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Japan tax newsletter

Ernst & Young Tax Co.

The Impact of the 2024 Japan Tax Reforms for Inbound Businesses: Detailed Review

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Contents

- Corporate taxation 2
- Consumption tax 8
- International taxation 9
- Individual income taxation 12
- Tax administration 13
- Mobility – Immigration 13

The fiscal year 2024 tax reform outline was released on 14 December 2023. This year's tax reform aims to promote growth, increased productivity, and sustainability. The corporate tax aspects of the reform include both immediate measures, such as measures to encourage wage growth, as well as measures to promote long term growth. Prime Minister Fumio Kishida says that these reforms will work in tandem with a stimulus package passed in November worth 17 trillion Yen (USD 119 billion) and will help "achieve a virtuous cycle in the economy."

The immediate measures include further incentives to increase wages, building upon Kishida's "new capitalism" program to encourage wealth re-distribution through higher wage growth in Japan.

The longer-term measures include tax credits for companies that produce or sell products that are critical for economic security and decarbonization, such as electric vehicles and semiconductors. The tax credits themselves are only available for 10 years (with a carry-forward period of 3 or 4 years), but the hope is that the additional investment in these sectors will promote longer term, sustainable growth in the Japanese economy. Another measure designed to support long-term growth is the proposed innovation box regime which will promote the development of intellectual property in Japan.

The tax reform also includes a series of changes to the Japanese consumption tax law. This includes a new requirement for platform operators to remit consumption taxes on behalf of foreign digital service businesses as well as other changes to reduce tax avoidance.

Preventing tax avoidance is one of the aims of another aspect of the tax reform – namely the changes to the scale based taxation component of Japan's enterprise tax, one of the local taxes in Japan.

The focus of this year's tax reform on stimulating the economy has led the government to delay planned tax increases on corporate, income, and tobacco taxes. These tax hikes were planned to fund increased defense spending (expected to reach 43 trillion yen for the 5-year period fiscal 2023 to fiscal 2027). But Yoichi Miyazawa, who chairs the Liberal Democratic Party's tax panel, said in December that "under the current political circumstances, it is difficult to make a decision this year" on the timing of the tax hikes. He did express the hope, however, that the increase will begin in fiscal 2026.

It's important to note that some provisions of the proposed tax reform may be amended, deleted or added to during deliberations of the National Diet regarding the reform bill. The final tax reform legislation is expected to be passed by 1 April.

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Corporate taxation

1. Scale Based Tax

Scale Based Tax, which is also referred to as size-based, factor-based or business-scale enterprise tax, was introduced in 2004 with the aim of providing local municipalities and prefectures with a steady influx of tax revenues from large corporations even if the companies are loss making and hence not paying any local income taxes.

Since then, for corporations with a stated capital (*shihonkin*) exceeding JPY100M, enterprise tax (a form of local corporate income tax) has not only been levied on their taxable income but also on capital factor and on the value-add factors. Specifically, the tax base of the value-add levy factors in salary expenses, net interest and net rent payments, as well as income for the current year but before any tax loss carry-forward deductions. The capital levy is based on the capital for tax purposes, which includes capital reserves and surplus amounts.

For small-and-medium sized corporations (SMEs), i.e., entities with a stated capital of JPY100M or less, Enterprise Tax has been levied only on their taxable income, which is like the tax base of Corporate Income Tax.

According to the tax reform materials the number of companies subject to Scale Based Tax had decreased by approx. 30% since its introduction. The purpose of this tax reform is to address cases where companies deliberately reduced their stated capital to avoid Scale Based Tax exposure.

In fact, there are loss-making entities which decreased their stated capital following the negative impact of the pandemic to manage their cash outflow from the capital and value-added levies which are due even if the taxable income is zero or negative.

There are two cases addressed by the reform act and the first case specifically covers capital reductions. A SME (i.e., stated capital of JPY100M or less) would be subject to Scale Based Tax if the total of its stated capital and capital surplus exceeds JPY1B, and if this entity was subject to Scale Based Tax in the previous fiscal year.

The new rule shall be applicable for fiscal years beginning on or after 1 April 2025. For having a fiscal year matching the calendar year, it will become effective from 1 January 2026. SMEs, which had not been subject to Scale Based Tax in the fiscal year before the new rules have become effective as well as SMEs established after the new rules have become effective will generally not fall under the regime. However, for SMEs which had a total of stated capital and capital surplus exceeding JPY1B at the end of the fiscal year ending on or after the promulgation date of the tax reform act and which have a total of stated capital and capital surplus exceeding JPY1B in the first fiscal year for which the rules become effective, Scale Based Tax will apply. In the second case, Scale Based Tax will apply to a SME if its total of stated capital and capital surplus exceeds JPY200M, and if this company is (directly or indirectly) wholly-owned by one or more (domestic or foreign) corporations in a 100%-group which in turn has or have a stated capital of more than JPY100M (or the foreign currency equivalent) and the aggregated total of its stated capital as well as its capital surplus exceeds JPY5B (or the foreign currency equivalent amount). This second change shall be applicable for fiscal years beginning on or after 1 April 2026 which is 1 January 2027 for so-called calendar year-end companies.

There will be some transitional measures with anti-avoidance character for the first case. For the second case, a tax credit would be available to the extent the new Scale Based Enterprise Tax exceeds the tax amount under the old Scale Based ruleset. The credit will be available only for the first and the second fiscal year beginning on or after the new rules have come into effect and will be limited to two-thirds and one-third of the excess amount respectively. Also, there will be some transitional exemptions for special business restructurings where a SME is acquired by a large domestic corporation and several conditions are met.

The applicable tax rates for both the SME Enterprise Tax and the Scale Based version are shown in the below table. These are the current percentages and for the Tokyo Metropolitan area. While the rates for companies based outside Tokyo, in local regions of Japan, would be lower than those shown here, the tax reform does not impact the rates itself.

For Tokyo metropolitan area	SMEs*	Large corporations*
National CIT	23.20%	23.20%
Local CIT	2.39%	2.39%
Inhabitant Tax	2.41%	2.41%
Enterprise Tax		
Income base	7.480%	1.180%
Capital levy**	n/a	1.260%
Value-added levy**	n/a	0.525%
Special Corporate Enterprise Tax	2.59%	2.60%
Effective (income) tax rate	34.59%	30.62%**

Notes:
* Assuming a taxable income of >JPY10m
** Effective statutory tax rate exclusive of capital levy and value-added levy

Loss-making large corporations still have to pay Scale Based Tax because of the capital levy and the value-added levy. On the other hand, the effective statutory income tax rate for SMEs is higher than for large corporations. Consequently, despite the additional capital and value-added levies, the effective tax burden under the Scale Based Tax might be lower compared to the SME Enterprise Tax.

We expect that some of the implications of this proposal will be:

- Companies that recently reduced their stated capital are likely to be impacted by the proposed changes. In particular, if the reduction was made by simply shifting the reduction amount to capital reserves or other capital surplus without actual cash out or offset against negative retained earnings such companies may wish to simulate the (cash) tax impact the new rules would have.
- In view of its lower effective statutory income tax rate, being subject to Scale Based Tax could be beneficial for certain corporations, especially for profitable companies. Also, the actual effective impact is manageable due to factors such as capital, interest expense, or rent expense being adjustable as well. Managing the Scale Based Tax impact requires forward-looking planning taking into account business forecast figures for the next three to five years.
- While a SME may fall under the new Scale Based rules, it should generally still be eligible for preferential SME tax treatment. The exact eligibility depends on the specific rules and guidelines for each SME-related tax benefit. For these reasons, companies wishing to take advantage of such preferential treatments should consult with tax specialists.

2. Innovation Box

An innovation box regime will be introduced in April 2025. The purposes of the innovation box are to strengthen Japan as a location for research and development activities and to encourage businesses to invest in intangible assets. Under the innovation box regime, income from intellectual properties such as patents and software can be subject to an income deduction. As background, European countries including the Netherlands, Britain and France started to introduce a patent/innovation box in the 2000's.

The regime will be introduced for fiscal years beginning on or after 1st April 2025 and the income deduction rate for qualified income subject to the innovation box is 30%.

The formula to calculate the income deduction amount is as follows:

$$\text{Income deduction amount} = \text{Qualified income} \times \frac{\text{Qualified expenditure}}{\text{Total expenditures}} \times 30\%$$

Intellectual properties subject to the innovation box will be patents and copy-righted software in the artificial intelligence area. These qualified intellectual properties should be acquired after April 2024. Qualified income from qualified intellectual properties subject to the regime will be license income excluding that from subsidiaries and capital gain income excluding that from disposals to overseas.

Qualified income is to be multiplied by a qualified expenditure ratio, which is also called a nexus fraction. This qualified expenditure ratio is intended to ensure that in principle R&D activities made by a company itself within Japan should be reflected in qualified income subject to the regime.

3. New Tax Credit for Manufacturing Products of Strategic Importance

The 2024 tax reform introduces a new tax credit to support manufacturers of products of strategic importance. The introduction of the new tax credit is part of the Japan Revitalization Strategy to promote domestic production in strategic fields. The new tax credit provides support to manufacturers active in such strategic industries.

The new tax credit is subject to amendments to the Industrial Competitiveness Enhancement Act ("ICEA"). ICEA serves as a basis to execute the Japan Revitalization Strategy and contains a wide range of measures including the newly introduced tax credit.

In simple terms, if a taxpayer invests into qualifying fixed assets to manufacture products of strategic importance, the taxpayer can enjoy a tax credit if the taxpayer meets specific conditions.

The revised tax law provides a definition of products of strategic importance. The scope of these products includes various types of semiconductors, electric vehicles, green steel, green chemicals and sustainable aviation fuel.

To access the tax credit, the taxpayer has to file a Business Adaptation Plan and has to have it certified by the relevant Ministry with oversight over the activities of the taxpayer. The certification has to happen before 31 March 2027.

Once the Ministry certifies the Business Adaptation Plan, the taxpayer has to acquire and start to use the fixed assets within 10 years after the date of certification.

There will be detailed guidelines about how to prepare a Business Adaptation Plan. Based on previous experience, we expect that the Business Adaptation Plan should show what investments the taxpayer wants to make in the specific strategic field, what the production and sales plans are, and what the investment timeline is. There will probably be other conditions as well including financial conditions.

Once the taxpayer acquires the qualifying fixed assets and starts to use them, the taxpayer is required to calculate the tax credit in the following manner for each financial year.

The taxpayer calculates two amounts. These amounts are:

i) the amount of investment into qualifying fixed assets and

ii) an amount which depends on the number of units of products of strategic importance sold in a financial year multiplied by a tax credit amount allocated to one unit of product sold.

The tax law will show tax credit amounts allocated to each product of strategic importance. The following tax credit amounts will apply per unit sold.

Product	Tax credit amount
Semiconductors	4k JPY to 29k JPY per sheet depending on the exact semiconductor type
Electric Vehicles	200k JPY to 400k JPY per vehicle depending on the EV type
Green Steel	20k JPY per ton
Green Chemicals	50k JPY per ton
Sustainable Aviation Fuel	30 JPY per liter

The lower of i) and ii) will be the tax credit that can be offset against the taxpayer's corporate tax liability. However, the taxpayer can only offset this tax credit against up to 40% of its corporate tax liability[1] (20% for companies manufacturing semiconductors).

In an exception to the general rule for tax credits, these unused tax credits can be carried forward for up to 4 years (3 years in the case of companies manufacturing semiconductors)

A simplified description of claiming this tax credit is as follows:

Step	Description
Step 1)	Prepare Business Adaptation Plan
Step 2)	Have it certified with the Ministry in charge
Step 3)	Make investments into qualifying fixed assets and start using the assets within 10 years after the date of Certification
Step 4)	Start manufacturing and selling products of strategic importance
Step 5)	Calculate the tax credit starting from financial years in which the company recognizes sales of products of strategic importance. Offset the calculated tax credit against corporate tax payable within limitations.

There are also additional considerations. Japanese tax law can limit the availability of this tax credit in specific cases. Generally Japanese tax law is intended to encourage taxpayers to increase salary expenses and investments when they are profit-making. The rules are complex, but typically if a taxpayer shows an increase in taxable income in a financial year compared to the previous financial year, but the taxpayer does not make a certain level of increase in salary expenses and in the acquisition of new fixed assets, the taxpayer may not be permitted to claim the new tax credit even if all other conditions are satisfied.

The taxpayer should be aware of these complex rules and plan accordingly to avoid unexpected surprises at the end of the financial year.

1. If the taxpayer also utilizes carbon neutrality tax credit and digital transformation tax credit, the total combined tax credit is limited to 40% of the annual corporate tax payable.

4. Amendments to the Wage-related Tax Credit

Japanese tax law provides a tax credit to companies that increase their spending on salaries and training expenses.

The calculation of the wage tax credit is complex. There are various formulas, conditions and definitions to consider. The focus is on whether the company can show that it has increased its incremental salary expense (as defined by tax law) and its incremental training expense (as defined by tax law) exceeding certain parameters. If these parameters are exceeded, the taxpayer can claim a certain percentage of the incremental increase in salary and training expenses as a tax credit.

Under the current rules, the tax credit is between 15% to 25% of the incremental increase in salary expense and 5% of the incremental increase in training expenses. The maximum tax credit amount is therefore 30%.

The 2024 tax reform extends this tax credit by three years and adjusts the rules. The tax credit ratio will be 10% to 25% and there will be more conditions to meet to get the 5% tax credit on training expenses. However, there will be an additional tax credit of 5% if the company receives a certification from the Ministry of Health Labor and Welfare to support initiatives to balance childcare and work and to promote women's advancement. The total tax credit therefore can be up to 35%.

In summary, the tax credit rates as follows:

	Tax credit rates under current rules	New rules
Incremental increase in salary expense	15% to 25%	10% to 25%
Incremental increase in training expense	5%	5% (however more conditions must be met for the 5% tax credit)
Additional tax credit	N/A	5% if the company is certified to support parenting and women's empowerment
Total	30%	35%

It is important to note that if the taxpayer has capital for tax purposes exceeding 1bn JPY and 1,000 employees or more or the taxpayer has more than 2,000 employees, the taxpayer is required to disclose a multi-stakeholder policy publicly to access the tax credit.

The 2024 tax reform also brings new rules and amended rules regarding companies with 2,000 employees or fewer and small and medium sized companies. As an overall comment, these rules are slightly more favorable than the general rules shown above.

Hiring people and spending money on training represent a net expense to the company even if the company can take a tax credit. In this context, tax planning is not a realistic option for this tax credit. However, it is of utmost importance that the taxpayer's compliance team understands the new rules and can properly apply them to calculate the tax credit amount.

5. Carbon Neutrality Tax Credit

Japanese tax law provides a tax credit to companies that make qualifying investments into carbon neutrality. The taxpayer must have its Business Adaptation Plan for Carbon Neutrality certified by the Ministry with oversight over its operations and has to acquire and start using qualifying fixed assets before 31 March 2024.

The 2024 tax reform extends the rules. The taxpayer must have its Business Adaptation Plan certified before 31 March 2026 and has to acquire and start using the qualifying fixed assets within 3 years after the date of certification.

In addition, the carbon improvement ratio (a specific formula to calculate value generated by one unit of CO_2 emission) is also required to increase from 7% to 15% in case of new investments.

6. Financial tax issues – Crypto asset taxation

For marketable cryptocurrencies held by a third party and subject to transfer restrictions or other conditions, the year-end valuation of such cryptocurrency will be calculated according to the valuation method chosen by the corporation. This can be either the cost method or the market price method — among other measures.

(*1) The term "cryptocurrency subject to transfer restrictions or other conditions" refers to a cryptocurrency that fulfills the following criteria:

- (a) There are certain restrictions on the transfer of the cryptocurrency, such as technical measures to prevent the transfer to others.
- (b) The person who owns that cryptocurrency has notified the cryptocurrency exchange operator that the restriction in (a) applies, so that they can make it publicly known at the certified payment service enterprise association.

(*2) The above evaluation method must be selected for each type of cryptocurrency with specific transfer restrictions or other conditions, and must be reported to the director of the relevant tax office by the deadline for submitting the tax return for the business year during which the cryptocurrency was acquired. If no evaluation method is chosen, it will be assumed that the ending balance of the cryptocurrency will be calculated based on the cost method.

Consumption tax

1. Platform operators

A new Platform taxation system that obligates platform operators to remit consumption taxes on behalf of foreign digital services businesses will be introduced. The intention is 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.

Among the provision of telecommunications services (excluding B2B) conducted by foreign businesses via digital platforms, those services for which consideration is received via a specified platform businesses will be deemed as being conducted by the relevant "specified platform operator" business. 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."

If the business falls under the category of a specified platform operator, 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 operator 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 operator 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, the necessary transitional measures will be established for prior designation and notification under the specified platform operator designation system.

2. Small business exemption

Revisions will be made to necessary systems in order to prevent tax avoidance by businesses through their inappropriate use of the small business exemption or the simplified calculation rules.

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 (which is basically the period two years prior to the current fiscal 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.

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

3. Export exemption for foreign tourists

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.

International taxation

1. Revision to the earnings stripping rules

Japanese subsidiaries of overseas groups frequently use loans, especially those from other group companies, as a means of financing their start-up arrangements, working capital needs and expansion plans. The Japanese tax system encourages this by permitting interest expenses to be tax deductible in principle. However, such deductions are subject to 3 main restrictions – the earnings stripping rule, thin capitalization rules, and transfer pricing requirements.

Japan's earnings stripping rules are intended to limit the deductibility of interest expenses where the net interest payments of a Japanese company exceed 20% of the adjusted taxable income. This adjusted taxable income is effectively similar to a company's Earnings before Interest, Taxes, Depreciation and Amortization (or EBITDA for short).

While the earnings stripping rule focuses on income and interest expenses in the P&L, the thin capitalization rule considers the amount of debt in a company's balance sheet. The thin capitalization rule seeks to limit tax deductions for interest expenses for companies with foreign related-party debt where, generally, the debt-to-equity ratio exceeds 3:1., i.e., there is more than 3 times the amount of debt compared to equity.

If the thin capitalization rules and earnings stripping rules both apply, then the rule that results in the largest disallowance is applied.

While thin capitalization related non-deductible amounts are permanently non-deductible, interest deductions disallowed under the earnings striping rule can be carried forward and utilized for up to seven years.

The earning stripping rule was previously amended to lower the "adjusted income" to 20% when computing the interest expense disallowance, and to expand the scope of "harmful" interest expenses to include third-party interest in addition to related party interest. The earning stripping rule is therefore quite restrictive.

Given this and the significant increase in interest rates in recent years, numerous financial institutions and companies have fallen within this limitation rule despite not having tax avoidance as a main motive for borrowing.

The proposed reform therefore aims to provide some relief for such companies by extending the carry forward period for excess interest from 7 years to up to ten years.

To reflect the intentions of this rule it will apply to periods beginning from 1 April 2022 to 31 March 2025, i.e., for calendar year-end companies during fiscal years ending December 2023 to December 2025.

2. Japan's Implementation of Pillar Two of the OECD's BEPS 2.0 Initiative

The OECD and G20 have continued to develop approaches and make recommendations for international tax rules aimed at preventing base erosion and profit shifting or "BEPS". The latest round of proposals is informally known as BEPS 2.0. As part of this under the "BEPS Inclusive Framework"[2] there were some developments announced in October 2021. These are intended to provide potential solutions to tax issues and challenges associated with the digitalization of the economy.

Japan is implementing such international agreements as part of its broader involvement in the BEPS initiatives and has introduced various measures into its domestic tax laws and tax treaties in recent years.

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2. The Inclusive Framework on BEPS brings together over 140 countries and jurisdictions to collaborate with the OECD and G20 on developing standards on BEPS related issues and review and monitor the implementation of the BEPS Package. (Per OECD website)

BEPS 2.0, consists of two pillars:

- Pillar One focuses on new nexus and profit allocation rules with the objective of assigning a greater share of taxing rights over global business income to "market countries", (i.e., jurisdictions in which the goods and services are used or consumed). However, other than the so-called Amount B (a streamlined transfer pricing approach to baseline marketing and distribution activities), this Pillar has been delayed and is subject to further discussions.
- Pillar Two relates to a new global minimum tax of 15%. This Pillar is applicable to multinational groups with a global turnover of €750 million or more (which is approximately 807m US dollars).

Pillar Two contains detailed Model Rules to calculate the existing effective tax rate and complicated mechanisms to capture and tax any shortfalls.

Pillar Two has been introduced, or is at the draft legislation stage, in most European countries and many countries in Asia Pacific. However, the US has not yet indicated a clear intention to implement Pillar Two into domestic law.

Japan has partially implemented Pillar Two, when it introduced the income inclusion rule (IIR). This rule permits the ultimate parent entity's jurisdiction to tax profits where they have not been subject to a rate of 15% or more in the local jurisdiction. So, this applies to overseas subsidiaries of Japan parented groups.

It also potentially could apply to Japanese subsidiaries of companies with headquarters in those overseas jurisdictions, such as Germany, France, the UK, etc., that have or are putting the IIR into effect.

However, given that Japan's statutory corporate tax rate is typically between 31% and 35%, then even with tax incentives the rate is unlikely to fall below 15%, hence BEPS Pillar Two will probably not generally apply to such Japanese subsidiaries. It should be noted that the test is based on accounting profits, so it is important to consider if there are any unusual transactions, deferred tax implications, etc., which could still result in a Pillar Two risk.

Also, significantly, there are detailed reporting requirements which are complex and burdensome for such subsidiaries as well as for the Headquarters company.

As part of the 2024 tax reform proposals there are some amendments to the IIR, but also it was confirmed that Japan expects to implement further Pillar Two rules:

The first is the Qualified Domestic Minimum Top-up Tax, (or "QDMTT"). Which would allow Japan to impose a top-up tax in line with global minimum tax rules, this would mean that Japan could tax any Japanese entity's profits not subject to a minimum rate of 15%, before an overseas jurisdiction can try to tax under the IIR.

Additionally, there is a backstop for situations where the local QDMTT is not applied, and the relevant parent entity is not subject to an IIR top-up tax. This Undertaxed Payments Rule (or "UTPR") permits other "third countries" in which the multinational group operates to apply a top-up tax.

The QDMTT and UTPR are not expected to be implemented in Japan until periods starting on or after April 2025, so effectively the fiscal year ended December 2026, at the earliest, for calendar year end companies.

As mentioned above, though we do not expect the Pillar Two rules to be widely applicable in Japan there may be situations where they could apply, and there will certainly be significant reporting obligations. We therefore recommend groups keep up to date with the ongoing discussions in relation to Japan and consider how they will work with their headquarters to meet the reporting obligations and whether they have sufficient people and technical resources to do so. Such best practices would include discussing with their tax return preparers and tax advisers and performing "dry run" practices prior to the relevant implementation date.

3. Introduction of the Japanese CARF and amendments to the Japanese CRS

Maintenance of "the Crypto-Asset Reporting Framework which provides the Automatic Exchange of Information on transactions in crypto-assets, etc. pertaining to non-residents (hereafter "Japanese CARF")" and "Common Reporting Standard for the Automatic Exchange of Information on Financial Accounts pertaining to non-residents (hereafter "Japanese CRS")" will be implemented. These revisions are scheduled to come into effect on January 1, 2026, with the first information exchange likely to be in 2027.

These changes are based on the implementation of the Crypto-Asset Reporting Framework ("OECD-CARF") and the amendments to the Common Reporting Standard ("Amended OECD-CRS"), which were established by OECD.

On November 10, 2023, 48 countries and regions, including Japan, that support this issued a "Joint Statement for the Implementation of the CARF", indicating their commitment to advance their national statutory preparation and carry out the first information exchange based on both systems by 2027.

(1) Introduction of the Japanese CARF

Reporting cryptocurrency exchange operators, such as cryptocurrency exchange operators and electronic payment instrument transaction operators (including issuers of electronic payment instruments), are expected to implement the identification and reporting procedures for the tax residency status, etc., of their customers, who conduct cryptocurrency transactions, in a similar fashion as the Japanese CRS. Under the proposals, by January 1, 2026, these operators will be required to establish a system to execute the necessary procedures in a timely and appropriate manner.

(2) Amendments to the Japanese CRS

With the introduction of the Japanese CARF, and in order to align and harmonize with it, while further tightening the existing system, the existing Japanese CRS is also expected to be amended, e.g., adding target assets and transactions to be captured, modifying customer verification procedures, adding items to report to tax authorities, and changes such as expanding the scope of financial institutions subject to compliance etc.

Even for existing "Reporting Financial Institutions, etc.", a reconsideration and preparation of compliance postures for performing the necessary operations in a timely and appropriate manner will be required by the effective date of the amended law, scheduled for January 1, 2026.

4. Extension of the tax exemption measure for interest relating to margins of over-the-counter derivative transactions

The effective period of the special measure for the taxation of interest relating to margins of over-the-counter derivative transactions of foreign financial institutions will be extended by three years (to 31 March 2027).

Individual income taxation

1. Income tax deductions

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.

2. Child allowance and dependent exemption

The income limitation of the child allowance will be abolished in 2024, and the covered period will be extended until the child graduates from high school. Considering 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.

3. Housing Loans

The borrowing limit for the housing loan tax credit which was scheduled to be decreased will instead be maintained, limited to young married couples and families with children.

4. Stock options

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 (currently JPY12 million), and the annual limit for stocks granted by certain incorporated companies will be raised to JPY36 million (currently 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.

Tax administration

The submission of a request for corrections based on acts of concealment or falsification will be added to the situations subject to heavy additional (penalty) taxes ("juukasanzei").

Regarding representatives of companies who commit fraudulent acts and disperse company assets to avoid tax obligations, measures will be implemented to impose secondary national tax liability on such representatives under certain conditions.

Mobility - Immigration

The Japanese government recently introduced a bill that would create a new "Digital Nomad Visa" for eligible foreign nationals and their dependents. The bill is now at the public comments stage and is expected to become law in late March 2024.

In general, the term "digital nomads" refers to individuals who are employed and receive salaries and benefits in one country (i.e., the home country) but work remotely from another country or multiple countries (i.e., the host country/countries). Digital nomads are typically not permitted to earn remuneration in the host country/countries.

If the bill passes in its current form, Digital Nomad Visa applicants will need to:

- Be nationals of specific countries (including those that signed a tax treaty with Japan and are part of Japan's Visa waiver program).
- Be employed by (i.e., have an employment contract with) and deliver services on behalf of an entity established outside Japan, provide professional services to individuals outside Japan, or sell certain goods to overseas entities or individuals, using information technology (e.g., via a laptop).
- Have an annual income of at least JPY 10 million (currently approx. US$ 67,000)
- Hold valid medical insurance that covers the cost of treatment in Japan and repatriation in case of death.

Eligible individuals will be allowed to work remotely from Japan for up to six months per calendar year and enter with qualifying dependents (i.e., spouse and children) provided they too are nationals of specific countries and hold valid medical insurance.

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