income ratio requirements pertaining to the special measure for paper companies in the determination of specified foreign affiliated companies, in the case of a fiscal year for which there was no gross revenue in the denominator as stipulated under the current law, and when other requirements may have been met, an entity was required to attach a schedule to the effect that it was a specified foreign affiliated company.

$$\frac{\text{Dividends, consideration for transfer of shares, interest on deposits, consideration for transfer of real estate, consideration for real estate loans, etc.}}{\text{Gross revenue}} > 95\%$$

As a result of these revisions, the administrative burden of attaching separate schedules for foreign related companies that do not generate gross revenue or income inclusion tax in the relative fiscal year is expected to lighten.

However, regarding expenses such as maintenance and management costs and interest expenses of the foreign related company that arose in a fiscal year in which gross revenue was not generated, there is a possibility that those costs which until now would have been carried forward as a loss generated in a fiscal year in which the entity is a specified foreign related company may no longer be able to be carried forward as losses generated in a fiscal year in which the entity is not a specified foreign related company. Accordingly, care will need to be paid to this point.

4. Establishment of reporting system for the automatic exchange of information requests related to crypto asset transactions of non-residents

(1) Establishment of reporting system for the automatic exchange of information requests related to crypto asset transactions of non-residents

With the establishment of the Crypto-Asset Reporting Framework (CARF) as a new international standard by the OECD, a new reporting system for the automatic exchange of information on crypto asset transactions of non-residents has been established. The main procedures for the reporting system are the same as those for the reporting system for the automatic exchange of financial account information of non-residents, as described below.

(a) Identification of the country of residence through the submission of a declaration by individuals conducting crypto asset transactions, and the confirmation of the contents of the declaration by reporting crypto asset exchange service providers

(b) Submission of matters to be reported by the reporting crypto asset exchange service provider to the district director of the relevant tax office

(c) Preparation and retention of records on matters concerning the country of residence of the specified individual by the reporting crypto asset exchange service provider

(d) Penalties for violating the obligation to submit notifications and the obligation to provide information to be reported

(2) Revision of reporting system for automatic exchange of information on financial accounts of non-residents

The reporting system for the automatic exchange of financial account information of non-residents was introduced by the 2015 tax reform and further revised by the 2020 tax reform. This system is based on the Common Reporting Standard (CRS), an international standard established by the OECD. As the CRS was revised along with the establishment of the above-mentioned CARF, the procedures for the identification of the country of residence and the provision of the matters to be reported (including those related to crypto assets) were revised again.

The above revisions will come into force on 1 January 2026.

5. Other

(1) Disallowed interest expenses ("excess interest") under the special exemption concerning the taxation of certain net interest expenses (the "earnings stripping rules") can now be carried forward for 10 years (current: 7 years) for excess interest in fiscal years beginning between 1 April 2022 and 31 March 2025.

(2) With regard to the special calculation (calculation of the amount in excess of the amount of increased retained earnings after a specified controlling relationship is created) that can exclude the amount deemed to have been paid from the amount of retained earnings after the date the specified controlling relationship was initiated from the amount of eligible dividends to be received from the subsidiary company, when such special calculation applies to the case of calculating the amount to be deducted from the book value of shares held by a subsidiary company in accordance with the measure to prevent tax avoidance by combining dividends from the subsidiary company and transfer of shares of the subsidiary company (special measure for reduction of book value of shares of a subsidiary company), the amount of eligible dividends received during the fiscal year in which the specified controlling relationship was initiated (limited to those dividends received after the day on which the specified controlling relationship was initiated) can also be eligible for the special calculation.

Individual income taxation

1. One-time fixed amount reduction of income tax and inhabitant tax

In order to increase income in parallel with the wage increases advocated by the Kishida Cabinet, fixed-amount deductions for individual income tax and inhabitant tax will be available from June 2024 for taxpayers with an annual income of JPY18.05 million or less. The amount of each deduction will be JPY30,000 (income tax) and JPY10,000 (inhabitant tax) per spouse or dependent relative (resident) living in the same household as the taxpayer. As for income tax derived from employment income and public pension income, tax reduction amounts will be deducted from withholding tax amounts, and tax reduction amounts derived from business income will be deducted from estimated tax prepayments. Tax reduction amounts of inhabitant tax will be deducted from the special collection or general collection amounts. If a deduction is made from the special collection of employment income earners, the collection of inhabitant tax will start from July 2024 instead of June 2024, and one eleventh of the amount of inhabitant tax after deducting the amount of the special deduction will be collected every month. The amount of decrease in inhabitant tax for each municipality will be covered by the national government.

As part of a comprehensive economic package designed to completely overcome deflation and alleviate the burden on individuals whose wages have not kept pace with rising prices, a fixed income and inhabitant tax deduction will be introduced. Over the past two years, income tax and inhabitant tax revenues have increased by JPY3.5 trillion. By returning this increase in tax revenues to the people in the form of taxes, the purchasing power of taxpayers is expected to increase.

2. Revision of dependent deduction (2025 tax reform)

The income limitation of the child allowance will be abolished in 2024, and the covered period will be extended until the child graduates high school. In light of this, the deduction for dependents will be revised for income tax from 2026 and personal inhabitant tax from 2027. The following proposals are expected to be discussed in the 2025 tax reform.

Exemption for dependents aged 16 to 18:
The current amount of exemption for dependents (income tax of JPY380,000 and inhabitant tax of JPY330,000) will be changed to JPY250,000 for income tax and JPY120,000 for inhabitant tax.

In regard to the amount of taxable income and tax liability that changes due to the revision of the deduction for dependents, appropriate measures will be taken by each government office and ministry to ensure the social security system or educational funding are not adversely affected.

3. Revision of housing-related tax credit for households with children

The borrowing limit of the housing loan for the special income tax credit will be expanded as follows in the case where an individual subject to the special provisions for childcare (Note) obtains or resides in a certified, newly built residence between 1 January 2024 and 31 December 2024.

(1) Certified housing:
JPY45 million → JPY50 million after revision

(2) ZEH-level energy-saving residence:
JPY35 million → JPY45 million after revision

(3) Residences that meet the energy-saving standards:
JPY30 million → JPY40 million after revision

In addition, if an individual subject to the special provisions for childcare carries out renovation work on their residence for the purpose of raising a child and resides in the residence between 1 April 2024 and 31 December 2024, an amount equivalent to 10% of the renovation cost (up to JPY2.5 million) will be eligible for a special deduction from the income tax amount.

(Note) "Individuals subject to the special provisions for childcare" refers to (1) individuals who are under 40 years of age and have a spouse, (2) individuals who are 40 years of age or older and have a spouse under 40 years of age, or (3) individuals who have a dependent under 19 years of age.

In order to promote the securing of safe and comfortable housing for this generation's parents, the borrowing limit for the housing loan tax credit will be raised and the floor area requirements for new houses will be relaxed.
In light of economic circumstances such as the rapid rise in housing prices, these measures will be taken in advance and implemented only in 2024.

4. Revision of stock option rules

The stock option rules will be revised with respect to gains from the exercise of stock options by certain executives. The annual limit on the exercise of stock options granted by an incorporated company established less than 5 years ago will be raised to JPY24 million (current: JPY12 million), and the annual limit for stocks granted by certain incorporated companies (Note) will be raised to JPY36 million (current: JPY12 million). As for restricted stocks, a regime will also be established to allow issuing companies to manage such stocks instead of entrusting securities companies with the custody of such stocks. Subject to the revision of the Order for Enforcement of the Small and Medium-sized Enterprises Business Enhancement Act, the scope of external highly skilled professionals will also be expanded.

(Note) "Certain incorporated companies" refers to incorporated companies for which the period from the date of establishment is 5 years or more and less than 20 years, and which are unlisted or for which the period from the date of going public is less than 5 years.

This is one of the tax measures designed to specifically to bolster the startup ecosystem. In particular, the upper limit of the annual exercise price will be significantly raised to enable startups in later stages to secure personnel.

5. Expansion of angel investor tax rules

The acquisition price of certain stock acquisition rights will be added to the scope of the rules. Investments through designated money trusts (independently managed) will also be in scope.

Consumption taxation

1. Introduction of platform taxation

Platform taxation, a system that obligates platform businesses to remit taxes on behalf of foreign businesses, will be introduced.

Among the provision of telecommunications services (excluding BtoB) conducted by foreign businesses via digital platforms, those services for which consideration is received via a specified platform businesses (Note) will be deemed as being conducted by the relevant specified platform business. If the business falls under the category of a specified platform business, it will be required to notify the Commissioner of the National Tax Agency to that effect by the deadline for filing a final return for the relevant taxable period. In addition, when the Commissioner of the National Tax Agency designates a specified platform business, the business will be notified to that effect, and the name of the platform will be made available on the internet. The specified platform business will also be required to attach support to their final tax return which documents the amount of money it has received for its provision of services. These revisions will be applied to telecommunications services provided on or after 1 April 2025. In addition, necessary transitional measures will be established for prior designation and notification under the specified platform business designation system.

(Note) The total amount of consideration for the provision of applicable telecommunications services must exceed JPY5 billion during the taxable period for the platform to be identified as a "specified platform business."

This system was introduced to maintain the fairness of taxation between domestic and foreign businesses, as well as to ensure an even playing field in the digital services market, which includes products such as applications and games.

2. Revision of tax-exempt enterprise system used by foreign businesses

The tax-exempt enterprise system will be revised as follows.

(1) Regarding the special exemption of tax payment obligations based on taxable sales for a specific period, determinations based on the amount of wages paid, which can be applicable instead of taxable sales, will no longer apply to foreign businesses.

(2) Regarding the special exemption from tax payment obligations for a newly established corporation with stated capital of JPY10 million or more, even if a foreign corporation has a base period, the application of this special measure will be determined at the time the business is commenced in Japan.

(3) Regarding the special exemption of tax payment obligations for specified newly established corporations with stated capital of less than JPY10 million, the scope of specified newly established corporations subject to this special measure will now include cases where the business operator has established a corporation that is directly or indirectly controlled by a person whose revenue, including overseas portions, exceeds JPY5 billion, and measures similar to those in (2) above will also be established.

(Note) These revisions will apply to taxable years beginning on or after 1 October 2024.

Foreign businesses avoid taxes by applying each individual system in a form not in line with the original purpose of the system. In order to address this issue, a comprehensive review of individual consumption tax special measures will be conducted (the same applies to 3.).

3. Revision of simplified taxation rules

Foreign entities that do not have a permanent establishment under the Income Tax Act or the Corporation Tax Act as of the first day of the relevant taxable period will not be eligible for simplified taxation rules. In addition, the same measure will apply to the application of the transitional measures for tax credits for small-scale enterprises who become qualified invoice issuers (the so-called "20% special measure").

These revisions will apply to taxable years beginning on or after 1 October 2024.

4. Revision of consumption tax exemption rules for foreign tourists (2025 tax reform)

The misuse of the consumption tax exemption rules for foreign tourists has presented problems in recent years. To combat these issues, duty-free sales will require the retention of information confirming that foreign tourists will take duty-free purchases outside of Japan (tentatively named "customs confirmation information") obtained through the duty-free sales management system provided by the government. The details of this system are to be determined in the 2025 tax reform, specifically addressing topics such as improving convenience, reducing burden on businesses, and preventing congestion at airports, among others.

5. Other

(1) Purchase tax credit rules for consumption tax will not be available for taxable purchases made with the knowledge that the goods were purchased duty-free under the consumption tax exemption rules for foreign tourists. This revision will apply to taxable purchases conducted by business operators in Japan on or after 1 April 2024.

(2) In regard to the transitional measures for tax credits for taxable purchases made from a person other than a qualified invoice issuer (the so-called "80%/50% deduction introduced with the invoice system"), these transitional measures will not be available for the taxable purchases in excess of JPY1 billion in the case where the total amount of taxable purchases from one tax-exempt business exceeds JPY1 billion in the relevant year or business year. This revision applies to taxable years beginning on or after 1 October 2024.

Asset taxation

1. Fixed asset tax

In the past few years, the fairness of fixed asset tax on land has been a topic of concern when considering current economic conditions. In particular, the price of commercial land has risen, and the gap in land prices between large cities and rural areas is widening. To address this issue, the burden adjustment measure for fixed asset taxes on land and tax reduction systems offered by local governments will be extended from 2024 to 2026.

2024 will be the year in which fixed asset taxes are reassessed once every three years, and with land prices subject to reassessments increasing in primarily large cities and decreasing in more rural areas, discrepancies in the burden adjustment level of larger cities are expected. In order to ensure fairness, the government has determined the burden adjustment measure to still be required.

2. Business succession tax rules

In regard to the special rules for a grace period for inheritance/gift tax on unlisted shares, the deadline for submission of the specially approved succession plan will be extended by two years.

Tax administration

The following revisions will be made to improve convenience for and ensure fairness for taxpayers.

1. Additions to heavy additional taxes

Heavy additional taxes will be imposed on those who have submitted a request for corrections based on acts of concealment or falsification. In regard to the application of the special measure that allows for deducting a certain period from the calculation period of delinquent taxes, clarifications are expected in the future that will disallow the application of this special measure in certain cases where national taxes were evaded using acts of concealment and a request for corrections are submitted as noted above. This revision will be applied to national taxes for which the statutory filing due date arrives on or after 1 January 2025.

2. Secondary tax liability on representatives of companies committing fraud to avoid taxes

If an incorporated company or similar entity that has evaded the payment of national taxes by deception or other fraudulent acts, or has received an inappropriate refund, does not pay or return said tax amount or refund, and subsequently it is deemed that there is still a shortfall in taxes due, certain representatives of that entity will have a secondary national tax liability for the delinquent national taxes, up to the lesser amount of the amount of national taxes evaded or refunded, or the value of the company assets received by or transferred by the representative(s) (excluding those items transferred as a result of certain transactions that are deemed to have been conducted as ordinary transactions). This revision will be applied to certain national taxes which become delinquent on or after 1 January 2025.

3. Other

(1) Enhanced convenience of e-Tax:
If a corporation files and pays taxes using G-Biz ID and e-Tax, the process will be made easier by no longer requiring the company to enter a security code or send digital certifications when filing or making a payment.

(2) Expansion of electronic delivery of disposition notices:
All disposition notices will be delivered via e-Tax.

(3) Payment via eLTAX: Local public funds other than local taxes can also be paid via eLTAX.

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Ernst & Young Tax Co.
Brand, Marketing and Communications
tax.marketing@jp.ey.com

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