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Japan Inbound Tax & Legal Alert

2021 Japan Tax Reform Proposal

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On 10 December 2020, proposals for the 2021 tax reform were announced by the Liberal Democratic Party ("LDP") and the New Komeito Party and were posted on the LDP's website. (Japanese / PDF)

With the background of economic recovery from COVID-19, this year's proposals include the establishment of tax incentives for investments in both digital and green technologies. In addition, R&D tax credits, earnings stripping rules, and tax administrative procedures, among others, will be amended.

Please see below for a list of some key items that may affect foreign companies doing business in Japan. It should be emphasized that these proposals have not been enacted and could change prior to becoming law. Deloitte will provide further details regarding certain proposals in the coming weeks.

Corporate Tax

1. Establishment of tax incentives for investments in digital transformation

Tax incentives will be established for the acquisition of cloud-based systems to create new demand and improve productivity through the development of new products, and/or the introduction of new production/sales methods. The incentives will be as follows:

- Either special depreciation of 30% or a tax credit of 3% (5% if data is linked to external party) of the cost of software will be available if acquired based on a plan certified under the revised Industrial Competitiveness Enhancement Act (the " ICE Act"). The incentives will be available for the assets acquired beginning from the effective date of the revised ICE Act until 31 March 2023.
- The sum of this credit and the tax credit for becoming carbon neutral (see 2 below) is limited to 20% of corporate tax.
- The total value of assets (including deferred assets) eligible for this relief is up to JPY 30 billion.

2. Establishment of tax incentives for investments in becoming carbon neutral

In order to achieve the goal of carbon neutrality by 2050, tax incentives will be established for investments in assets that make production processes carbon neutral and in assets for manufacturing carbon neutral products.

- Either special depreciation of 50% or a tax credit of 5% (10% in certain cases) of the acquisition cost of such assets will be available if acquired based on a plan certified under the revised ICE Act. The incentives will be available for the assets acquired from the effective date of the revised ICE Act until 31 March 2024.
- The sum of this credit and the tax credit for investments in digital transformation (see 1 above) is limited to 20% of corporate tax.
- The total value of assets (including deferred assets) eligible for this relief is up to JPY 50 billion.

3. Temporary removal of limitations on NOL utilization

For companies with an approved business plan and engaging in a range of certain investments, such as those in digital transformation and carbon neutrality, the limitation on the utilization of net operating losses ("NOLs") arising during a period affected by COVID-19 will be temporarily lifted to allow the utilization of up to 100% of such NOLs for a certain period.

4. Revision of R&D tax credits

The credit rates and credit limits, as well as the scope of R&D costs eligible for the tax credits, will be amended.

5. Revisions to the tax credits for wage and investment increases

The tax incentives for promoting wage and investment increases for large companies will be revised to allow corporations with increased salaries for new hires or training costs to receive the tax credit.

6. Extension of disallowance of R&D and certain other tax credits for large companies by three years

The tax credits for promoting investment in digital transformation and carbon neutrality will be added to the scope of disallowed tax credits if additional requirements not satisfied.

7. Deferral of capital gains taxation for certain share-for-share exchanges

The tax provisions on share-for-share exchanges will be revised to allow the deferral of taxation of capital gains on shares transferred by a company in exchange for shares in its parent company, if certain conditions are met.

International Taxation

1. Revisions to earnings stripping rules

The scope of interest payments subject to earnings stripping rules will be amended to exclude certain interest related to insurance policies, and interest income from bond investment trusts will be added to scope of interest income for purposes of calculating net interest expense.

2. Revision of calculation of non-deductible interest on debt allocable to a Japanese permanent establishment ("PE")

The interest used in calculating non-deductible interest on debt attributed to a Japanese PE of a foreign company will be expanded to include "other financing" related to the interest.

3. Deferral of capital gains taxation for certain share-for-share exchange by foreign corporations

Capital gains on shares transferred by a foreign company with a PE in Japan in exchange for shares in its parent company may be deferred, but this will only apply to the portion of such gains allocable to the shares managed by the PE.

Financial Services Taxation

1. Revisions for promotion of Japan as a financial hub

The below revisions will be included as part of the initiative to promote Japan as a global financial center:

- Profit-linked compensation paid to directors of certain investment firms will be deductible if certain conditions are met (e.g., disclosure on the website of the Financial Services Agency).
- Foreign assets acquired by foreign individuals - who are either resident in Japan for a short period or overseas - through inheritance or gift from foreign residents in Japan on working visas will be exempt from inheritance or gift tax.
- Carried interest from partnerships engaging in share transfers in the course of business may be separately assessed as capital gains in certain cases.

2. Taxation of foreign partners

The determination of the ownership percentage under a partnership agreement for foreign partners of funds of funds for the purposes of exemption from income tax will be relaxed, and the application form for such exemption (including copies of the relevant agreement) will be required to be submitted every five years.

3. Extension of electronic application for exemption from tax on interest arising from certain cross-border transactions

The exemption from taxation of interest arising on margins of over-the-counter derivatives issued by foreign financial institutions will be extended by three years, and the exemption from taxation of interest on bond repurchase agreements issued by foreign financial institutions will be extended by two years.

Individual Income Tax

1. Revision of tax on retirement benefits

The 50% exemption of short-term retirement benefits (those with service length of five years or less) will no longer be available (even for non-directors).

Tax Administration

1. Abolition of use of seals for tax documents

Necessary measures will be taken so that seals are no longer required on tax documents in principle.

2. Revisions to electronic book preservation rules

Pre-approval for electronic book preservation will be abolished and revisions for preventing electronic data tampering will be made to improve both work productivity (through digital accounting) and data quality (through use of clouds accounting software).

3. Measures to ensure appointment of tax representatives by foreign companies and non-residents

With an increasing number of cross-border transactions, measures will be taken to ensure that foreign corporations and non-residents properly appoint tax representatives for more effective tax audits.

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