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Japan tax alert

Ernst & Young Tax Co.

2020 Japan tax reform outline

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The 2020 tax reform outline was released on 12 December 2019. In this alert, we provide an overview of the major reforms and revised provisions contained in the outline. Please note that provisions may be revised, deleted or added during Diet deliberations regarding the reform bill.

Corporate taxation

1) Revision of the consolidated taxation regime (transition to a group income and loss sharing regime)

Replacing the current consolidated taxation regime, under which the entire corporate group is treated as a single taxable entity, a new group income and loss sharing regime – in which each entity of the corporate group calculates and files corporate income taxes individually while adjustments, such as the offsetting of profits and losses between group companies, are simultaneously conducted – will be introduced. The new regime maintains the basic framework of the current consolidated taxation regime – e.g., the offsetting of profits and losses – while also reflecting the consideration given to reducing the administrative workload of companies.

Building a better working world

The design of a new regime that is better aligned with the tax rules governing corporate reorganizations — in terms of market value taxation and the restriction on utilization of net operating losses (NOL) upon an initial tax consolidation or entry into an existing tax group — will reduce both the number of entities subject to market value taxation and the number of entities subject to the restriction on utilization of NOL. Furthermore, with regard to research and development (R&D) tax credit rules and foreign tax credit rules, the calculation of tax credits will continue to be conducted on the group level in the same manner as under the current rules.

Application of the group income and loss sharing regime will begin with fiscal years starting on or after 1 April 2022. Additionally, transitional measures pertaining to the transition from the current consolidated taxation regime will be implemented.

2) Introduction of a tax incentive to promote open innovation

In the event a business company, etc. invests in a startup company which meets certain criteria through the acquisition of shares in said startup company between the period from 1 April 2020 to 31 March 2022, that business company will be allowed to deduct 25% or less of the acquisition cost of said shares on the condition that it records that portion in its own special account. The amount invested must be at least JPY100 million (or at least JPY500 million in the case of investment in a foreign entity). (There will be a limit on the amount invested to which the incentive applies.)

If a business company, etc. applies this tax incentive and later transfers said shares or fulfills certain other criteria (e.g. receives dividends, etc.), then an amount stipulated in relation to the corresponding criteria in the special account must be reversed and included in taxable income. However, the foregoing will not apply to cases when shares have been owned for a period of 5 years.

3) Establishment of a tax incentive to encourage the introduction of 5G infrastructure (5th generation mobile communication systems)

Entities qualifying as specified business operators implementing 5G systems, etc. in accordance with Certified Introduction Plans (name tentative) recognized under the Act to Promote the Spread of Specified Advanced Information Communication Systems (name tentative; slated for enactment) that acquire and place into service certified equipment and facilities, etc. in Japan between the enforcement date of the Act and 31 March 2022 will be eligible to elect between a 30% special depreciation or 15% tax credit in relation to said acquisition cost. However, the credit will be limited to 20% of the corporation tax amount in the applicable fiscal year.

4) Revision of criteria for the application of special measures concerning taxation (R&D tax credit rules, etc.)

The condition pertaining to the measures which disallow the application of R&D tax credit rules and other tax credit provisions related to the enhancement of productivity (henceforth, "specified tax credits") for large corporations will be revised.

The condition which states that the domestic capital investments of a large corporation must exceed 10% of its total depreciation expenses of the applicable fiscal year will be revised to state that such expenses must exceed 30%.

5) Other

- The non-deductible entertainment expense rules will be extended by two years. Corporations with stated capital in excess of JPY10 billion will be excluded from the scope of corporations eligible for the special tax measure for the deduction of hospitality-based food and drink expenses.
- The tax incentives for strengthening local business facilities will be revised and extended by 2 years.
- The corporate hometown tax system will be revised and extended by 5 years.
- The special measure for taxation of the replacement of specified assets through purchase will be revised and extended by 3 years.

International taxation

1) Addressing schemes which incorporate subsidiary dividends and subsidiary share transfers

Tax rules will be revised to address schemes which produce capital losses through the transfer of subsidiary shares.

In the event an entity receives a certain amount of dividends from a subsidiary over which it has a certain degree of control, and said dividends exceed an amount equivalent to 10% of the book value of said subsidiary shares, then the reduction of the book value of those subsidiary shares by the amount of said dividends that are excluded from taxable income will be required. Reduction of the book value will reduce the amount of capital losses incurred at the time of subsidiary share transfer by an amount equivalent to the reduction in book value. "A certain degree of control" refers to a relationship where the entity directly or indirectly owns more than 50% of shares of another entity.

However, exempted from this measure will be cases in which the subsidiary is a domestic entity and where 90% or more of its total shares from the time the subsidiary was incorporated to the time said control relationship was established were owned by domestic entities. Furthermore, this measure will not apply to cases in which total dividends are less than the amount of net increase in the retained earnings of the subsidiary after said control relationship was established and cases in which the dividends are received after 10 years have elapsed since said control relationship was established. Additionally, dividends of JPY20 million or less will not be subject to this measure.

2) Other

- In the controlled foreign corporation (CFC) rules, usance interest will be excluded from the scope of interest received subject to the partial inclusion system.
- The scope of foreign taxes eligible for credits under the foreign tax credit rules will be revised.
- The scope of the non-qualified interest expense amount utilized in the earnings stripping rules will be revised.

Individual income taxation, tax administration, and other reforms

1) Individual income taxation

The scope of the exemption for widows or widowers will expand to include never married single parents. The eligibility criteria for application of the exemption will be the same as those applied in cases of bereavement or divorce.

With regard to ordinary NISAs, the investment period will be extended by 5 years and accompanied by revision of the system into a new two-tiered system. With regard to installment-type NISA, the period in which accounts may be opened will be extended by 5 years.

2) Revision of the Electronic Books Maintenance Act

Two requirements will be added to the conditions for the preservation of invoices and receipts received electronically as electronic data: (1) The issuer has affixed a time stamp to the data and (2) The use of a system (service) which does not allow the user (receiver) to freely modify the data.

3) Extension of the consumption tax return filing deadline

When an entity to which the special measure for the extension of the final corporate tax return deadline applies submits a notification indicating an extension of the final consumption tax return deadline, then a one-month extension of the final consumption tax return deadline will be granted in relation to taxable periods in which fall the final day of the fiscal year in which said notification was submitted or fiscal years thereafter.

This reform applies to taxable periods in which fall the final day of fiscal years ending on or after 31 March 2021.

4) Measure to ensure appropriate taxation in relation to foreign transactions, etc.

In regard to the foreign asset reporting requirements, in the event a taxpayer fails to present or submit the required documents by the designated deadline, further additional taxes will be imposed in relation to the failure to file.

In the event an employee of the National Tax Agency, etc. requests a taxpayer to present or submit documents concerning foreign transactions or foreign assets and the taxpayer fails to present or submit said documents by the designated deadline and a request for the exchange of information is made to a foreign tax authority, corrections and determinations will be permitted for a period of three years following the date of said request, regardless of restrictions on said periods specified under the existing laws and regulations.

5) Other reforms

- Rectification of the taxation of real estate income derived from foreign pre-owned real estate (thereby deterring cases in which the employment of short useful lives calculated via the simplified method enable the offset of gains and losses whereby depreciation expenses exceeding rent revenue are recognized) will be implemented.
- Rectification of the purchase tax credit regulations (consumption tax) as pertains to the acquisition of rental residences (thereby deterring cases in which taxpayers intentionally raise their taxable sales ratio by conducting a series of contrived gold ingot transactions) will be implemented.
- The levying of fixed asset taxes through the deeming of the user of a given fixed asset as the owner thereof will be permitted in the event that the owner of said fixed asset cannot be ascertained.
- In view of the recent trends pertaining to market interest rates, the interest tax rate and the interest rate on tax refunds will be decreased (from 1.6% to 1.1%).