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Japan Tax & Legal Inbound Newsletter

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On 16 December 2022, proposals for the 2023 tax reform were announced by the ruling parties and were posted on the LDP's website. (Japanese / PDF)

With the objective of creating a positive cycle of growth and distribution, the proposals aim to increase investment in markets, industries and people in an integrated manner while properly implementing tax and other policies to redistribute wealth so that as many people as possible can enjoy the benefits of growth. To this end, the proposals include amendments to tax incentives for promoting open innovation to allow M&As which involve existing shares to be eligible for the incentives, and revisions to the R&D tax credits which add costs for highly skilled researchers to the scope of eligible R&D costs in order to incentivize businesses to spend more for R&D.

In the area of international tax, a global minimum tax, which is conceptually aligned with the OECD's Pillar Two initiative, will be implemented from fiscal years beginning on or after 1 April 2024 to ensure a level playing field by reducing international corporate tax competition.

In addition, the proposals include several tax measures to secure stable funds for an increase in defense spending. The details of these measures will be further discussed next year to be implemented in stages from FY2024.

Please see below for a list of some of the key items that may affect foreign headquartered companies doing business and individuals residing in Japan. It should be emphasized that these proposals have not been enacted and could change prior to becoming law.

Corporate Tax

1. Revision of R&D tax incentives

(1) Revision of the general R&D tax incentives

The general R&D tax incentives will be revised as shown in the table below.

<table>
<tr><th>Items</th><th>Proposed Revisions</th></tr>
<tr><td>Tax credit rate</td><td>The incentives will be revised as follows:
■ % of increased R&D costs* > 12%
Tax credit rate = 11.5％ + (% of increased R&D costs – 12%) x 0.375
➢ Special provision raising the credit limit to 14% (generally 10%) will be extended by 3 years.
■ % of increased R&D costs ≦ 12％
Tax credit rate = 11.5％ – (12% – % of increased R&D costs) x 0.25
➢ The minimum tax credit will be reduced from the current 2% to 1%.
* % of increase R&D costs = (Current R&D costs – 3-year average R&D costs)/ 3-year average R&D costs</td></tr>
<tr><td>Tax credit limit</td><td>The maximum credit amount for the fiscal years beginning from 1 April 2023 to 31 March 2026 will be revised as follows:
■ If % of increased R&D costs is greater than 4%: addition of 0.625% per one percent increase (up to 5%)
■ If % of increased R&D costs is less than -4%: deduction of 0.625% per one percent decrease (up to 5%)
■ If R&D costs are greater than 10% of average sales, either the above provision or the additional R&D tax credit available where R&D costs are greater than 10% of average sales, whichever allows a greater credit limit, will be applicable.</td></tr>
<tr><td>Additional R&D tax credit and additional credit limit available where R&D costs are greater than 10% of average sales</td><td>Extended by 3 years</td></tr>
<tr><td>Additional credit limit available where R&D costs increase despite a decrease in sales of 2% or more from prior FY beginning before 1 February 2020</td><td>Discontinued at the end of the applicable period</td></tr>
</table>

(2) Revision of R&D tax incentives for SMEs

The R&D tax incentives for SMEs will be revised as shown in the table below.

<table>
<tr><th>Items</th><th>Proposed Revisions</th></tr>
<tr><td>Additional R&D tax credit if % of increased R&D costs > 9.4% (Maximum tax credit and credit limit)</td><td>The calculation formula will be revised as follows and the applicable period will be extended by 3 years.
■ Additional credit = 12% + (% of increased R&D costs – 12%) x 0.375
■ The credit limit will be increased by 10% of corporate tax.</td></tr>
</table>

Additional R&D tax credit and additional credit limit available where R&D costs are greater than 10% of average sales	Extended by 3 years
Additional credit limit available where R&D costs increase despite a decrease in sales of 2 % or more from prior FY beginning before 1 February 2020	Discontinued at the end of the applicable period

(3) Tax incentives for joint or outsourced research

The scope of eligible R&D costs for tax incentives for joint or outsourced research will be revised to include the R&D costs in the table below.

Costs added to eligible R&D costs	Details	Tax credit %
R&D costs for joint research with (or research outsourced to) Venture Companies	A company is a Venture Company if the following apply: ■ The company conducts business that contributes to certain business activities under the Act on Strengthening Industrial Competitiveness (the "SIC Act"). ■ The Ministry of Trade, Economy and Industry has certified that the company's management resources are used to carry out business with high productivity or contribute to new business development for the specified business activities ■ Certain other conditions are met.	25%
Personnel costs for highly skilled researchers engaged in R&D	Personnel costs for highly skilled researchers engaged in R&D are entitled to the incentives if all the following apply: ■ The company performs R&D using such personnel who are its directors or employees and pays their personnel costs. ■ The ratio of a/b ≧ 1.03. a. Highly skilled personnel costs for current FY engaged in R&D (excluding research for practical application) b. The above personnel costs for previous FY ■ Certain other conditions are met.	20%

These incentives will not apply to R&D costs for joint research with (or research outsourced to) venture companies with a focus on R&D.

POINT:

The additional tax credit and credit limit for general type R&D tax incentives will be revised to make the incentives more attractive for companies spending more money for R&D. Specifically, the slope of the rate curve will be amended to make larger R&D investments more beneficial, while reducing the minimum rate of credit from the current 2% to 1%. Further, the establishment of a credit limit range, as opposed to the current flat rate of 25% of corporate tax, will result in larger R&D investments being given a higher credit limit. This will be the case for both R&D credits applicable to large companies and those for SMEs.

In addition, the scope of eligible R&D costs will be expanded to include R&D costs for joint research with, or research outsourced to, venture companies (excluding R&D venture companies) and costs for highly skilled researchers engaged in R&D to promote the hiring of R&D personnel with doctorate degrees and external, experienced researchers.

2. Revisions to tax incentives for promoting Open Innovation

The following revisions will be made to the tax incentives for promoting open innovation.

Items	Proposed Revisions
Addition of eligible type of share acquisition	The following type of acquisition will be added. ■ Shares which are acquired from an entity/person other than the original issuer (qualified venture company) will be added to the scope of specified shares. In order for taxpayers to be eligible, they are required to acquire majority voting rights of the qualified venture company. ➢ Upper limit of acquisition cost of the specified shares acquired under this category is JPY 20 billion. ➢ Certain revisions to the requirement will be considered: 1) minimum shareholding period will be five years, 2) minimum total investment costs will be JPY 500 million, and 3) only domestic companies will be eligible as qualified venture companies for this purpose. ➢ Some of the conditions which trigger a reversal of the deduction and subsequent inclusion in taxable income will be reconsidered.
Reduction of upper limit for acquisition cost	With regard to the acquisition cost of specified shares obtained as part of direct capital investments in a qualified venture company, the upper limit will be reduced from JPY 10 billion to JPY 5 billion.
Exclusions from eligible investments	The following criteria will be added to determine eligibility: ■ Investments made to qualified venture companies whose majority shares are already owned by the investor will be excluded from eligible investments; and ■ For incremental investments in qualified venture companies where the investor has already acquired minority voting rights using open innovation tax incentives, the incremental investment should bring the voting right ratio of the investor from below 50% to 50% or higher in order to be eligible.

POINT:

In order for venture companies to consider various options as their exit strategy, the acquisition of the shares from entities other than the original issuer (e.g., the venture company) will be added to the eligible acquisition method. Furthermore, for the true growth of venture companies, a new system will be introduced to allow eligible acquiring companies to receive tax benefits continuously if some additional requirements (e.g., growth rate of venture company or scale of investment in venture company) are met within five years after the acquisition. It is expected that those proposed revisions will strongly accelerate the growth of venture companies in Japan.

3. Revisions to tax incentives for promoting Regional Future Investment

The tax incentives for promoting Regional Future investment will be revised as follows with an extension of two years until 31 March 2025 (the same will be applied to individual income tax).

<table>
<tr><th>Items</th><th>Proposed Revisions</th></tr>
<tr><td>Increased tax credit rate rand special depreciation</td><td>■ The following new set of requirements will be added to the existing requirements which the taxpayers are required to meet in order to be eligible for the incentive:
➢ The average added value of the regional economic business certified by the relevant ministry is JPY 5 billion or more in the prior two years;
➢ The regional economic business is expected to create an added value of JPY 300 million or more; and,
➢ The labour productivity growth and return on investment is expected to exceed a certain level.
■ Note that under the current regulation it is not necessary to meet the requirement for being considered “cutting-edge” if the regional economic business is conducted at a location where buildings or structures used to be located but they could not be used anymore due to a specified emergency disaster. This special treatment will end by 31 March 2023.</td></tr>
<tr><td>Revisions for approval of business plan by relevant ministry</td><td>■ The following improvements will be made to the approval process:
➢ The financial impact (e.g., fluctuation in demand) will be taken into consideration for the purpose of calculating revenue as part of the application evaluation.
➢ With regard to the requirement for being advanced, some measures will be taken to improve the accuracy of the evaluation by the evaluation committee.
■ With regard to businesses related to the manufacturing of specified important materials which are stipulated in the relevant laws on promotion of economic security, such businesses will no longer fall into the category of supply chain type.
■ The requirement that planned capital investments in the depreciable assets must be 10% of the prior year’s depreciation expense or more will be revised to 20% of the prior year’s depreciation or more.</td></tr>
</table>

4. Revisions to tax incentives for promoting Digital Transformation (“DX”) investment

The tax incentives for promoting DX investment will be revised as follows with an extension of two years until 31 March 2025.

<table>
<tr><th>Items</th><th>Proposed Revisions</th></tr>
<tr><td>Requirements for productivity improvement or development of new demand</td><td>New requirement:
■ Sales is expected to increase 10% or more.</td></tr>
<tr><td>Requirements for business transformation</td><td>New requirement:
■ Overseas sales ratio of the targeted business is expected to exceed a certain ratio.</td></tr>
</table>

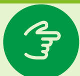
The above revisions will not be applied to assets acquired before 1 April 2023 based on an application which was submitted before 1 April 2023. In addition, there may also be a new requirement for human resource development and hiring which will be introduced, however no specific description was included in the 2023 tax reform proposals.

5. Expansion of tax-qualified share distribution

Distribution of shares of a wholly-owned subsidiary by a company (the “Distributing Company”), whose business restructuring plan is certified under the SIC Act, during the period from 1 April 2023 to 31 March 2024 will be treated as a “Share Distribution” (as defined under tax law) if it is made in the form of “Dividends from Specified Surplus” (as

prescribed under the SIC Act). Further, such “Share Distribution” will be treated as a “Qualified Share Distribution” (i.e. tax neutral) if the following requirements are satisfied. These changes are applicable for individual and corporate income tax purposes.

- Only shares in the wholly-owned subsidiary are distributed to the shareholders of the Distributing Company in proportion to their ownership percentages.
- The number of shares in the wholly-owned subsidiary held by the Distributing Company immediately after the distribution will be less than 20% of the total number of its outstanding shares.
- Approximately 90% or more of the employees of the wholly-owned subsidiary are expected to continue to be engaged in the subsidiary's business.
- The “Non-controlling” test, "Business Continuity” test and "Management Continuity” test (similar to those under existing “Qualified Share Distribution” rules) are satisfied.
- Other requirements, such as the grant of (or expectation to grant) stock options to specified management of a related business operator or an affiliated foreign company under the certification, are satisfied.



POINT:

Prior to the reform, distribution of shares of a wholly-owned subsidiary was treated as a taxable transaction when a portion of shares was retained by the Distributing Company. Based on this reform, distribution of shares in a wholly-owned subsidiary may qualify for tax neutral treatment as “Qualified Share Distribution” even when a portion of the shares is retained by the Distributing Company subject to certain other conditions outlined above. This reform is in line with the reform request made by the Ministry of Economy, Trade and Industry to facilitate a phased spinoff.

International tax

Global minimum taxation

In October 2021, an international agreement was reached to solve the tax challenges arising from the digitalization of the economy based on the OECD / G20 Inclusive Framework on BEPS. This international agreement consists of two pillars: the allocation of new taxation rights to market countries ("Pillar 1") and global minimum taxation ("Pillar 2").

Under the 2023 tax reform, Japan will introduce the Income Inclusion Rule (“IIR”), which is conceptually aligned with IIR put forth by the OECD / G20 Inclusive Framework. While the tax reform provides for the following basic structure.

(1) Taxpayer

A domestic company that belongs to a “Specified Multinational Enterprise Group” (i.e. generally, a group whose gross revenues are equivalent to EUR 750 million or more in at least two of the four fiscal years immediately preceding the target fiscal year) is liable to pay national corporate income tax on the “Global Minimum Tax Amount” (see below) for each target fiscal year.

(2) Target fiscal year

Target fiscal year is a period with respect to which the “Ultimate Parent Entity" (i.e. generally, a company that directly / indirectly holds a controlling interest in another company, but which is not itself controlled by another company) of a multinational enterprise group prepares its consolidated financial statements.

(3) Global Minimum Tax Amount

The Global Minimum Tax Amount will be calculated based on various factors outlined in the tax reform proposal document and ultimately allocated to National Corporate Income tax and Local Corporate tax as follows:

1. National Corporate Income tax is calculated by multiplying the Global Minimum Tax Amount by 90.7/100 (“Specified Base Corporate Income Tax” or “SBCIT”).

2. Local corporate tax is calculated by multiplying the SBCIT amount by 93/907.

(4) Filing and payment

Filing and payment are required within 15 months (18 months in certain cases) from the day immediately after the last day of each target fiscal year. However, filing is not required if there is no Global Minimum Tax Amount for the target fiscal year.

(5) Safe harbor

De minimis exclusions and transitional safe harbor rules using certain information on the country-by-country report, etc. will apply.

(6) Information return

Information related to the Specified Multinational Enterprise Group (e.g. name of constituent company, effective tax rate for each country, Global Minimum Tax Amount, etc.) must be provided to the district director of the competent tax office via e-filing within 15 months (18 months in certain cases) from the day immediately after the last day of each target fiscal year.

(7) Effective date

National corporate income tax on the Global Minimum Tax Amount and Local Corporate tax on the SBCIT amount will be applicable from the domestic company's fiscal years beginning on or after 1 April 2024.

POINT:

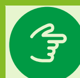
In the 2023 tax reform, the Japanese government has reconfirmed its support for Pillar 2 by deciding to introduce the IIR. Further, the Japanese government indicated that it is considering to include the Undertaxed Profits Rule (“UTPR”) and Qualified Domestic Minimum Top-up Tax (“QDMTT”) in future tax reforms based on ongoing international discussions.

Income Tax

1. Revision of NISA

A Nippon Individual Savings Account (“NISA”) earns tax-exempt income on dividends and capital gains from listed shares, etc., held in the account for a specified exemption period. This tax exemption period and the deadline for opening a NISA account will be discontinued. In addition, the annual contribution limit and the tax exemption total investment limit will be increased as per the below in FY2024 and thereafter.

Type	Outline	Annual contribution limit	Total investment limit
Installment	Long term, instalment, and diversified investment in specified mutual funds	JPY 1.2 million	JPY 18 million (with lump-sum type)
Lump-sum	Investment in listed shares, etc.	JPY 2.4 million	JPY 12 million
Total		JPY 3.6 million	JPY 18 million



POINT:

The revisions will significantly increase the annual contribution limits (increased by three times for the instalment investment type and by two times for the lump-sum investment type). The revisions are meant to encourage more middle-income taxpayers to participate in the capital market.

2. Minimum tax on significantly high income earners

A minimum tax on significantly high income earners will be implemented to ensure fair taxation. Specifically, the minimum tax will be levied on the difference between amounts A and B below, if A is greater than B.

A: Minimum income tax = (Income – JPY 330 million) x 22.5%

B: Base income tax

Capital gains on reinvestment in start-ups which are exempt from tax and income exempted under the NISA system will be excluded from the calculation of the base income tax.

The revision will be applicable to individual income tax from FY2025.

POINT:

Dividends and capital gains from listed and non-listed shares are taxed separately from other sources of income at a rate of (national) individual income tax of about 15%. This means that for individual taxpayers with primarily investment income, the minimum tax would be applicable if investment income is approximately JPY 1 billion or more.

Inheritance/ Gift Tax

Revision of the inclusion period and amount of gifts concerning inheritance tax

Currently, all property that a person, who is an heir of a decedent, acquired as a gift from the decedent within three years before death are included in the taxable estate of the decedent for inheritance tax purposes. This provision is only applicable to those who have received property through inheritance.

The following are the applied revisions.

	Current	Proposed
Taxable Estate Inclusion Period	Within three years before the date of death	Within seven years before the date of death
Deductions from the taxable estate on property acquired by gift	None	Deduction of JPY 1 million (Only applicable to the portion of the taxable estate that was gifted in the four-year period beginning seven years before and up to three years prior to the date of death)

This revision will be applied to the inherited property acquired by gift from 1 January 2024.

POINT:

The inclusion period of gifts will be increased by one year per year beginning 1 January 2027. If the date of death is on or after 1 January 2031, the maximum duration of within seven years will be applied.

For a death occurring on or before 31 December 2026, the current inheritance tax calculation of within 3 years will be applied.

Japanese Consumption Tax ("JCT")

1. New transitional measures for the Qualified Invoice System

The following transitional measures regarding the Qualified Invoice System ("QIS") will be implemented from 1 October 2023.

Item	Proposed transitional measures
Simplified JCT calculation for new JCT taxpayers	Under QIS, only enterprises registered as Qualified Invoice Issuers are permitted to issue Qualified Invoices. Qualified Invoices are required for purchasers to claim a deduction for any input JCT. To become a Qualified Invoice Issuer, an enterprise must be a JCT taxpayer. Consequently, enterprises that are exempt from the JCT reporting obligation (i.e. small amount of taxable sales) must elect to become voluntary JCT taxpayers in order to become a registered Qualified Invoice Issuer. The 2023 tax reform's transitional measure will allow new JCT taxpayers to calculate the amount of JCT liability in a simplified manner on its JCT return for the tax period. Any such enterprise will be allowed to calculate its JCT liability as 20% of the output JCT (as if it incurred input JCT in the amount of 80% of the output JCT, regardless of the actual amount of input JCT incurred). In order to qualify, exempt enterprises must register to be a Qualified Invoice Issuer or file a Notification of Election to become a Voluntary JCT taxpayer during the tax period between 1 October 2023 and 30 September 2026.
Eased documentation requirements for input JCT deduction for enterprises with small taxable sales	Under the current QIS regulations, a JCT taxpayer is, in principle, required to retain Qualified Invoices and other necessary accounting books and records to deduct any input JCT. According to the 2023 tax reform, the above documentation requirements will be eased for enterprises with taxable sales of JPY 100 million or less during the base period[1] or JPY 50 million or less during the specified period[2]. These enterprises will be allowed to deduct input JCT without retaining the relevant Qualified Invoices (i.e., only required to retain accounting books), with respect to taxable purchases of less than JPY 10,000 (JCT-inclusive) incurred during the period 1 October 2023 to 30 September 2029.
De minimis rule for Qualified Credit Notes	In principle, under QIS, Qualified Invoice Issuers must issue Qualified Credit Notes containing necessary items for any sales refunds. The 2023 tax reform presents a de minimis rule that exempts the obligation to issue Qualified Credit Notes for sales refunds of less than JPY 10,000 (JCT-inclusive). This rule will be available to all Qualified Invoice Issuers and will apply to sales refunds of taxable transactions occurring on or after 1 October 2023.

[1] The "base period" refers to the second prior fiscal year.

[2] The "specific period" refers to the first six months of the previous fiscal year.

2. Revisions to Qualified Invoice Issuer registration

1) Deadline for filing a registration application

The due date for filing an application for registration to be a Qualified Invoice Issuer will be extended as follows.

	Current	Proposed
Registration will be effective from the beginning of the following tax period if an application is filed by:	One month before the day prior to the beginning of the following tax period	15 days before the beginning of the following tax period

2) Deadline for filing a notification of registration cancellation

The due date for filing a notice to request a registration cancellation will be extended as follows.

	Current	Proposed
Cancellation will be effective from the beginning of the following tax period if a notification is filed by:	31 days before the end of the tax period in which the notice was filed	15 days before the beginning of the following tax period

3) Timing of registration as a Qualified Invoice Issuer

Under a transitional measure in the current JCT Law, an enterprise becomes a JCT taxpayer from the date that they are registered as a Qualified Invoice Issuer (if the registration is complete in the tax period from 1 October 2023 to 30 September 2029).

According to a transitional measure in the 2023 tax reform, an enterprise that intends to become a JCT taxpayer and register as a Qualified Invoice Issuer on or after 2 October 2023 can specify a desired effective date of registration if the date is at least 15 days after the application submission date. If such desired date is specified, the enterprise will be deemed to become registered as a Qualified Invoice Issuer from the desired date as opposed to the registration completion date.

3. Platform taxation

With regard to consumption taxation on the provision of cross-border services, the government is considering measures to ensure appropriate taxation taking into account the regulatory responses in other countries, enforcement issues and the role of platform operators, and the fairness of domestic and foreign competitive conditions.

Tax Administration

Revisions to the Electronic Record Retention Law ("ERRL")

Certain requirements and procedures for electronic record retention will be relaxed to accelerate the transition to electronic record retention, taking into consideration the current circumstances, as well as feasibility and necessity for ensuring proper taxation.

Title (Article)	Proposed Revisions	Effective Date
Electronic Books -ERRL 4(1)	The scope of High-Quality Electronic Books (*) will be limited to general ledgers, journals, and the other specific data included in the books. (*) Electronic Books can be classified into general Electronic Books and High-Quality Electronic Books. When a company adopts use of High-Quality Electronic Books, penalty tax for understatement of liability can be mitigated. However, in order to be considered as using High Quality Electronic Books, several additional requirements must be met and a notification needs to be filed with the designated tax office.	Books related to national taxes with a tax filing due date on or after 1 January 2024

Scanned digital documents -ERRL 4(3)	■ The requirements related to definition, gradation and size of information will be abolished. ■ The requirement to confirm the identity of who input scanned digital documents will be abolished. ■ For the cross-reference requirement, the scope of documents required to have cross references with records related to national tax will be limited to important documents defined in the ERRL. (e.g., contracts, receipts, etc.)	Records related to national taxes to be retained on or after 1 January 2024
Electronic transaction records -ERRL 7	■ The requirements for electronic transaction records will be relaxed as below: ➢ The measure that the search requirement is not applicable to taxpayers who can download electronic transaction records upon a request from national tax auditors will be applied to: ✓ Taxpayers whose taxable sales for the base period are JPY 50 million or less (currently JPY 10 million or less). ✓ Taxpayers who can present or provide paper documents upon a request ➢ The requirement to retain data of the input user for assurance of integrity will be abolished. ■ For taxpayers not able to retain electronic transaction records under the ERRL 7 requirements due to reasonable circumstances, a grace measure allowing taxpayers to retain electronic transaction records not in accordance with ERRL 7 requirements will be applicable if both of following conditions are met: ➢ The commissioner of the designated tax office acknowledges that the taxpayer of corporate income tax or individual income tax is not able to retain electronic transaction records due to reasonable circumstances. ➢ The taxpayer can download electronic transaction records or can present or provide paper documents upon a request from national tax auditors ■ Transitional measures for preservation of electronic transaction records will be abolished after 31 December 2023.	Electronic transaction records occurring on or after 1 January 2024

POINT:

The requirements for High-Quality Electronic Books implemented in 2021 will be simplified to accelerate the transition to electronic record retention by limiting the scope, and the requirements for scanned digital documents will also be relaxed to accelerate the transition.

The current transitional measures for preservation of electronic transaction records will be abolished after 31 December 2023. However, the additional grace measure will be implemented for enterprises not able to retain electronic transaction records under the ERRL 7 requirements due to reasonable circumstances. In addition, the search requirement will be relaxed to accelerate the transition to electronic transaction records.

Other

Tax measures to finance an increase in defense spending

Tax measures to finance an increase in defense spending will be implemented in stages over several years from FY2024 to secure the defense budget of over JPY 1 trillion in FY2027. Specifically, to finance the increase in defense spending, corporate and personal income taxes, as well as tobacco tax are planned to be raised. Details are as shown in the table below.

Tax items	Measures	Implementation period
Corporate income tax	■ A special levy will be added. ➢ Special levy = Corporate tax x 4.0% - 4.5% ➢ A deduction of JPY 5 million from corporate tax as a tax base will be available to small and medium-sized enterprises ("SMEs").	In or after FY2024
Personal income tax	■ A special levy will be added for a certain period. ➢ Special levy = Income tax x 1% ➢ Special tax for reconstruction will be reduced by 1% while extending the applicable period by the necessary period to secure the sufficient funds for reconstruction.	
Tobacco tax	■ Tobacco tax will be raised in stages by JPY 3 per cigarette with sufficient consideration for tobacco farmers and securing predictability for tobacco companies.	

Japan Tax Reform

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