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Japan: Inbound Tax Alert

2019 Japanese Tax Reform Proposal

December 2018 - News Flash

In Brief

On 14 December 2018, proposals for the 2019 tax reform were approved by the Liberal Democratic Party ("LDP") and the New Komeito Party and were posted on the LDP's website. (Japanese / PDF)

Under this tax reform, among other changes, R&D tax credits, earnings stripping rules, transfer pricing rules and the Japanese CFC rules 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.

1. Corporate Tax

(1) Revision of R&D tax credits

- The rates for the general R&D tax credit will be revised (although the maximum and minimum credits will remain the same) and the credit limit for certain venture companies conducting R&D will be raised from the current 25% to 40% of corporate tax liability.
- The additional R&D tax credit available for companies whose R&D costs exceed 10% of average revenue will be extended by two years and the framework will be revised.
- The additional R&D tax credit for small and medium sized enterprises ("SMEs") will be extended by two years, but the required minimum percentage of an R&D cost increase to be eligible for the additional credit will be raised from the current 5% to 8%.

(2) Revision of other tax incentives for SMEs

- The reduced corporate tax rate for SMEs will be extended by two years.
- Certain tax credits and additional depreciation available for SME investment promotion and SME business enhancement will be extended by two years.

(3) Revisions to local taxes

- Introduction of special corporate enterprise tax and reduction of corporate enterprise tax rates (although the total corporate enterprise tax rates will remain basically unchanged).
- A special corporate business transfer tax (tentative name) will also be introduced.

(4) Revisions related to corporate reorganizations

- In mergers, corporate divisions or share-for-share exchanges, the issuance of shares in the ultimate parent company (i.e., the indirect owner) will no longer disqualify these as tax-free transactions (although not applicable for certain foreign ultimate parent companies).

(5) Others

- Introduction of market valuation for cryptocurrencies.
- Simplification of procedures for participating in, or withdrawing from, a tax consolidated group.
- Revision of certain procedural requirements for deductible performance based director compensation.

2. International Tax

(1) Revisions to earnings stripping rules

- Clarification of net interest expense as total interest paid minus total corresponding interest received. However, interest paid which is taxable in Japan in the hands of the recipient will be out of scope, with the exception of interest on certain intragroup loans.
- Dividends excluded from taxable income no longer need to be added back for calculating adjusted income.
- Net interest expense exceeding 20% of adjusted income will be non-deductible.
- The de minimis interest threshold will be raised from the current JPY10 million to JPY20 million.
- The earnings stripping rules will not apply if the ratio of total net interest expenses of a company and its Japanese related parties to their total adjusted income is 20% or less.
- The deductible amount of excess net interest carried forward will be limited in total to 20% (currently 50%) of the adjusted income for the current fiscal year.

(2) Revisions to transfer pricing rules

- The definition of intangible assets will be clarified as "assets other than tangible or financial assets for which consideration would generally be paid if they were transferred between independent parties."
- The discounted cash flow (DCF) method will be added as a new pricing method for calculating intangible transactions without comparables, and may also be used by the tax authority as a method for presumptive taxation.
- The tax authority will be granted discretion to correct the transfer price of transactions involving hard to value intangibles (HTVIs) if estimates used by the taxpayer to calculate the arm's length price are different from the tax office's determination by a variance greater than 20%.
- An interquartile range may be used in certain cases to adjust functional or other differences between the controlled and comparable transactions.
- The statute of limitations for transfer pricing purposes will be extended from the current six to seven years.

(3) Revisions to the Japanese CFC rules

- The definition of Paper Company will be amended to exclude certain foreign related companies whose main business is to hold shares in subsidiaries or certain real estate, or those which play essential roles in resource development projects.
- The criteria for an insurance business to fulfil the substance test and the management and control test for determination as a Paper Company will be revised.
- For purposes of calculating income under the entity-based approach and determining the creditable foreign tax of the Japanese corporation, the tax consolidation and pass-through taxation rules of the country in which the head office of the CFC is located will be disregarded.
- Adjustments to eliminate double taxation will be available for dividends received from foreign subsidiaries if the prescribed documents are attached to the relevant amended returns or request for correction.

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