18 April 2025

Japan tax newsletter

Ernst & Young Tax Co.

2025 Japan Tax Reforms Enacted - Taxation highlights for Inbound Businesses

The better the question. The better the answer. The better the world works.

Shape the future with confidence

EY Japan Tax Alerts and Newsletters

You may access past alerts from the link below.
https://www.ey.com/ja_jp/technical/ey-japan-tax-library/tax-alerts

Contents

On 20 December 2024, Japan's government (a coalition comprised of the Liberal Democratic Party and Komeito) released the 2025 Tax Reform Outline. These tax reforms were passed into legislation on 31 March 2025.

This newsletter provides an introduction to key tax reforms that are relevant for Inbound groups, i.e., overseas headquartered groups that operate (or invest) in Japan typically through Japanese subsidiaries and branches.

Please click here to access the overall 2025 Japan tax reform outline as released in the EY Japan tax newsletter published on 26 February 2025.

Please click here to access another EY 2025 tax reform newsletter that is focused on finance- and real estate-related tax issues.

After losing seats in the lower house of parliament in last year's election, Japan's ruling parties were forced to negotiate with opposition parties on the details of the 2025 tax reforms.

The main point of contention was the tax-free income threshold for individuals, which has been JPY1.03 million. The Democratic Party for the People (DPP) objected to the proposed JPY 1.23 million threshold, advocating for a higher amount of JPY 1.78 million. In the end, the parties agreed to further discussions which resulted in additional reform bills, that are also now approved and have become law. The amount of the threshold will increase to JPY 1.6 million (including a basic deduction JPY 950,000 and an employment income deduction of JPY 650,000).

The new laws also include adjustments to corporate and tobacco taxes, aimed at funding increased defense spending. The "Special Defense Corporation Tax" is a 4% surtax effective from April 2026. The increase in defense spending is a response to what Japan perceives as growing threats in the region. Foreign Minister Takeshi Iwaya has said, "Japan now faces the most severe and complex security environment since the end of World War II."

The Accounting Standards Board of Japan (ASBJ) recently issued new standards for leases. Lessees will need to adopt new recording practices, which include the on-balance sheet inclusion of leases. However, under the new laws, the current treatment of leases will be codified for tax purposes, meaning that the tax treatment will diverge from the accounting treatment. This shift in lease accounting is expected to have significant tax implications for corporations, as it will alter the timing and recognition of expenses and liabilities.

There are also changes to the corporate income tax treatment of corporate reorganizations, particularly spin-offs.

In terms of international taxation, the now enacted 2025 tax reforms will further align Japan’s tax rules with the OECD’s Global Minimum Tax regime, comprising international measures intended to combat tax base erosion and ensure a minimum 15% tax on the profits of multinational entities. The new laws will introduce the undertaxed profits rule (UTPR) and the qualified domestic minimum top-up tax (also referred to as a QDMTT).

Furthermore, as well as increasing the tax allowance thresholds for individuals (as mentioned above) there will also be other salary deductions to support families with young adult dependents. The angel investor taxation system will also be modified to provide potential refunds for investments in startups.

In summary, the reforms reflect Japan's move toward global tax compliance and enhanced fiscal sustainability while providing support for certain individuals.

1. Corporate Taxation

(1) Special Defense Tax

The 2025 tax reform introduced a new corporate income tax intended to provide additional financial resources to improve the defense capabilities of Japan.

The tax base for the special defense tax is the corporate income tax payable. The tax rate is 4%. Under the proposed rules, the taxpayer can deduct a fixed amount of JPY 5 million from its corporate tax payable for the calculation of the tax base for special defense tax.

It is also important to note that although tax credits such as income tax credit, foreign tax credit, reduce the corporate tax payable under general rules, the taxpayer is required to add back these tax credits to the corporate tax payable for the calculation of the tax base for special defense tax.

The annual compliance for special defense tax will be the same as regular corporation tax.

The special defense tax will increase the effective rate of tax for Japanese companies and permanent establishments. If we consider corporate taxpayers in Tokyo, their statutory effective tax rate tax will increase from 30.62% to 31.52% where the corporate taxpayer is subject to business scale enterprise tax. The effective tax rate will increase from 34.59% to 35.43% where the corporate taxpayer is subject to regular enterprise tax in Tokyo.[1]

This new tax will apply to financial years starting on or after 1 April 2026.

(2) Leasing

(i) Treatment for lessees in lease transactions

Operating Lease

The Accounting Standards Board of Japan announced a new accounting standard for leases in September 2024. Under the new accounting standard, the lessee is required to recognize the leased asset (the right to use the asset) on the balance sheet and a lease liability for leases that would currently be treated as operating lease for accounting purposes (i.e., off-balance recognition by the lessee). The lessee will recognize depreciation expenses and interest expenses related to the operating lease under the new accounting standard.

The new accounting standard will apply to financial years starting on or after 1 April 2027; however, early adoption is permitted for financial years starting from 1 April 2025.

---

1. Enterprise tax is a form of local corporate income tax. The local enterprise tax status (regular enterprise tax or business scale enterprise tax) and the local enterprise tax rate vary depending on the equity structure of the corporate taxpayer. Different local enterprise tax rates on taxable income result in the different effective tax rates for corporate taxpayers.

The following issues are expected to arise:

- Current Japanese tax law provides specific rules for finance leases (as defined by Japanese tax law). However, there are no specific tax rules applying to operating leases. Under the current practice, the lessee deducts the operating lease fees from its taxable income for corporate income tax purposes. This treatment is in line with the accounting treatment; therefore the taxpayer does not have to make any book to tax adjustments to calculate its taxable income.
- Under the new accounting standard, the lessee will recognize the operating lease on the balance sheet and will recognize depreciation expenses and interest expense for accounting purposes. However, the new law codifies the currently applied tax treatment to operating leases. The lessee will deduct the amount of lease fees[2] for corporate income tax purposes in the financial year when the payment obligation for the lease fees arises.
- Therefore, there will be a difference between the accounting and tax treatment. The taxpayer is required to make book to tax adjustments to calculate the taxable income.

It is important to note that the new accounting standard will only apply to listed companies, companies subject to audit under the Company Act of Japan, etc.

New depreciation rules for finance leases where the asset is returned to the lessor

There are finance leases where the lessee is obliged to return the asset to the lessor at the end of the lease and the lessee guarantees a specific residual value of the asset. Under the current rules, the lessee can depreciate the asset up to the amount of the guaranteed residual value. Under the new rules, the lessee can depreciate the leased asset up to JPY 1. These rules will apply for leases contracted after 1 April 2027.

There will be transitional rules allowing lessees to use the new depreciation rules for leases concluded before 31 March 2027 in relation to financial years starting on or after 1 April 2025.

Operating lease fees and local enterprise tax

Enterprise tax is a local corporate income tax. If a company is subject to business scale enterprise tax, the company pays enterprise tax on its taxable income and also on non-income factors such as on capital component and value-added component. The definition of value-added component includes the total of taxable income, net salary expense, net interest expense and net rental expense.

The 2025 tax reform clarifies that if a company leases land or houses, the net rental expense of land and houses for the value-added component includes only the expense which is deducted for corporate tax purposes in the same fiscal year.

---

2. These lease fees include expenses incurred for the lease of assets and for using the leased asset.

(ii) Treatment for lessor in lease transactions

Corporate Tax

In case of a finance lease, the lessor recognizes the income upon the delivery of the asset to the lessee. However, Japanese tax law has a specific provision that allows the lessor to recognize income from the lease under a so-called deferred payment rule over the lease term. There are specific rules covering how to calculate the income and corresponding expenses to be included into the taxable income of the relevant financial years.

The changes from the 2025 tax reform abolish the deferred payment rule for leases. However, there will be transitional measures introduced:

- If a taxpayer has delivered the leased assets before 1 April 2025, the taxpayer is allowed to continue to use the deferred payment rule for leases where the leased asset is delivered to the lessee in financial years starting prior to 1 April 2027.
- If a taxpayer decides to stop using the deferred payment rule in financial years starting between 1 April 2025 and 31 March 2027, the taxpayer will recognize the deferred income component equally over five financial years.

Consumption Tax

Similar to corporate income tax, the lessor should recognize consumption tax on the delivery of the leased asset to the lessee in a finance lease transaction under general rules. However, if the corporate taxpayer uses the deferred payment method to recognize income for corporate income tax purposes, the lessor can recognize sales subject to consumption tax in line with the corporate income tax treatment.

The 2025 tax reform abolishes this treatment for consumption tax purposes as well, but transitional measures will be introduced.

If the taxpayer delivered leased assets before 1 April 2025, the taxpayer could calculate the sales amount subject to consumption tax under the deferred payment method where the leased assets are delivered in financial years starting before 1 April 2027.

If the taxpayer decides to stop using the deferred payment rule in financial years starting on or after 1 April 2025, the remaining balance of the payments will be treated as taxable sales for consumption tax purposes in equal amounts over ten financial years.

2. International Taxation

BEPS Pillar 1 and Pillar 2

In October 2021, an international agreement was made based on the OECD/G20 Inclusive Framework on BEPS in an effort to tackle the tax challenges posed by the digitalization of the economy. This international agreement consisted of two pillars - the provision of new taxing rights to market jurisdictions (Pillar 1) and a global minimum tax (Pillar 2). The 2023 tax reform introduced legislation for the Income Inclusion Rule (IIR) of Pillar 2. With the 2025 tax reform, the Undertaxed Profits Rule (UTPR) and the Qualified Domestic Minimum Top-up Tax (QDMTT) is enacted in accordance with international agreements.

Pillar 2 (also referred to as the "Global Anti-Base Erosion (or GLoBE) Rules) relates to a new global minimum tax of 15%. This Pillar is applicable to Specified Multinational Entity groups with a global turnover of EUR 750 million or more (which is approximately US$ 780 million).

Pillar 2 contains detailed Model Rules to calculate the existing effective tax rate and complicated mechanisms to capture and tax any shortfalls.

Japan has previously, partially implemented Pillar 2, when it introduced the income inclusion rule (or IIR). This rule permits the ultimate parent entity's jurisdiction to tax profits where they have not been subject to a rate of 15% or more in the local jurisdiction. Thus, this applies to overseas subsidiaries of Japan parented groups, as well as Japanese subsidiaries of relevant groups where an IIR has been implemented in the parent company jurisdiction.

New UTPR

Domestic corporations that are constituent entities of a Specified Multinational Entity group, as well as foreign corporations with permanent establishments that are constituent entities for these purposes, will be subject to the UTPR for each applicable fiscal year.

Summary of UTPR:

- The UTPR functions as a tax mechanism that applies additional taxes in a subsidiary's country of residence (i.e., Japan) to ensure that the tax burden of the parent company of a specified group reaches the minimum tax rate of 15%. This typically occurs when the effective tax rate in the parent company's country of residence is below the minimum tax rate. For example, if a subsidiary is located in Japan and the parent company is located in a low-tax country, Japan can tax the subsidiary up to the point where the tax burden of the parent company reaches the minimum tax rate.
- This UTPR mechanism is envisioned to apply only in limited situations where taxation under an IIR has not occurred. The UTPR acts as a supplementary mechanism to the IIR's taxation approach.
- In the implementation of the UTPR, the top-up tax is allocated to the country where each constituent entity is based, and then imposed by that country. This allocation of the top-up tax among the countries is determined by factors such as the number of employees and the value of tangible assets.

The same calculation applies to the UTPR top-up tax for domestic corporations and for foreign corporations with permanent establishments in Japan. An exemption criteria will be established for the initial stages of international business activities.

New QDMTT

Domestic corporations that are constituent entities of a Specified Multinational Entity group, foreign corporations with permanent establishments that are constituent entities of such a group, and certain joint ventures, will be subject to QDMTT for each applicable fiscal year.

Summary of QDMTT:

- The QDMTT functions as a tax mechanism that assesses additional taxes on a company in its country of residence, in cases where the effective tax rate in that country falls below the minimum tax rate. The additional tax is applied so that the tax burden of the company reaches the 15% minimum tax rate.
- When the QDMTT applies taxation up to the minimum tax rate, the tax paid can be credited against the tax liability calculated under the IIR or UTPR from other jurisdictions. Thus, the QDMTT serves to shield domestic companies by offsetting the potential tax burden that would be imposed by the IIR or UTPR from abroad.
- The OECD's website is expected to disclose whether Japan is recognized as a jurisdiction that levies the QDMTT in accordance with the "QDMTT Accounting Standard and Consistency Standard," thereby qualifying for the QDMTT Safe Harbour (which corresponds to the exemption criteria for domestic top-up taxes in Japan).

Similar to the IIR top-up tax, transitional exemption using income amounts and Country-by-country reporting (CbCR) items and other special provisions are to be established. Furthermore, similar to the UTPR, exemption criteria will be established for the initial stages of international business activities.

The QDMTT related to joint venture companies, etc., is essentially calculated in the same manner as the QDMTT for constituent entities.

A Japanese company that is a member of a Specific MNE group will be required to submit via e-Tax a group QDMTT report to the tax authority within one year and three months (one year and six months in certain cases) from the day following the end of each applicable fiscal year.

In light of the need to provide groups with sufficient time to prepare for new administrative procedures, the start date for the application of these new revisions will be for the accounting periods of the companies that begin on or after 1 April 2026, i.e., for calendar year end companies, the relevant period will be the year-ending 31 December 2027.

Future issues to consider

Regarding Pillar 2, it has been determined that revisions will continue to be considered in 2026 tax reform and onwards, based on the content of guidance to be issued in the future. Additionally, necessary reviews will be conducted for existing tax systems from the perspective of ensuring proper taxation in relation to Pillar 2.

Meanwhile, in relation to Pillar 1, it is expected that Japan will continue to proactively contribute to international discussions aimed at the prompt signing of a multilateral treaty that includes new taxing rights for market jurisdictions. In light of the provisions of the upcoming treaty, Japan will deliberate on the taxation methods pertaining to new taxing rights assigned to it as a market jurisdiction, the taxation framework, and the procedures for avoiding double taxation as mandated by the treaty, while also considering both national and local corporate tax regimes. Regarding the simplification and streamlining of the transfer pricing tax regime, Japan has resolved to assess future actions based on global discussions and the practices of other nations, with no immediate reform anticipated. Should other countries adopt such measures, Japan is prepared to act in line with international agreements, adhering to existing legislation and tax treaties.

3. Individual income taxation

(1) Basic Deduction and income thresholds

The basic deduction will be increased to a maximum of JPY 950,000 based on income levels from the current amount of JPY 480,000, while the minimum employment income deduction for individual income tax purposes will be raised to JPY 650,000 from the current JPY 550,000.

The annual income threshold for taxation will be increased to JPY 1.6 million yen from the current level of JPY 1.03 million.

In addition to the increase in basic deductions, the total income amount requirements for both dependents and spouses living in the same household will increase to JPY 580,000 from JPY 480,000.

The maximum qualifying income of college-aged children under the specified deduction for dependents will be raised to JPY 1.5 million from JPY 1.03 million. In addition, the reduction of dependent deductions for high-school aged children will be deferred.

These proposals are expected to apply for tax year 2025 and thereafter.

(2) Enhancements to NISA

NISA（Nippon Individual Savings Account）is a tax-free investment scheme in Japan designed to encourage individuals to invest in stocks, ETFs, mutual funds, and other financial instruments. It is similar to the UK's Individual Savings Account（ISA）.

Currently, investors can switch financial institutions for their NISA accounts, but the 1 to 2 week confirmation process by the tax office（designed to prevent duplicate accounts）often discourages investment. Under the 2025 tax reform proposals, taxpayers will be able to start investing immediately after applying for a NISA account, streamlining the process and making it more investor friendly. Furthermore:

- The minimum transaction amount for Tsumitate NISA accounts will be adjusted to JPY10,000 or less from JPY 1,000 or less, expanding investment opportunities across a wider range of securities made available under the adjusted limits.
- Additionally, a revision is being considered to optimize unit purchases within the fixed monthly investment amount, particularly in cases where unit multiples do not align with the prescribed cap.

(3) Revisions to iDeCo savings plan

Individuals enrolled in both iDeCo（Individual Defined Contribution Pension Plan, which is a voluntary, tax-advantaged retirement savings plan in Japan, that is broadly similar to a 401(k) or IRA in the U.S.）and defined benefit pension plans will see their maximum monthly contribution limit increase from JPY 12,000 to JPY 20,000. This change will be effective from December 2024.

(4) Extension of Reinvestment Period Under Angel Investor Tax Rules

To further support startup investments, the government has extended the reinvestment period under the Angel Taxation System. Previously, investors had to reinvest proceeds from share sales within the same fiscal year to qualify for tax incentives. Under the new proposal, this period has been extended to a maximum of two years.

Youtube: @EYJapan
Facebook: EYJapanOfficial
X Twitter: @Japan_EY

Comments or general inquiries regarding this tax newsletter may be directed to our Brand, Marketing, and Communications team.

Ernst & Young Tax Co.
Brand, Marketing and Communications
tax.marketing@jp.ey.com

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multidisciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

About EY's Tax services
EY's tax professionals in Japan provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. Our highly regarded tax professionals operate in four major cities in Japan. Our talented people, consistent methodologies and unwavering commitment to quality service help you to build the strong compliance and reporting foundations and sustainable tax strategies that help your business succeed. For more information, please visit ey.com/en_jp/about-us/ey-tax.

ED None

ey.com/en_jp