

Japan: Inbound Tax Alert

2020 Japanese Tax Reform Proposal

December 2019 – News Flash

In Brief

On 12 December 2019, proposals for the 2020 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, tax consolidation rules, various credits (i.e., R&D, wage and investment, etc.), and anti-avoidance rules will be amended.

Please see below for a list of some key items that may affect foreign headquartered 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. Change from a tax consolidation system to a group aggregation system

- The basic framework of the group aggregation system will be as follows:
 - Taxable entity: a parent company and each of its subsidiaries
 - ◇ Filing of returns, applications and notifications for subsidiaries may be made with the e-signature of the parent company.
 - The following concepts and procedures will be the same as the tax consolidation system:
 - ◇ Applicable companies
 - ◇ Application procedures
 - ◇ Joint liability to pay tax
 - ◇ Group fiscal year (i.e., the fiscal year of the parent company)
 - ◇ General applicable anti-avoidance rules
 - Group aggregation is only available for blue form taxpayers.¹
- Calculation of taxable income and tax liability
 - Offsetting of profits and losses and utilization of net operating loss (“NOL”) carryforwards
 - ◇ Offsetting of profits and losses within a tax consolidated group: Total losses of group companies (to the extent of total group income) will be allocated among profit-generating companies on a pro rata basis according to their income.
 - ◇ In the event that a group company's net profit, NOL, or NOL carryforward for a fiscal year are amended in a subsequent fiscal year, recalculation of such net profit, NOL, or NOL carryforward will generally only be made by that group company only and not by other members of the group.
 - ◇ The tax office, however, may disallow such recalculation if they find that the company is inappropriately reducing its tax liability.

¹ Blue form taxpayer status is a specified status in Japanese tax law that provides a wide range of tax privileges, subject to certain conditions, to taxpayers filing blue form tax returns.

- Book value adjustments for group companies
 - ✧ Valuation gain or loss on shares in group subsidiaries and gain or loss on share transfers within an aggregated group will no longer be recognized.
 - ✧ The book value of the shares of a group company immediately before leaving the group will be the book value of its net assets.
 - ✧ The shares of a subsidiary which will join the group aggregation, but which is no longer expected to be 100% owned by the parent company will be marked-to-market, and valuation gain or loss on those shares will be recognized by the shareholder of the subsidiary.
- Treatment when starting group aggregation or participating in group aggregation
 - The following companies will be exempt from mark-to-market valuation:
 - ✧ At the start of group aggregation:
 - A subsidiary which is expected to continue being 100% owned by the parent company
 - The parent company which is expected to continue to own 100% of any subsidiary of the group
 - ✧ At the time of joining group aggregation:
 - A 100% owned subsidiary joining the group through a qualified share-for-share exchange
 - A newly established company within the group
 - A company fulfilling the conditions for a qualified corporate reorganization
 - ✧ NOLs of companies subject to mark-to-market valuation incurred before the start of group aggregation or participation in group aggregation will be forfeited.
 - Limitation on the utilization of NOLs and built-in losses
 - ✧ The utilization of NOLs and built-in losses of group company assets incurred before the start of group aggregation or participation in the group will be limited until the earlier of the following dates:
 - the date five years after the establishment of the more than 50% shareholding relationship; or
 - the date three years after the start of group aggregation or participation in the group.
 - ✧ The following companies will, however, be exempt from the above restriction:
 - A company which has been more than 50% owned by the parent company for more than five years.
 - The parent company which has more than 50% owned any of the group subsidiaries for more than five years.
 - A company which fulfils the joint business test with another group company.
 - Separate return limitation year (SRLY) rules will apply to NOLs which are generated before the start of group aggregation or participation in an aggregated group. Such NOLs can only be utilized by the company which originally generated them.
 - If a company becomes 100% owned by the parent company and, as a result, participates in group aggregation in the middle of a fiscal year, the company may treat the date following the end of its fiscal year in which the 100% shareholding relationship is established as its effective date of participation and the beginning of its fiscal year.
- Withdrawal from an aggregated group
 - Certain assets of a group company leaving the aggregated group will be marked-to-market, and valuation gain or loss on such assets will be recognized for the fiscal year immediately before withdrawal if the company is expected to cease its main business.
 - The rule that requires a company leaving a tax consolidated group to adopt the same fiscal year

as that of the parent company for its first fiscal year after withdrawal will be discontinued.

- Other relevant treatment

- The dividend exclusion rules for both aggregated groups and non-aggregated groups filing standalone return will be revised.
- The following items will be determined on a group basis:
 - ✧ Determination of small and medium-sized enterprises (“SMEs”)
 - ✧ Foreign tax credit
 - ✧ R&D tax credit

- Effective date

- The new rules will be applicable for fiscal years beginning on or after 1 April 2022.
- Transitional measures
 - ✧ The group aggregation system will automatically replace the tax consolidation system, and will apply to existing groups for fiscal years beginning on or after 1 April 2022.
 - ✧ Existing consolidated groups may elect not to join the group aggregation system and file standalone return by filing notifications before the start of the first fiscal year beginning on or after 1 April 2022.

2. Tax relief for open innovation

- If a company carries on certain types of businesses and files a blue form tax return, investments made in venture capital between 1 April 2020 and 31 March 2022, for which 25% or less of the acquisition cost is recognized as an expense for accounting purposes, may be deducted as a tax expense.

3. Amendments to special measures disallowing R&D tax credits and certain other incentives

- Special measures disallowing R&D tax credits and certain other incentives to large companies will be revised as follows:
 - ✧ The minimum percentage of domestic capital investment to depreciation expenses in order for large companies to claim these tax credits will be raised from the current threshold of over 10% to over 30%.
 - ✧ The scope of eligible equipment will be expanded to add fifth generation (“5G”) mobile communication systems.

4. Revision of tax credits for wage and capital investment increases

- The minimum percentage of domestic capital investment to depreciation expenses to claim these tax credits will be raised from the current 90% to 95%.

5. Special depreciation or tax credit for 5G mobile communication systems

- A 15% tax credit or 30% special depreciation will be available for mobile network operators certified under a new law to be established for promoting the use of 5G mobile communication systems, if the operators acquire and start using such systems for domestic businesses between the effective date of the law and 31 March 2022.

6. Tax incentives for the relocation and expansion of headquarter functions from major cities to local areas

- These incentives will be revised, and their end date will be extended by two years.

7. Tax rules on stock compensation and directors’ compensation will be revised

2. Japanese consumption tax (“JCT”)

1. Extension of the JCT filing due date

- Companies currently allowed to extend the filing due date for corporate tax returns will be allowed to extend the filing due date for JCT returns by one month, subject to prior notification.
- This extension rule will be applicable for fiscal years ending on or after 31 March 2021.

3. International Tax

1. Anti-tax avoidance measures on the combined use of dividends from certain subsidiaries and transfers of certain subsidiaries' shares

- If a taxpayer corporation receives dividends, etc. from certain Specified Related Subsidiaries² and the Subject Dividend Amount³ exceeds 10% of the tax basis in the shares of the Specified Related Subsidiary, the tax basis in the shares shall be reduced by the portion of the Subject Dividend Amount to the extent excluded from taxable income due to a participation exemption, etc..
- Certain dividends are excluded from application of the above rule.

2. Revision of the earnings stripping rules

- If a beneficial interest in receivables owned by a Japanese permanent establishment ("PE") of a foreign company has already been determined to be transferred to the head office of the foreign company, interest paid by the foreign company to the PE will no longer be out of scope for purposes of the earnings stripping rules.

² "Specified Related Subsidiary" refers to a corporation with which the taxpayer has a direct/indirect ownership of more than 50% of the shares or certain voting interests in another entity (including specially affiliated relationships) on the date the payment of the dividends is resolved by the Specified Related Subsidiary.

³ "Subject Dividend Amount" refers to all payments (i.e., dividends, etc.) received from the same Specified Related Subsidiary during the same fiscal year of the taxpayer (up to the date of receipt of the Dividends).

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