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Japan tax alert

Ernst & Young Tax Co.

2026 Japan tax reform outline (Overview)

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The fiscal year 2026 tax reform outline was released on 19 December 2025. In this alert, we provide an overview of the major reforms and revised provisions contained in the outline. Please note that the contents of the reform outline may be subject to revisions during discussions among the ruling and opposition parties, or throughout deliberations regarding the reform bill in the Diet.

Contents

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Corporate taxation

1. Creation of tax incentives to promote bold capital investment

- To promote large-scale and high value-added capital investment across all industries, a tax incentive will be created for production equipment and facilities (such as machinery, tools, appliances, fixtures, buildings and accompanying facilities, structures, and software) acquired based on capital investment plans that have received confirmation as stipulated by the Industrial Competitiveness Enhancement Act, provided they meet a certain scale. For eligible assets, there will be an option to select either immediate depreciation or a tax credit of 7% of the acquisition cost (4% for buildings, etc.).
- The tax credit limit will be 20% of the corporate income tax, and the amount exceeding the credit limit can be carried forward for three years.

2. Revision of R&D tax rules

- A new R&D tax incentive for the "strategic technologies" category will be created separately from that for the general category. For R&D expenses related to "key industrial technologies under the Industrial Technology Enhancement Act" - including AI, advanced robotics, quantum technology, semiconductors and communications, bio and healthcare, fusion energy, and space - a tax credit of 40% will apply. For joint or commissioned research with certified R&D institutions, the tax credit will be 50%. The tax credit limit will be 10% of the corporate income tax, and the amount exceeding the credit limit can be carried forward for three years.
- The credit rate curve for general-category R&D, as well as sliding scale measures for tax credit limits will be subject to revision.
- Restrictions will be imposed on the amount eligible for tax credits for outsourced research conducted overseas.

3. Revisions to tax incentives to promote wage increases

- Tax incentives for large enterprises will be abolished as of 31 March 2026.
- The incentives for medium-sized enterprises will continue with revised requirements aimed at encouraging higher wage increases, and will then be abolished upon the expiration of the applicable period on 31 March 2027.
- Regarding incentives for small and medium-sized enterprises, the current system will be maintained, and necessary revisions will be considered when the expiration of the applicable period approaches.
- Additional tax credits for education and training expenses will be abolished.

4. Other

- Requirements for the non-applicability of special tax measures (specific tax credit rules) will be strengthened.
- The tax incentive to promote open innovation will be revised for the M&A type and extended by two years.
- The applicability requirements for partial spin-off tax rules will be revised.
- Tax incentives for strengthening local business facilities will be revised and extended by two years.
- Regarding the special measures for the expensing of small-scale depreciable assets acquired by small and medium-sized enterprises, the threshold for acquisition costs will be raised to less than JPY400,000 (from the current threshold of less than JPY300,000), and the application deadline will be extended by three years.
- A special provision for document retention related to transactions within corporate groups will be established.
- The measure permitting the inclusion of amounts related to adjustment accounts in the investment book value adjustment system under the group relief regime will be subject to revision.

International taxation

1. Revision of Japanese Controlled Foreign Company ("JCFC") rules

- A special provision regarding the treatment of dissolved foreign affiliated companies will be established.
- The special provision regarding the asset ratio requirements for paper companies, as well as the provision that allows for the calculation of the tax burden ratio using the maximum tax rate, will be revised.

2. Other

- Necessary revisions will be implemented to clarify global minimum taxation measures, in light of the details published in OECD guidance.
- Regarding the special provisions for taxation on foreign partners of investment partnerships, the requirements for the ratio of equity interest held by limited liability partners will be raised from the current threshold of less than 25% to a new threshold of less than 50%.

Individual income taxation

1. Revision of the so-called "annual income barrier" threshold for tax on individual annual income

- In light of the rise in the consumer price index, the basic deduction will be raised from the current JPY580,000 to JPY620,000, and the minimum guaranteed amount for employment income deduction will be increased from the current JPY650,000 to JPY690,000, respectively. Additionally, the special provision for the basic deduction will be raised to JPY420,000 (applicable for employment income up to JPY6.65 million), and the minimum guaranteed amount for employment income deduction will also be increased by an additional JPY50,000.
- As a result of these revisions, a starting threshold for income tax burdens for all taxpayers (the total amount of the basic deduction and employment income deduction) will be JPY1.78 million or higher. The above revisions will be applied to income taxes from 2026 and to the individual inhabitant tax from 2027.

2. Expansion of NISA

- The age eligibility for the accumulation-type framework will be expanded to include individuals starting from birth. For account holders who are children aged 0 to 17, the annual investment limit will be set at JPY600,000, and the tax-free holding limit will be JPY6 million.

3. Creation of special income tax for national defense (tentative name)

- To secure funding for the enhancement of defense capabilities, a new additional tax, tentatively named the special income tax for national defense, will be imposed at a rate of 1% on income tax amount starting from January 2027.
- In parallel, the tax rate for the special income tax for reconstruction will be reduced by 1%. The taxation period will be extended for an additional 10 years until 2047.

4. Extension and revision of the housing loan tax credit

- The period for the housing loan tax credit will be extended for an additional 5 years until 2030.
- The reduction period for purchasers of second-hand homes will be extended from 10 years to a maximum of 13 years. The maximum loan amount eligible for the tax credit will be raised from the current JPY30 million to JPY35 million (JPY45 million for young married couples and households with children). The scope of the special provision, which has relaxed the floor area requirements to 40 square meters, will also be expanded to include second-hand homes.

5. Revision of the taxation rules pertaining to crypto asset transactions

- Subject to revisions of the Financial Instruments and Exchange Act and related laws, capital gains arising from spot trading, derivative trading, and ETFs will be taxed separately at a flat rate of 20% (15% national income tax, 5% individual inhabitant tax) - but only for crypto assets that contribute to the wealth building of citizens. Carryforward rules will be created for losses incurred, allowing them to be carried forward and deducted over a three-year period.

6. Other

- Measures seeking additional tax burdens on high-net-worth individuals will be reviewed and expanded to a broader group.
- For the hometown tax donation program, an upper limit on the amount deductible from individual inhabitant tax will be created.
- Interest on corporate bonds received by shareholders of family companies will be included in aggregate taxation even when the interest is received via a third party (specified corporation) interposed between the shareholder and the family company.
- In regard to the prefectural inhabitant tax interest levy, a new system will be introduced to allocate tax revenues across prefectures and local governments based on individual income amounts.

Asset taxation

1. Revisions to valuations of rental real estate and fractionalized real estate products

- In light of discrepancies between market prices and inheritance tax values for rental properties, the following revisions will be made:
- For certain rental properties acquired or newly built for consideration within five years prior to the commencement of inheritance or gifting, valuation for the tax period will be based on the fair market value equivalent (calculated based on acquisition cost).
- For fractionalized rental real estate products, regardless of acquisition date, valuation for the tax period will be based on the fair market value at that time.

2. Other

- The tax breaks for lump-sum gifts of educational funds will be abolished upon expiration of the applicable period (March 2026).

Consumption taxation

1. Revisions to consumption tax on cross-border e-commerce

- For cross-border mail-order sales of goods priced at JPY10,000 or less, regulations will be introduced requiring sellers to collect and remit consumption tax.
- In cases of goods sold via digital platforms, regulations shifting the tax obligations to the platform operators who mediate such transactions will also be introduced.

2. Revision of qualified invoice system

- After the transitional measure for small-scale enterprises who become qualified invoice issuers (the so-called "20% special measure") concludes, a new 2-year transitional measure will be created to allow the tax liability to be set at 30% of the sales tax.
- The transitional measure for tax credits for taxable purchases from a tax exempt business (the so-called "80% deduction introduced with the invoice system") will be gradually phased out, but its applicable period will be extended by two years. Deduction rates will be reduced stepwise: 70% from October 2026, 50% from October 2028, and 30% from October 2030, with the measure ending at the end of September 2031.

3. Other

- Consumption tax rules will be revised to include the provision of services related to real estate located in Japan to non-residents.

Tax administration and other items

- In line with reforms to the Code of Criminal Procedure, reforms will be implemented to digitize national tax violation investigation procedures.
- The international tourist tax will be raised from JPY1,000 to JPY3,000 per departure.
- The environmental performance levy within the automobile tax will be abolished.
- The special measure under which a customs-tax valuation amount is considered as 60% of overseas retail price only for imported personal-use goods will be abolished.

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