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2022
Japan Tax Reform Proposals
Digest

On 10 December 2021, proposals for the 2022 Japan tax reform were announced by the ruling parties.

With the objectives of “positive cycle of growth and distribution" and “development of new society after COVID-19”, this year’s proposals include significant enhancements to tax incentives for wage increase, expansion of tax incentives for promoting open innovation, and others. These proposals are expected to encourage the creation of new business industries and allow existing businesses to innovate.

Regarding the group aggregation system, which will commence in April 2022, treatment of tax goodwill on the shares of exiting subsidiaries will be revisited.

Although the 2022 Japan tax reform does not include specific details, the government intends to introduce measures related to digital taxation and global minimum taxation, which are currently being worked by the OECD and the G20, in the future.

In addition, transitional measures for preservation of electronic transaction records will be applied allowing a two-year grace period from 1 January 2022 for companies depending on their specific circumstances.

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.

Corporate Tax

1. Revisions to tax credits for wage increases

The tax credits for wage increases will be revised as follows:

- Corporations filing blue form[1] tax returns will be allowed to claim the tax credits for the fiscal years (“FYs”) beginning from 1 April 2022 to 31 March 2024 as shown in the table below.

Conditions	Tax credit (up to 30%)
Wage payments to continuously employed employees in current FY ＞ Wage payments to continuously employed employees in previous FY	− (No change)
Wage payments to continuously employed employees in current FY ≧ Wage payments to continuously employed employees in previous FY × 103%	15% of total wage payment increase

[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, for taxpayers filing blue form tax returns.

Wage payments to continuously employed employees in current FY ≧ Wage payments to continuously employed employees in previous FY ×104％	25% (additional 10%) of total wage payment increase
Training costs in current FY ≧ Training costs in previous FY × 120％	20%/30% (additional 5%) of total wage payment increase

- The tax credit will be limited to 20% of corporate tax for the current FY.
- The tax credits will be available for large companies, but those with stated capital of JPY1 billion or more and 1,000 or more regular employees must notify the Ministry of Economy, Trade and Industry ("METI") that they have announced their policies on wage increases, establishment of business relationships, and other specified items via the internet.

The tax credits for wage increases for small and medium-sized enterprises ("SMEs") will also be revised as follows with an extension of one year.

Conditions	Tax credit (up to 40%)
Total wage payments in current FY≧ Total wage payments in previous FY × 101.5% (no change)	15% of total wage payment increase (no change)
Total wage payments in current FY ≧ Total wage payments in previous FY × 102.5％	30% (additional 15%) of total wage payment increase (currently 25%)
Training costs in current FY≧ Training costs in previous FY × 110％	25%/40% (additional 10%) of total wage payment increase

POINT:

Because the revision for large companies is intended to promote wage increases for each employee, the eligibility will be determined by the wage increase percentage (i.e., 3% or 4%) of continuously employed employees, while the available tax credits will be based on an increase in total wage payments. A maximum 30% tax credit will be available for large companies which increase training costs by 20% or more, but it should be noted that large companies exceeding a certain size must notify METI of their announcement of wage increase and other policies publicly to receive these tax credits.

In contrast, the tax credits for SMEs are intended to support SMEs to provide job opportunities in regional economies. Therefore, an increase in total wage payments will continue to determine the tax credit eligibility. A 2.5% or more increase in total wage payments combined with a 10% or more increase in training costs will give SMEs a tax credit of up to 40% of total wage increases.

2. Revisions to disallowance of R&D and certain other tax incentives for large companies

Currently, large companies are not allowed to claim R&D and certain other tax credits unless certain conditions are met. One of the conditions - the required wage increase for continuously employed employees from the previous fiscal year - will be revised to raise the percentage of the required increase from the current ＞0% to at least 1% (or at least 0.5% for fiscal years beginning from 1 April 2022 to 31 March 2023), if both of the following apply:

- The company has stated capital of JPY1 billion or more and has 1,000 or more regular employees.
- The company had positive income (i.e., more than zero) for the previous fiscal year.

POINT:

The disallowance was implemented in the 2018 tax reform and tightened in 2021 tax reform. The 2022 revision is intended to further tighten the measure against large companies unwilling to increase wages despite increasing profits.

3. Revisions to tax incentives for promoting open innovation

The requirements for the tax incentives for promoting open innovation will be relaxed as follows and the applicability of the incentives, which are set to expire on 31 March 2022, will be extended by two years to 31 March 2024:

- One of the current requirements is that a recipient of investment for open innovation (i.e., a venture company) be fewer than 10 years from establishment. The maximum period from establishment will be extended to 15 years if the company is loss-making and its R&D costs to revenue ratio is 10% or more.
- Currently, 25% or less of the total acquisition cost of the specified shares may be accounted for using a special account and the amount accounted for in the special account is includable as a deduction (only to the extent of taxable income for the fiscal year), but the deduction is reversed to taxable income if certain events occur within five years from the acquisition of the specified shares. This required shareholding period for the deduction and for being exempt from the reversal will be reduced from the current five years to three years.

4. Treatment of unsubstantiated expenses on tax returns based on acts of concealment or falsification

If a taxpayer files corporate tax returns, or does not file corporate tax returns, through conduct of concealment or falsification of cost of sales (excluding the direct cost of acquiring assets for sale), such expenses will no longer be deductible if the underlying transaction, or the amount of the cost or expenses, cannot be substantiated in the books or confirmed in an examination by the tax office of the taxpayer's customers or vendors.

This revision will be applicable to fiscal years beginning on or after 1 January 2023.

5. Revisions to group aggregation system

Currently, goodwill for tax purposes ("tax goodwill") on the shares of an aggregated group subsidiary is not included in the tax basis of the shares in the subsidiary at the time of its exit from the group, resulting in an overstated capital gain or understated capital loss for the group companies holding the shares. The group aggregation system will be revised to allow such tax goodwill to be included in the tax basis of the shares of an exiting subsidiary.

- Tax goodwill = Of the acquisition cost of shares of a group subsidiary acquired at market value by another group company before the subsidiary is aggregated or joins the group, the portion which would have been recognized as tax goodwill if the group company had acquired the shares in a non-qualified merger with the subsidiary as the disappearing company.
  - The amount of such tax goodwill is calculated pro-rata according to the number of acquired shares if the shares in the subsidiary are acquired in stages or by more than one group company.
  - The tax goodwill will be zero if the subsidiary is merged into another company in a non-qualified merger.
- The revisions will also be applicable to companies of a group which has transitioned from the tax consolidation system to the group aggregation system.
- The revisions will apply only if the following are satisfied:
  - All of the group companies holding the shares of an exiting subsidiary attach a calculation statement of the tax goodwill to their final tax returns for the fiscal year of exit.
  - All of the group companies holding the shares of an exiting subsidiary retain the supporting documents for the calculation.
- Companies subject to mark-to-market valuation at the time of exit from group aggregation due to the main business not expecting to continue are not eligible for the revisions.

POINT:

With the tax consolidation system to be replaced by the group aggregation system in April 2022, the rules for valuing the shares of exiting subsidiaries from an aggregated group have been expected to be significantly revised, and one of the key revisions is this change in the treatment of tax goodwill on the shares of exiting subsidiaries. Because the revision will allow taxpayers to deduct acquisition premiums paid in mergers in prior years (i.e., tax goodwill) subject to certain conditions, more Japanese companies are expected to apply group aggregation despite increasing mergers and acquisitions in Japan.

In practice, however, it may be difficult for group companies to retain or obtain all the necessary information to calculate tax goodwill (e.g., the market value at the time of the acquisition of the land or shares held by the exiting subsidiary at the time of exit) if the company acquired the subsidiary a significant time prior.

6. Revisions to enterprise tax rate for non-SMEs

Currently, the following reduced rates for the income portion of size-based enterprise tax are applicable for non-SMEs. Going forward, the reduced rates for taxable income of JPY 4,000,000 or less and taxable income more than JPY4,000,000 and JPY 8,000,000 or less will no longer be applicable, and the standard single rate of 1.0% will be applicable for fiscal years beginning on or after 1 April 2022.

- 0.4% for taxable income JPY 4 million or less
- 0.7% for taxable income more than JPY 4 million and JPY 8 million or less
- 1.0% for taxable income more than JPY 8 million

Consumption Tax

Revisions to transitional measure for Japanese consumption tax ("JCT") exempt enterprises

From 1 October 2023, a new qualified invoice system will be introduced and if a company wishes to issue qualified invoices to its customers, it must submit an application (i.e. register) to become a qualified invoice issuer with the tax office by the end of March 2023. In general, if a JCT exempt enterprise (i.e. a company (or individual business) not required to file a consumption tax return) wishes to issue qualified invoices, firstly, it must become a JCT taxpayer (i.e. a company (or individual business) that is required to file a consumption tax return) by filing a notification to become a JCT taxpayer with the tax office. This notification is generally effective from the start date of the following business year. This means that a JCT exempt enterprise is eligible to become a qualified invoice issuer only from the start date of the following business year. Currently, under a transitional rule, JCT exempt enterprises are eligible to become a JCT taxpayer and issue qualified invoices from the registration date for the taxable period which includes 1 October 2023 without filing the notification to become a JCT taxpayer. The 2022 tax reform will extend the application period for the transitional rule as follows:

a. JCT exempt enterprises will be able to issue qualified invoices from the registration date during the taxable periods which include the days from 1 October 2023 to 30 September 2029.

b. If JCT exempt enterprises (except the JCT exempt enterprises which will register in the taxable period which includes 1 October 2023) apply the transitional rule, they must generally keep their JCT taxpayer status for two business years (FY for a corporation) following the business year it registered as a qualified invoice issuer.

POINT:

This revision offers more flexible timing for JCT exempt enterprises to register as qualified invoice issuers.

International Tax

Expansion of the scope of earnings stripping rules

The scope of earnings stripping rules for foreign corporations will be expanded as follows:

	Current	Proposed
Foreign corporations with permanent establishment ("PE") in Japan	Income attributable to PE (A)	(A) ＋Japan sourced income subject to Japanese corporate income tax (other than income attributable to PE)
Foreign corporations without PE in Japan	—	Japan sourced income subject to Japanese corporate income tax

POINT:

Under the new rules, earning stripping rules will be applicable to foreign corporations without a PE in Japan if they have Japan sourced income subject to Japanese corporate income tax (e.g., rental income deriving from Japanese real estate).

Tax Administration

1. Assets and Liabilities Report

- **Filing obligation**

In addition to taxpayers who are currently obligated to file an Assets and Liabilities report ("AL Report"), a tax resident who owns assets for which the total value is JPY 1 billion or more as of 31 December of a given year, will be obligated to file an AL Report effective from 2023.

- **Filing due date**

Effective from 2023, the filing due date of the AL Report will be extended to 30 June (currently 15 March) of the following year. The same extension will be provided for the Foreign Assets report (collectively with the AL Report, "Reports").

- **Safe harbor rule for late filing**

Currently, there is a safe harbor rule for the late filing of the Reports. Under the safe harbor rule, the Reports which were filed after due date shall be deemed to be filed by the due date in cases where the taxpayer does not anticipate the assessment of the additional tax after the tax investigation by the tax authority.

For Reports related to 2023 and after, the above rule will be applicable only in cases where the taxpayer files the Reports before he/she is notified of the tax investigation.

- **Revision to the Reports**

Various revision will be made to the Reports from 2023. For example, "General movable assets" for which the acquisition cost is less than JPY 3 million (currently less than JPY 1 million) may be omitted from the Reports.

POINT:

While the filling due date will be extended, the scope of taxpayers who are obliged for filing an AL Report will be expanded to taxpayers who own high-value assets regardless of their taxable income even if their taxable income amount is not high.

2. Transitional measures for preservation of electronic transaction records

Transitional measures for preservation of electronic transaction records will be applicable for the period 1 January 2022 through 31 December 2023, if both of following conditions are met. Under the transitional measures, preservation of electronic records of transactions which are not preserved in accordance with the requirements provided in Electronic Record Retention Law ("ERRL") and preservation in hard copy of electronic records of transactions will be allowed without filing notifications to tax office, regardless of the requirements provided in ERRL.

- Tax officer agrees that there are unavoidable circumstances where electronic records of transactions are not preserved in accordance with the requirements provided under ERRL
- Hard copy of preserved electronic records of transactions or screen of the electronic records of transactions can be submitted or presented in a well-ordered and clear state upon request

POINT:

It should be emphasized for further information (enforcement regulation, circular notice, Q&A etc.) how the detailed definition of "unavoidable circumstances" will be specified.

Income Tax

Revisions of withholding tax for dividend income from 100% owned domestic subsidiaries etc.

Dividend income received by domestic companies shown below will no longer be subject to withholding tax. The revision will be applicable to dividends to be received on or after 1 October 2023.

- Dividend income received from wholly owned domestic subsidiaries
- Dividend income received from domestic affiliated companies, whose outstanding shares are directly over one third owned, as of dividend record date

POINT:

Dividend received from wholly owned domestic subsidiaries and domestic affiliated companies, whose outstanding shares are directly over one third owned, are not included in the taxable income for recipient companies. Withholding tax levied on such dividends under the current law will not be levied under this proposal. Ownership of domestic affiliated companies will be judged based on the state as of dividend record date, meaning that requirements for continued holding period will not be introduced.

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