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2025 Japan tax reform outline

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Japan tax newsletter

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Contents

On 20 December 2024, Japan's ruling party (a coalition comprised of the Liberal Democratic Party and Komeito) released the 2025 Tax Reform Outline (below "the Outline"). This newsletter provides an overview of the major amendments and revisions contained in the Outline.

The centerpiece of the 2025 tax reform is the strategic shift towards an economy energized by salary growth and robust investment, aptly labeled as "Realizing a Growth-Oriented Economy Driven by Wage Increases and Investment."

This shift is designed to address the evolving economic and societal frameworks of present day. Amidst inflationary pressures, this year's reform will recalibrate the tax obligations individuals face by refining key elements such as the basic exemption and employment income deductions. Moreover, this year's reform aims to invigorate capital expenditures by ambitious small and medium-sized enterprises ("SMEs"), fostering a "virtuous cycle of growth" within regional economies. To this end, the SME investment incentive tax rules will be further revised.

Keeping pace with the economy's global and digital transformation, this year's reform will introduce new revisions for global minimum taxation ("GMT"), including the undertaxed profits rule ("UTPR") and the qualified domestic minimum top-up tax ("QDMTT"), while also reassessing the consumption tax exemption rules for foreign tourists. In addition, the establishment of a "special corporation income tax for national defense" (tentative name) is proposed as a fiscal strategy to secure funds for a national defense build-up.

Please note that the contents of this newsletter may be partially revised, deleted or added in response to the outcome of discussion between the ruling and opposition parties and future Diet deliberations on the reform bill.

Corporate taxation

1. Revision of SME-related tax rules

SMEs are the bedrock of Japan's economy, employing 70% of the labor force, and their sustained growth is indispensable for the prosperity and advancement of regional economies. Among these, SMEs that achieve sales beyond the JPY10 billion mark serve as regional cornerstones, as they not only capture markets outside of their locales through exports and international ventures, but also stimulate new domestic demand through their local supply chains. Fostering such enterprises is crucial for creating a virtuous cycle of growth in local communities. Accordingly, a series of enactments and revisions will be implemented to empower growth-driven SMEs with the aspiration to surpass JPY10 billion in sales, enabling them to undertake bolder capital investments.

(1) Revision of SME business enhancement tax rules

The SME business enhancement tax rules will be revised as described below and extended by 2 years.

(i) Capital assets that meet the following criteria will be added to the designated types of capital assets for business enhancement(*).

(*)"Designated types of capital assets for business enhancement" refers to assets that significantly contribute to the improvement of management capabilities as defined in Article 16, Paragraph 2 of the Order for Enforcement of the Small and Medium-sized Enterprises Business Enhancement Act, which includes assets contributing to the enhancement of productivity, revenues, digitalization efforts, and the consolidation of operational resources (limited to those assets described in business enhancement plans in accordance with Article 17, Paragraph 1 of the same Act).

- The investment plan is expected to yield an average annual return on investment rate of 7% or more (current: 5%).
- The assets must be essential for achieving the objectives of an investment plan that has been confirmed by the Minister of Economy, Trade, and Industry as meeting the criteria set for business scale expansion. This includes machinery, tools, instruments, buildings and facilities, and software that are of a certain scale or larger.

In regard to the aforementioned capital assets,

- A choice is available between special depreciation up to the acquisition cost (15% or 25% of the acquisition cost for buildings and facilities) combined with the standard depreciation limit, and a tax credit of 7% of the acquisition cost (1% or 2% for buildings and facilities). The rates for the special depreciation or tax credit for buildings and facilities are set at 15% or 1% if the employee wage increase ratio is 2.5% or more, and 25% or 2% if the employee wage increase ratio is 5% or more. However, if the wage increase ratio is less than 2.5%, neither special depreciation nor tax credit can be applied.
- The tax credit rate for the aforementioned equipment (excluding buildings and facilities) acquired by certain SMEs is set at 10%.
- The total acquisition cost of the assets eligible for this rule is capped at JPY6 billion.

(ii) In addition to the above, the following revisions will be made to designated types of capital assets for business enhancement.

- For assets sold during a specified period, business enhancement indicators of at least an average of 1% per year compared to older models will be assessed based on either per-unit-time production volume, yield rate, or input cost reduction rate.
- The investment plan that has been approved by the Minister of Economy, Trade, and Industry, is expected to yield an average annual return on investment rate of 7% or more (current: 5%).
- Assets essential for achieving the objectives of investment plans related to remote operation, visualization, or automation (i.e. assets for digitalization) will be excluded.
- Assets used for crypto asset mining are excluded from the eligible assets.

(iii) In light of expected revisions to the Act on Rationalizing Distribution and Improving Transactional Propriety for Food and Other Products, designated capital assets for business enhancement acquired by SMEs as outlined in a sustainable supply business activity plan (tentative) which has been certified under the revised Act on Rationalizing Distribution and Improving Transactional Propriety for Food and Other Products and was deemed as a certified business enhancement plan under the Small and Medium-sized Enterprises Business Enhancement Act, will be subject to the revised version of this tax rule.

(iv) In the determination of enterprises deemed to be large enterprises, shares or equity held by large corporations will exclude those that meet all of the following criteria:

- The corporation in question is a corporation qualified for agricultural land ownership as defined by the Agricultural Land Act.
- A specified approved company (*) holds more than 50% of the total number or total amount of issued shares or equity of that corporation qualified for agricultural land ownership.

  (*) "A specified approved company" mentioned above refers to those approved companies defined by the Special Measures Law for Facilitating Investment in Agricultural, Forestry, and Fisheries Corporations, where local public entities, agricultural cooperatives, agricultural cooperative associations, the Central Union of Agricultural Cooperatives, or the Japan Finance Corporation hold more than half of the total voting rights of the shareholders.

Revision outline (applicable until the end of FY2026)

<table>
<tr><th>Designated types of capital assets for business</th><th>Criteria</th><th>Validated by</th><th>Eligible capital assets</th><th>Other criteria</th></tr>
<tr><td>Capital assets for productivity enhancement (type A)</td><td>Assets that enhance productivity by an average of 1% or greater compared to the previous model
*Either per-unit-time production volume, yield rate, or input cost reduction rate.</td><td>Industrial associations, etc.</td><td rowspan="3">▪ Machinery and equipment (JPY1.6 million or more)
▪ Tools (JPY300,000 or more)
(limited to measurement or inspection tools for type A)
▪ Equipment/supplies (JPY300,000 or more)
▪ Building facilities (JPY600,000 or more)
▪ Software (JPY700,000 or more)
(For type A, the capital assets must exclusively include features that allow for the gathering of operational data and possess analytical and guidance functionalities.)</td><td rowspan="4">▪ Components that constitute production-related assets
*with the exclusion of office equipment and supplies, building facilities related to the head office or employee dormitories, and facilities associated with employee benefits
▪ Must be a domestic investment
▪ Assets cannot be used assets or leased assets</td></tr>
<tr><td>Capital assets for revenue enhancement (type B)</td><td>Assets related to investment plans with an average annual return on investment rate* of 7% or more.
*The period used for the calculation should align with the longest depreciation life among the investment assets.</td><td rowspan="2">Bureau of Economy, Trade and Industry</td></tr>
<tr><td>Capital assets to consolidate operational resources (type D)</td><td>Assets associated with investment plans that anticipate an adjusted return on assets (ROA) or a tangible fixed asset turnover ratio exceeding a certain percentage</td></tr>
<tr><td>Capital assets for business scale expansion (broadening of type B)</td><td>▪ Average annual return on investment rate of 7% or higher
▪ Preparation of a roadmap aiming for sales exceeding JPY10 billion
▪ Aiming for an average annual sales growth rate of 10% or more
▪ Prior fiscal year's sales exceeding JPY1 billion but less than JPY9 billion.
▪ Minimum investment amount of JPY100 million or more than 5% of the prior fiscal year's sales
▪ An employee wage increase rate of 2.5% or 5.0% or more, among other criteria
*Corporations that have received certification for expansion measures are not eligible for the SME investment incentive tax rules and the special depreciation allowance for small-value assets during the period defined in the investment plan.</td><td></td><td>▪ Machinery and equipment (JPY1.6 million or more)
▪ Tools (JPY300,000 or more)
▪ Equipment/supplies (JPY300,000 or more)
▪ Software (JPY700,000 or more)
▪ Buildings and facilities (JPY10 million or more)
(Limited to buildings and facilities that are newly installed in conjunction with the introduction of assets contributing to the enhancement of productivity)
*The upper limit for the total amount of capital investment eligible for tax incentives is JPY6 billion.</td></tr>
</table>

Source:FY 2025 Tax revisions related to economic and industrial matter,https://www.meti.go.jp/main/zeisei/zeisei_fy2025/zeisei_fy2024/zeiseikaiseigaiyou2025.pdf

To encourage active capital investment in facilities and business expansion by SMEs and to promote the creation of SMEs with high growth potential to become mid-sized companies with sales exceed JPY10 billion, incentive measures will be implemented for SMEs aiming to exceed JPY10 billion in revenue. As a result, SMEs are likely to see a boost in productivity with their capital investments.

(2) Extension of special measure for the taxable base of the property tax related to SME capital investments

The special measures for the taxable base of the property tax related to certain machinery and equipment acquired by SMEs which contribute to productivity enhancement and employee wage increases, and are outlined in a plan for the implementation of advanced machinery and equipment as stipulated in the Small and Medium-sized Enterprises Business Enhancement Act, will be revised as described below and extended by two years.

(i) Eligible assets are limited to certain machinery and equipment acquired based on a plan designed to increase employee wages and other compensation.

(ii) The tax base for relevant machinery and equipment is as follows.

(a) If the plan includes a policy to increase the amount of employee wages and other compensation by at least 1.5%, the tax base for the first three years is set at half the cost.

(b) If the plan includes a policy to increase the amount of employee wages and other compensation by at least 3%, the tax base for the first five years is set at one quarter of the cost.

(3) Extension of the SME investment incentive tax rules

The application deadline for the SME investment incentive tax rules will be extended by two years after certain revisions (as mentioned above in 1.(1)(iv)).

(4) Two-year extension of the special measures for the reduced the corporation tax rate for SMEs

The applicable period of special measures for the reduced corporation tax rate for SMEs (15% of income equal to or less than JPY8 million per annum) will be revised and extended by two years.

(i) For fiscal years where taxable income exceeds JPY1 billion, the tax rate applied to the first JPY8 million of taxable income will be raised to 17% (currently 15%).

(ii) Corporations under the group relief system will not be eligible.

The majority of SMEs with extremely high incomes that fall under the upcoming revisions to these special measures are expected to utilize the SME business enhancement tax rules under certain criteria. In these instances, the entities stand to enjoy advantages that far surpass the changes to the reduced corporation tax rate, resulting in tax revisions that are both more distinct and impactful.

2. Revision of lease-related tax rules

In line with the introduction of new accounting standards for lease transactions, the tax treatment for lease transactions will be revised for both lessees and lessors as follows:

(1) Treatment for lessees in lease transactions

- When a corporation that is a lessee in a lease transaction rents assets through an operating lease transaction, and there is an amount payable by the corporation under the terms of the contract related to that transaction, the portion of the amount that constitutes a determined liability will be recognized as a deductible expense in the fiscal year in which that such liability is determined.

  (Note 1) The term "operating lease transaction" mentioned above refers to rental transactions of assets that are not lease transactions (finance lease transactions).

  (Note 2) The amount payable mentioned above includes the costs required for renting the asset and the direct expenses required to use the asset for business purposes. It excludes the cost of sales related to the revenue of that fiscal year, the cost of completed construction, and other costs similar to these, as well as the amount of expenses that should be considered as the cost of acquiring fixed assets and the amount of expenses that become deferred assets.

- For depreciation of lease assets related to non-ownership transfer lease transactions concluded on or after 1 April 2027, it will be allowed to depreciate assets down to JPY1 (as a residual value) at the end of the lease term without deducting the guaranteed residual value included in the acquisition cost in the calculation using the straight-line method for the lease term.
- In regard to the calculation of the tax base for the value-added portion of enterprise tax, when a corporation rents land or buildings as part of an operating lease transaction in each fiscal year, and there is an amount payable by the corporation under the terms of the contract related to that transaction as consideration for the leasehold rights, the portion of that amount that is deducted in the calculation of corporation taxable income will be treated as the rental payment for the fiscal year in which it is deducted.

When a corporation that is a lessee applies the new lease accounting standards, there will be no change in the tax treatments for operating lease transactions. There are some case where tax adjustments are required in light of the changes in accounting treatments.

(2) Treatment for lessors in lease transactions

- For corporation tax purposes, the special provision for determining which fiscal year profit and expenses of lease transfers are attributed to (installment method) will be abolished. Additionally, the following transitional measures will be established.
  - For lease transfers conducted by corporations before 1 April 2025, profit and expenses can be calculated using the installment method (limited to the method that considers only the interest-equivalent amount of lease transfers as profit for each fiscal year starting after that date) for fiscal years starting before 31 March 2027.
  - For fiscal years starting between 1 April 2025 and 31 March 2027, if the application of the installment method is discontinued, the deferred lease profit amount will be recognized as revenue in equal installments over five years.
- For consumption tax purposes, the special provision for the timing of asset transfers related to lease transfers will also be abolished. Additionally, the following transitional measures will be established.
  - For corporations that conducted asset transfers corresponding to lease transfers before 1 April 2025, the amount of consideration for the transfer of assets can be calculated using the installment method for fiscal years starting before 31 March 2030.
  - If the application of the installment method is discontinued for fiscal years starting on or after 1 April 2025, the remaining amount of the payment obligation will be recognized as the amount of consideration for the transfer of assets in equal installments over ten years.

For lease transfers conducted by leasing companies, the special provisions for lease transfers in both corporate tax and consumption tax will be abolished due to the introduction of new accounting standards for lease transactions. For corporation tax purposes, it is anticipated that measures will be implemented to ensure that the calculation of taxable income corresponds with the new lease accounting standards. For consumption tax purposes, it is anticipated that the total consideration for asset transfers will be recognized in full at the moment the lease transfer takes place. Note that transitional measures will be introduced for existing contracts, taking into account the tax obligations of the lessor.

3. Clarification of calculation method for adjustment accounts in relation to assets transferred as result of a non-qualified merger

The calculation method for adjustment accounts in relation to assets transferred as a result of a non-qualified merger and similar transactions will be revised as follows.

(i) The calculation method for adjustment accounts will be clarified for cases where the value of assets and liabilities transferred is equal according to a certain asset valuation, and there is no consideration for the transfer.

Regarding the calculation of the amount for adjustment accounts in relation to assets transferred as a result of non-qualified mergers or similar transactions without consideration, there was a lack of clarity in the method for calculating the amount of the asset adjustment account when the value of assets and liabilities transferred is equal according to a certain asset valuation and there is no consideration for the transferred assets. Consequently, a certain number of corporations have been deliberately paying JPY1 as consideration to classify the transaction as "with consideration" and thus calculate the amount for the asset adjustment account. The applicable calculation methods will be clarified to mitigate such ambiguities.

(ii) The tax treatment for the scenarios where non-qualified mergers or similar transactions, under which the value of the transferred assets exceed the value of the transferred liabilities, are executed without consideration nor a formal asset valuation, will be clarified.

In scenarios where non-qualified mergers or similar transactions, under which the value of the transferred assets exceed the value of the transferred liabilities, are executed without consideration nor a formal asset valuation, necessary provisions will be implemented for the calculation methods of the asset adjustment account or the liability variance adjustment account, as well as the amount of increased capital.

4. Distribution ratios for spin-offs of wholly-owned subsidiaries under the group relief system

For group relief corporations that distribute shares of another group relief corporation through a share distribution, causing the latter (the "spin-off corporation") to be removed from the relief group, the following revisions will be made for the calculation of (1) the distributed capital amount that serves as the basis for calculating the amount of deemed dividend, (2) the amount to be deducted from the capital amount, and (3) the book value of the spin-off corporation's shares that forms the basis for calculating the gain or loss on the transfer of shares owned by the shareholders of the group relief corporation who received the shares of the spin-off corporation through the share distribution.

These revisions will allow calculations to be made using the amounts recorded at the end of the prior fiscal year in determining the ratio by which the amounts of the group relief corporation's capital or the book value of its owned shares immediately before the share distribution is multiplied.

(i) For the numerator of the ratio, the book value of the spin-off corporation's shares before investment book value adjustment will be adjusted by adding or subtracting the book value adjustment equivalent amount.

(ii) For the denominator of the ratio, the book value adjustment equivalent amount related to the spin-off corporation's shares held by the group relief corporation immediately before the share distribution will be adjusted.

(iii) The "book value adjustment equivalent amount" refers to the amount equivalent to the book value net asset shortfall or excess that would result from applying the investment book value adjustment provisions, assuming that the total book value of assets and liabilities held by the spin-off corporation at the end of the prior fiscal year is the total book value of assets and liabilities held by the spin-off corporation immediately before the share distribution.

(iv) If the group relief corporation has filed an interim tax return based on provisional settlement of accounts within six months before the date of the share distribution, the end of the period for the interim fling will be considered the end of the prior fiscal year.

(v) If there are increases or decreases in the amount of the spin-off corporation's capital or retained earnings (excluding the amount related to income and investment book value adjustment) from the end of the prior fiscal year to immediately before the share distribution, these changes will be considered in the total book value of assets and liabilities of the spin-off corporation at the end of the prior fiscal year. If the spin-off corporation holds other spin-off corporations, the investment book value adjustment of those other spin-off corporations will also be considered.

(1) The distributed capital amount that serves as the basis for calculating the amount of deemed dividend

$$\text{Capital of the group relief corporation immediately before the share distribution} \times \frac{\text{Book value of the spin-off corporation's shares immediately before the share distribution} \pm \text{the equivalent of the book value adjustment related to the spin-off corporation}}{\text{The amount obtained by subtracting the book value of liabilities from the book value of assets at the end of the prior fiscal year for the group relief corporation} \pm \text{the equivalent of the book value adjustment related to the spin-off corporation}}$$

(2) The amount to be deducted from the capital amount

$$\text{Capital of the group relief corporation immediately before the share distribution} \times \frac{\text{Book value of the spin-off corporation's shares immediately before the share distribution} \pm \text{the equivalent of the book value adjustment related to the spin-off corporation}}{\text{The amount obtained by subtracting the book value of liabilities from the book value of assets at the end of the prior fiscal year for the group relief corporation} \pm \text{the equivalent of the book value adjustment related to the spin-off corporation}}$$

(3) Book value of spin-off corporation's shares

$$\text{Book value of the group relief corporation's shares held by shareholders immediately before the share distribution} \times \frac{\text{Book value of the spin-off corporation's shares immediately before the share distribution} \pm \text{the equivalent of the book value adjustment related to the spin-off corporation}}{\text{The amount obtained by subtracting the book value of liabilities from the book value of assets at the end of the prior fiscal year for the group relief corporation} \pm \text{the equivalent of the book value adjustment related to the spin-off corporation}}$$

Furthermore, the same treatment applies to the book value of shares of group relief subsidiaries in the following cases.

- The amount to be deducted from the capital related to the qualified share distribution conducted by the group relief corporation
- The amount of the split capital that forms the basis for calculating the amount of deemed dividend related to the demerger conducted by the group relief corporation, and the amount to be deducted from the capital amount
- In cases where the shareholders of the group relief corporation receive shares of the surviving corporation as a result of the demerger conducted by the group relief corporation, in regard to the book value corresponding to the split net assets that forms the basis for calculating the gain or loss on the transfer of owned shares, the book value of the shares of the group relief subsidiaries that serves as the basis for determining the ratio by which the amount of the group relief corporation's capital immediately before the demerger or the book value of the owned shares immediately before the demerger is multiplied.

Currently, the calculation of the amount equivalent to the book value adjustment was to be done using the book value of the shares of the wholly-owned subsidiary involved in the share distribution "immediately before" the distribution. However, by using the amount obtained by adding or deducting the investment book value adjustment calculated based on the book value net asset value at the end of the prior fiscal year to the "immediately before" book value of the wholly-owned subsidiary's shares, the calculation can now be conducted with some timing flexibility when carrying out the spin-off.

5. Other

(1) Extension of tax incentives for investment in the future of the region

The special depreciation or tax credit system for the acquisition of specific business machinery and equipment within the promotion zones of regional economy advancement projects will be revised as follows, with the applicable period extended by three years.

(i) Certain measures will be implemented in regard to the special depreciation rate to 50% and the tax credit rate to 5%, respectively.

(ii) The special depreciation rate for machinery, equipment, and tools will be reduced to 35% (currently at 40%).

(iii) The investment scale requirement for specific regional economy advancement project facilities will be raised to JPY100 million or more (currently JPY20 million or more).

(iv) There will be revisions regarding the confirmation requirements by the minister in charge of the approved regional economy advancement project.

> The overall goal of this measure is to strengthen the foundation for regional growth and development by promoting investment in facilities within regional economy advancement projects that leverage the unique characteristics and appeal of the region to create high added value and have a significant economic impact on the area.
>
> Furthermore, it is generally understood that the larger the scale of investment, the longer it takes to conduct capital investment. Additionally, recent shortages of materials and other factors have led to delays in procurement, making it challenging to complete capital investments within the original two-year period. Consequently, the period will be extended by three years to accommodate cases where investments cannot be completed within the original timeframe.

(2) Establishment of a tax system for promoting resource recycling

A system will be established that allows for a special depreciation of 35% of the acquisition cost for entities that have received certification for recycling sophistication plans under the Act Concerning Sophistication of Recycling Business, etc. to Promote Resource Circulation. This applies to those who acquire certain large-scale advanced recycling facilities designated by the Minister of the Environment in consultation with the Minister of Finance, and employ them for certified projects during the period from the date of enforcement of the Act until 31 March 2028. The upper limit for the total acquisition cost of eligible assets under this system will be JPY2 billion.

(3) Extension of the hometown tax donation (*Furusato Nozei*)

The measures for hometown tax donation for businesses will undergo certain revisions, and the applicable deadline for the special tax credit measures will be extended by three years (until FY2027).

(i) Local public entities that are certified and have carried out projects utilizing donations for creating towns, people, and jobs (referred to as "donation utilization projects") are required to provide a written verification ("confirmation document") to the Prime Minister's Office both when the donation utilization project is completed and at the close of each fiscal year, to affirm that the project has been conducted appropriately.

(ii) When a certified local public entity receives donations related to the donation utilization projects it implements, and the content of the contracts associated with those projects meets certain criteria, the organization is required to report the name of the corporation that made the donation to the Prime Minister's Office and also to publicly disclose the name of the corporation that provided the donation.

(iii) Other necessary measures will also be established.

As regional economies face challenges such as population decline, depopulation, and the decline of local industries, there is a demand for public-private collaboration to transform these challenges into engines of growth. Consequently, the regional revitalization support tax system (the hometown tax donation for businesses) will be extended to create and expand the flow of funds to local regions and to encourage the return of talent to these areas. Meanwhile, in light of incidents where certifications for regional revitalization plans have been rescinded due to misconduct, revisions will be implemented to bolster the oversight of the execution of donation utilization projects and to improve the visibility of how donations are used, with the goal of fostering the system's growth.

(4) Abolishment of the 5G implementation tax incentive

The special depreciation or tax credit system for certain facilities related to 5G information and communication systems acquired will be abolished at the end of its applicable term.

(5) Abolishment of the digital transformation investment promotion tax incentive

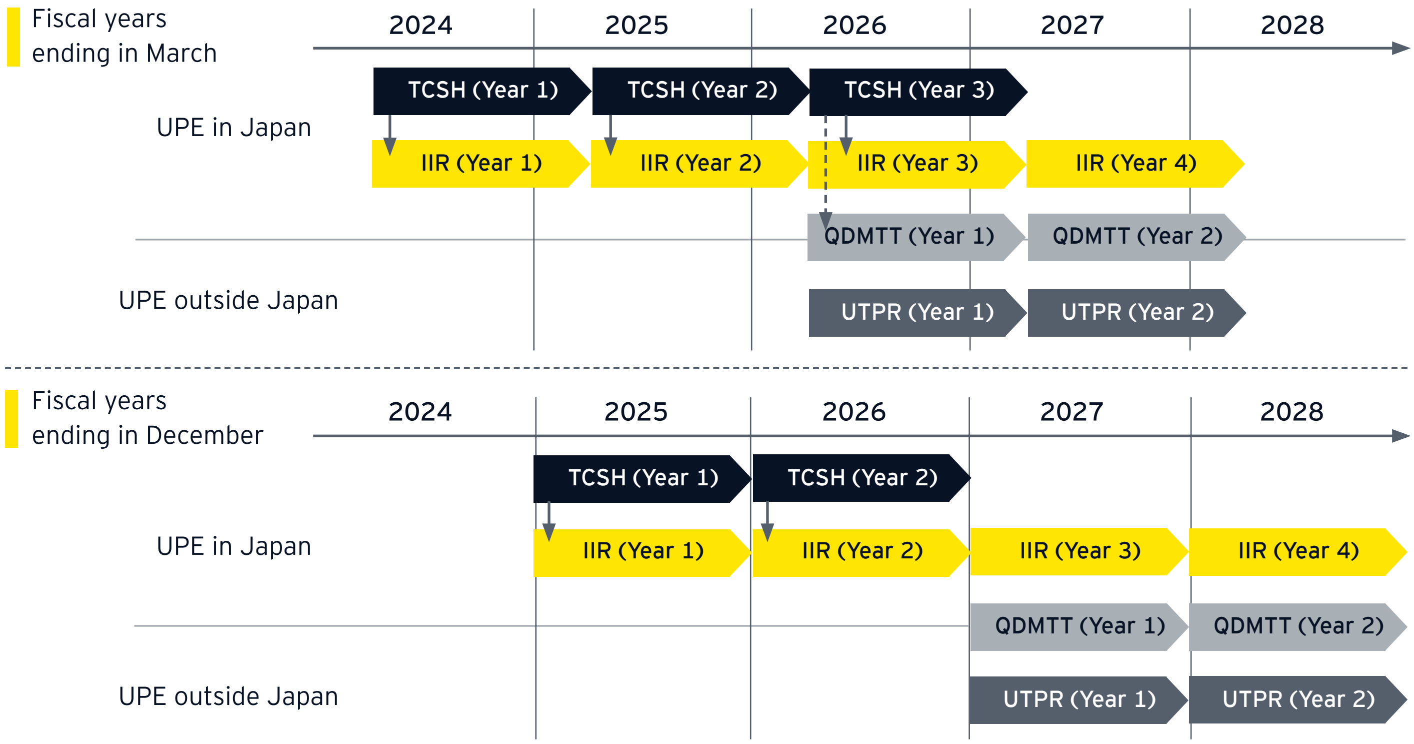
The special depreciation or tax deduction regime for investments in digital equipment will be abolished at the end of its applicable term.

International taxation

1. Aligning with global minimum tax rules

In October of 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) will be enacted in accordance with international agreements. In light of the need to afford affected companies ample 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. Please refer to Figure 1 for the application schedules of companies with fiscal years ending in March and December, respectively.

Figure 1: General application of global minimum tax for companies with fiscal years ending in March and December, respectively



* TCSH: Transitional CbCR Safe Harbor

(Note) Figure 1 only illustrates application based on Japanese laws; therefore, there is a possibility that IIR, QDMTT, or UTPR based on laws outside of Japan may apply.

(1) Aligning with UTPR

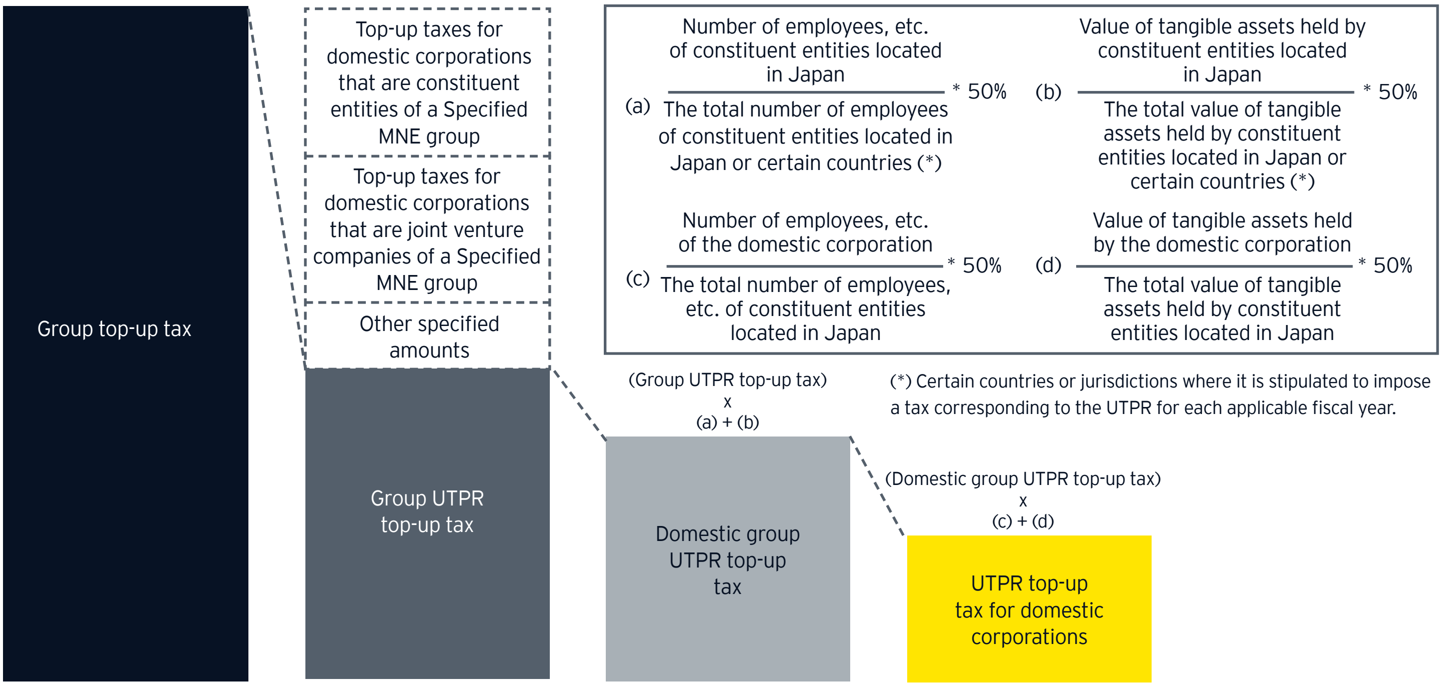
(i) Establishment of UTPR for each applicable fiscal year

An assessment of UTPR for each applicable fiscal year will be established.

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

The UTPR top-up tax for domestic corporations is calculated as shown in Figure 2. The same applies to the UTPR top-up tax for foreign corporations with permanent establishments that are constituent entities.

Figure 2: Calculation of UTPR top-up tax for domestic corporations



If the determined applicable fiscal year for a Specified MNE group falls within five years after the start date of the first fiscal year in which it became a part of the Specified MNE group, and corresponds to a fiscal year considered to be in the initial stages of international business activities, the group UTPR top-up tax for that applicable fiscal year will be considered zero.

For other matters, the following provisions will apply.

Item	Treatment
Amount of UTPR	The amount calculated by applying a tax rate of 90.7 percent to the UTPR top-up tax (tax base) for each applicable fiscal year.
Filings and payments of the UTPR	Within one year and three months (or one year and six months in certain cases) from the day following the end of each applicable fiscal year.
When there is no group UTPR top-up tax (tax base)	Filing is not required
Special provisions for electronic filings	Same as those for corporate tax
Blue return system	Not applicable
Inclusion of reasons for amendments	Applicable
Presumptive tax	Not applicable
Inquiries and penalties, etc.	Same as those for corporate tax

(ii) Revision of local corporate tax on international minimum taxation

In regard to local corporate tax on international minimum taxation, the amount of UTPR (excluding penalties) will be added to its scope, and its name will be changed to the local corporate tax on international minimum taxation in relation to top-up taxes (tentative name).

The calculation, filing, payment, inquiries, and penalties will be the same as those for the current local corporate tax on international minimum taxation.

(iii) Revision of the reporting regime for Specified MNE groups

The scope of required submissions will be expanded to include foreign corporations with permanent establishments that are constituent entities belonging to Specified MNE groups, and certain matters related to the UTPR top-up tax will be added to the scope of items that must be reported under this regime.

The UTPR functions as a tax mechanism that applies additional taxes in a subsidiary's country of residence to ensure that the tax burden of the parent company of a Specified MNE group reaches the minimum tax rate (15%). This 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 will 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 the IIR has not occurred. If the system were composed solely of the IIR, it is conceivable that actions could be taken to avoid IIR taxation by relocating the parent company potentially subject to IIR taxation to a low-tax country, while moving subsidiaries located in the low-tax country to the country where the parent company was originally located. However, with the UTPR in effect, if the subsidiary faces taxation in its country of residence, it guarantees the tax obligation at the minimum tax rate. In this capacity, 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, as previously described.

(2) Aligning with QDMTT rules

(i) Establishment of a QDMTT for each applicable fiscal year

An assessment of a QDMTT for each applicable fiscal year will be established.

Domestic corporations that are constituent entities of a Specified MNE group, as well as domestic corporations that are joint venture companies related to a Specified MNE group, and foreign corporations with permanent establishments that are constituent entities of a Specified MNE group, or foreign corporations that are joint venture companies with permanent establishments related to a Specified MNE group, will be subject to QDMTT for each applicable fiscal year.

The QDMTT for constituent entities is determined as the total amount for each category listed in Figure 3.

Figure 3: QDMTT for constituent entities

<table>
<tr><td colspan="2"></td><td colspan="2">Domestic ETR</td></tr>
<tr><td colspan="2"></td><td>Less than 15%</td><td>15% or higher</td></tr>
<tr><td rowspan="2">Net group GloBE income</td><td>Yes</td><td>(a) Current period group QDMTT × attribution rate
(b) Recalculated group QDMTT × historic attribution rate
(c) QDMTT on undistributed income</td><td>(a) Recalculated group QDMTT × historic attribution rate
(b) QDMTT on undistributed income</td></tr>
<tr><td>No</td><td colspan="2">(a) Recalculated group QDMTT × historic attribution rate
(b) QDMTT on undistributed income
(c) Group QDMTT attributable to permanent differences × attribution rate</td></tr>
</table>

Definitions

- Domestic ETR: The proportion of the amount listed in (a) to the amount listed in (b)
  (a) Adjusted covered taxes of the domestic group (the total amount of the adjusted covered taxes for all constituent entities, etc. located in Japan)
  (b) Net GloBE income of the domestic group
- Net GloBE income of the domestic group: The remaining amount after deducting the total amount of losses for all constituent entities etc. located in Japan from the total amount of income for all constituent entities etc. located in Japan.
- Current period group QDMTT: (Net GloBE income of the domestic group - substance-based income exclusion related to Japan) × (15% - Domestic ETR)
- Recalculated group QDMTT: The amount calculated as the shortfall from the group QDMTT for a past applicable fiscal year, in cases where a recalculation of the Current period group QDMTT for that past fiscal year is required.
- Attribution rate: The percentage calculated when determining the degree of contribution of the domestic corporation to the Current period group QDMTT or the Group QDMTT attributable to permanent differences.
- Historic attribution rate: The proportion calculated when determining the degree of contribution of the domestic corporation to the recalculated group QDMTT.
- QDMTT on undistributed income: The amount calculated as the QDMTT corresponding to the portion of the income amount of each domestic corporation (limited to investment entities, etc.) that was not distributed to other constituent entities.
- Group QDMTT attributable to permanent differences: The remaining amount after deducting the sum of the adjusted covered taxes of each constituent entity related to Japan from the amount by which the group QDMTT falls below zero.

If a domestic corporation that was a constituent entity of a Specified MNE group has been dissolved due to a merger in a past fiscal year, or if the residual property of that domestic corporation has been finalized in a past fiscal year, and there is an amount in each applicable fiscal year for (Recalculated group QDMTT × Historic attribution rate) as shown in Figure 3, these amounts will be included in the QDMTT related to the past applicable fiscal years of the constituent entities related to the recalculated group QDMTT.

Similar to the IIR top-up tax for each applicable fiscal year, transitional exemption using income amounts and CbCR items and other special provisions are to be established.

Furthermore, similar to the UTPR for each applicable fiscal year, 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.

For other matters, the following provisions will apply.

Item	Treatment
Amount of QDMTT	The amount calculated by applying a tax rate of 75.3 percent to the QDMTT (tax base) for each applicable fiscal year.
Filings and payments of QDMTT	Within one year and three months (or one year and six months in certain cases) from the day following the end of each applicable fiscal year.
When there is no group QDMTT (tax base)	Filing is not required
Special provisions for electronic filings	Same as those for corporate tax
Blue return system	Not applicable
Inclusion of reasons for amendments	Applicable
Presumptive tax	Not applicable
Inquiries and penalties, etc.	Same as those for corporate tax

(ii) Establishment of local corporate tax on QDMTT (tentative name)

For corporations that are constituent entities belonging to a Specified MNE group, or corporations that are joint venture companies related to a Specified MNE group, local corporate tax on QDMTT will be assessed on the specified standard corporate tax amount related to the QDMTT for each taxable fiscal year.

For other matters, the following provisions will apply.

Item	Treatment
Amount of local corporate tax assessed on QDMTT	The amount calculated by applying a tax rate of 247/753 to the specified standard corporate tax amount related to the QDMTT (i.e. taxable base) for each taxable fiscal year.
Specified standard corporate tax amount related to the QDMTT	QDMTT for each applicable fiscal year (excluding penalties)
Filing and payment of local corporate tax on the specified standard corporate tax amount related to the QDMTT	Within one year and three months (or one year and six months in certain cases) from the day following the end of each taxable fiscal year.
Special provisions for electronic filings	Same as those for local corporate tax on standard corporate tax amounts
Inquiries and penalties, etc.	Same as those for local corporate tax on standard corporate tax amounts

(iii) Establishment of a reporting regime for group QDMTT and related matters.

A domestic company subject to group QDMTT will be required to submit via e-Tax a group QDMTT report to the tax director of the competent 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.

Definitions

- Corporations subject to group QDMTT reporting: Domestic corporations that are constituent entities belonging to a Specified MNE group, domestic corporations that are joint venture companies related to a Specified MNE group, foreign corporations with permanent establishments that are constituent entities belonging to a Specified MNE group, foreign corporations that are joint venture companies with permanent establishments related to a Specified MNE group, or certain corporations that were constituent entities or joint venture companies related to a Specified MNE group in a past fiscal year.
- Reporting requirements for group QDMTT and related matters:
  - Name of ultimate parent company of the Specified MNE group
  - Names and countries of constituent entities of the Specified MNE group
  - QDMTT and related matters of the Specified MNE group
  - Any other necessary matters
  - A request expressing the intention to apply the exemption related to income amounts, etc.

If it is determined that the tax authorities from the home country of the ultimate parent company or the designated reporting entity of a Specified MNE group can furnish Japan with the required group QDMTT reporting items related to that group, then the corporation responsible for submitting these items may be exempted from this obligation.

In cases where there are multiple entities obligated to report matters related to group QDMTT, filing exemptions, ultimate parent company reporting items, penalties, and other matters will be the same as the current reporting regime for specified MNE groups.

The QDMTT functions as a tax mechanism that assess additional taxes on a company belonging to a Specified MNE group in their country of residence, in cases where the effective tax rate in that country falls below the minimum tax rate. The additional tax is applied to the extent that the tax burden of the company reaches the 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).

Future issues to consider

Regarding Pillar 2, it has been determined that revisions will continue to be considered in 2026 tax reform and onwards, taking into account 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 the Pillar 2.

Meanwhile, regarding Pillar 1, it remains crucial for Japan to keep contributing proactively to international discussions aimed at the prompt signing of a multilateral treaty that includes new taxing rights distribution to market jurisdiction. 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 if taxing rights are extended to local public entities, and the procedures for avoiding double taxation as mandated by the treaty, all while 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) Revisions to IIR

(i) Pushdown of deferred tax expenses related to JCFC rules

The calculation of the amount of tax related to the current net profit or loss of constituent entities, which includes amounts contained in the adjusted covered taxes of other constituent entities subject to the JCFC rules, will now include deferred tax expenses.

> In the 2023 tax reform, a push-down measure was introduced to treat certain amounts of the adjusted covered taxes related to the current net profit or loss of the parent company, which derive from the parent company's income due to JCFC rules, as the allocated current period covered tax for those constituent companies. Regarding this issue, the method for calculating the allocated current period covered tax related to the deferred tax expenses had been deferred in the 2023 tax reform due to ongoing international discussions. However, with this revision, it is expected that the deferred tax expenses will also be included in the allocated current period covered tax.
>
> For instance, when a domestic corporation and its controlled foreign company ("CFC") share the same fiscal year, the income inclusion of the CFC's income for period X1 usually occurs in the domestic corporation's period X2, with the corresponding corporate tax liability being acknowledged in the domestic corporation's period X2. In this scenario, if the unpaid corporate tax liability of the domestic corporation for period X2 is pushed down to the CFC (which is a constituent entity), in its period X2, a discrepancy in the timing of recognition will occur. Conversely, if the domestic corporation recognizes the deferred tax liability associated with the income inclusion for period X1 within the same period, and this can be pushed down to the period X1 of the CFC (which is a constituent entity), it is expected that any misalignment in the timing of recognition would be rectified.

(ii) Other

In addition, the below revisions will also be made.

- In the case of calculating the recalculated top-up tax of a jurisdiction, a special measure will be established regarding the method of reversing deferred tax liabilities in relation to the measure which allows for the reduction of the adjusted covered taxes related to the deferred tax liabilities recorded in a past fiscal year by the amount pertaining to the portion of deferred tax liabilities that has not been reversed by the end of the fiscal year five years after that past fiscal year.
- In the calculation of the net profit or loss after tax for the current period, an adjustment measure which deems the amounts related to transactions that occur between a constituent entity and another constituent entity located in different jurisdictions to have been conducted at arm's length prices is also applicable to transactions among joint venture companies.
- In the calculation of the net profit or loss after tax for the current period, when a sale of assets occurs between constituent entities that are located in the same jurisdiction, an adjustment measure is applied that deems the amount related to the transaction of the selling constituent entity to have been conducted at an arm's length price equivalent. This measure will now also apply to the constituent entity that made the purchase of the assets in the transaction.
- When applying the special provision for the current period net profit or loss of flow-through entities, in cases where other flow-through entities are interposed between the constituent entity owner and the covered flow-through entity, it is required that the laws of the country where the constituent entity owner is located treat the income of the other flow-through entities and the covered flow-through entities as the income of their members.
- Other necessary measures will also be established.

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

The following revisions will be made to the JCFC rules.

(1) Revision of the income inclusion timing

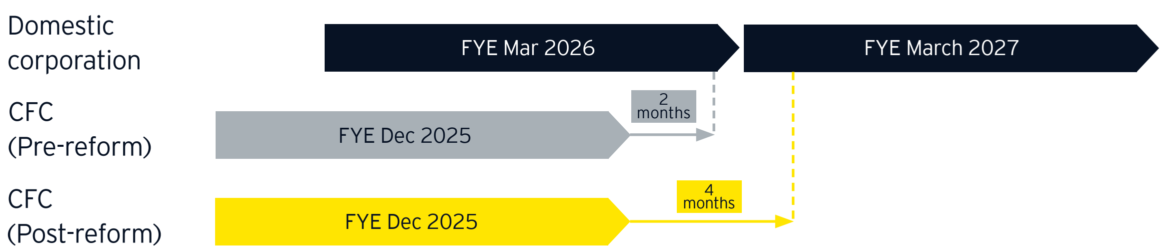
The amount corresponding to the taxable amount for each fiscal year of a controlled foreign company ("CFC") of a domestic corporation is deemed to be part of the domestic corporation's revenue. This amount will now be included in the income calculation for the domestic corporation's fiscal year that includes the day after four months (currently two months) have passed from the end of the CFC's fiscal year.

This revision will apply to the taxable amounts of CFCs related to fiscal years of domestic corporations that begin on or after 1 April 2025, limited to the taxable amounts related to fiscal years of the CFCs that end on or after 1 February 2025.

Furthermore, for the taxable amounts of CFCs related to fiscal years of domestic corporations that begin before 1 April 2025 (limited to the taxable amounts related to fiscal years of the CFCs that end between 1 December 2024 and 31 January 2025), a transitional measure will be enacted which allows for the application of the JCFC rules to fiscal years of the domestic corporation that begin on or after 1 April 2025, which includes the day after four months have passed from the end of the CFC's fiscal year.

As an example of this revision, if a domestic corporation has a March fiscal year-end and the CFC has a December fiscal year-end, the income inclusion timing is expected to be shifted back by one fiscal year, as shown in Figure 4.

Figure 4: Income inclusion timing when domestic corporation has March FYE and CFC has December FYE



Under the current provisions, a domestic corporation with a fiscal year ending in March 2025 would need to include the taxable amount of a CFC for the fiscal year ending in December 2024. However, by applying the transitional measures, it is expected that this income inclusion can instead be carried out in the domestic corporation's fiscal year ending in March 2026.

(2) Revisions to document attachment and preservation requirements

The following items will be excluded from the scope of documents related to CFCs that are required to be attached to or preserved with the tax return.

(i) Statements of changes in shareholders' equity and statements of appropriation of profit and loss

(ii) Detailed breakdown of account items related to the balance sheet and income statement

Individual income taxation and asset taxation

1. Recalibrating tax obligations amid inflationary trends

(1) Revision of the basic exemption

For individuals with a total income amount of JPY23.5 million or less, the basic exemption will be raised from the current maximum of JPY480,000 to a maximum of JPY580,000. As a result of this revision, the basic exemption will be as shown in the table below.

Total income	Deduction
JPY23.5 million or less	JPY580,000
More than JPY23.5 million, less than or equal to JPY24 million	JPY480,000
More than JPY24 million, less than or equal to JPY24.5 million	JPY320,000
More than JPY24.5 million, less than or equal to JPY25 million	JPY160,000

(Note) This reform will apply to individual income taxes for tax year 2025 and thereafter. In regard to the withholding of salaries and public pension payments, the revisions will apply to salaries and public pensions that are to be paid on or after 1 January 2026.

(2) Revision of the minimum guaranteed amount of salary employment deduction

- The minimum guaranteed amount of salary employment deduction will be increased from JPY550,000 to JPY650,000.

  (Note) This reform will apply to individual income taxes for tax year 2025 and thereafter.

- In line with the above amendment, necessary measures will be taken regarding the withholding tax tables for employment income and related matters.

  (Note) This amendment will apply to salaries and other compensation to be paid on or after 1 January 2026.

Income tax faces the challenge of a progressively heavier tax obligation as a result of inflation, given that the basic exemption is a static amount. With that said, there has been a noticeable trend of inflation in recent times. Consequently, to mitigate the tax burden faced by individuals, the basic exemption for income tax is set to be raised.

Additionally, since the employment income deduction is calculated based on a percentage of employment income, the deduction amount will increase as wages rise with inflation. However, for incomes where the minimum guaranteed amount applies, the deduction amount will not increase even if the income does, due to how the system is structured. Accordingly, as a means of combating inflation, as well as a way to address adjustments to employee hours, the minimum guaranteed amount will be increased.

These revisions have been made as a result of discussions between the ruling and opposition parties about the so-called "JPY1.03 million wall." Further consideration and deliberation on this topic have already been confirmed. It is important to note that the details of these revisions could be subject to modifications based on the outcomes of ongoing discussions between the ruling and opposition parties.

(3) Establishment of a special deduction for specified relatives (tentative name)

- Should a resident support a relative who is 19 years old or older and under 23 years old (not including the resident's spouse or family employees of blue return taxpayer, etc., and only if their total income is JPY1.23 million or less) and who is not eligible as a dependent for deductions, a special deduction will be deducted from the resident's total income for that year.

  (Note) This reform will apply to individual income taxes for tax year 2025 and thereafter.

Total income of the relative	Deduction
More than JPY580,000, less than or equal to JPY850,000	JPY630,000
More than JPY850,000, less than or equal to JPY900,000	JPY610,000
More than JPY900,000, less than or equal to JPY950,000	JPY510,000
More than JPY950,000, less than or equal to JPY1 million	JPY410,000
More than JPY1 million, less than or equal to JPY1.05 million	JPY310,000
More than JPY1.05 million, less than or equal to JPY1.1 million	JPY210,000
More than JPY1.1 million, less than or equal to JPY1.15 million	JPY110,000
More than JPY1.15 million, less than or equal to JPY1.2 million	JPY60,000
More than JPY1.2 million, less than or equal to JPY1.23 million	JPY30,000

- This revision will allow for the above deduction to be applied at the time of withholding for salaries and public pensions, if the deduction amount exceeds a certain threshold.

  (Note) This amendment will apply to salaries and public pensions to be paid on or after 1 January 2026.

Amidst the acute shortage of workers, there have been observations that the tax system plays a role in influencing the working hours of employees, especially for university students engaged in part-time work. Accordingly, for university-aged children in the range of 19 to 22 years old, if their total income amount is up to JPY850,000 (equivalent to an employment income of JPY1.5 million), their parents, or other qualifying relatives, can receive an income deduction of the same amount as the specified dependent deduction (JPY630,000). Additionally, should the total income of the university-aged child exceed JPY 850,000, a graduated system will be implemented whereby the deduction available to the parents or other qualifying relatives will be progressively reduced.

(4) Necessary measures accompanying the above revisions

In conjunction with the above revisions, the following measures will be taken.

- Raising the income amount requirement

Criteria	Measures
Combined income amount of the cohabitating spouse and dependent	JPY580,000 or less (currently JPY480,000 or less)
Total gross income of child supported by a single parent	JPY580,000 or less (currently JPY480,000 or less)
Total income of working student	JPY850,000 or less (currently JPY750,000 or less)

  (Note) This reform will apply to individual income taxes for tax year 2025 and thereafter.

- Revision of individual inhabitant tax

  There will be no revisions to the basic exemption (currently JPY430,000). Other revisions and related measures will be similarly implemented for individual inhabitant tax as well.

  (Note) This reform will apply to individual inhabitant taxes for tax year 2026 and thereafter.

2. Other major revisions

In addition, the following revisions were included in the 2025 tax reform.

(1) Extension of the housing loan tax credit aimed at supporting young married couples and households with children

Individuals subject to the special provisions (*1) who construct or otherwise acquire certified housing that is available for residential use between 1 January and 31 December of 2025 will be able to apply a special tax credit on their income tax based on the year-end balance of their relevant housing loans, up to the limits shown in the table below.

This revision is intended as a temporary measure for a length of one year.

Category of certified housing, etc.	Maximum loan
Certified housing (*2)	JPY50 million
ZEH (Net Zero Energy House) Standard Energy-Saving House	JPY45 million
A dwelling for specified additions of improvements to save energy	JPY40 million

(*1) "Individuals subject to the special provisions" refers to (1) individuals who are under 40 years of age and have a spouse, (2) individuals who are 40 years of age or older and have a spouse under 40 years of age, or (3) individuals who have a dependent under 19 years of age.

(*2) "Certified housing" refers to certified long-term high-quality housing and certified low-carbon housing

(2) Revision of measures for the tax exemption of dividends and capital gains arising from small investments in listed shares in tax exempt accounts (NISA)

With the aim of facilitating a consistent transition from savings to investment and fostering conditions favorable for the development of a "nation founded on asset investment and management," measures will be taken to allow for immediate purchases when changing financial institutions and raise the minimum trading unit of listed investment trusts (ETFs) to less than or equal to JPY10,000 per unit (currently less than or equal to JPY1,000).

(3) Revision of the contribution limit for individual defined contribution pension plans (iDeCo)

Bearing in mind the function of private pensions to supplement public pensions and assist in accumulating assets for individuals to enjoy a comfortable retirement, while also acknowledging the present trend of rising wages, revisions will be implemented to the contribution limits for individual defined contribution pension plans (iDeCo).

Subject to	Maximum contribution
Category 1 policyholders	JPY75,000 (currently JPY68,000 per month)
Corporate pension plan enrollees	From JPY62,000 per month, deducting the contributions for each defined-benefit corporate pension and the contributions for corporate-type defined contribution pensions (currently: JPY20,000).
Individuals not enrolled in a corporate pension plan (excluding Category 1 and Category 3 policyholders)	JPY62,000 per month (currently JPY23,000 per month)

(4) Revision of the adjustment provisions for retirement income deduction

If an individual receives a retirement payment (excluding lump-sum old-age benefits paid as lump sums under the Defined Contribution Pension Law) in a year and has received a lump-sum old-age benefit payment within the nine years prior to the year before the payment, that lump-sum payment will be subject to the special measure for excluding overlapping service periods in the calculation of the retirement income deduction.

(Note) The above revision applies to cases where an individual receives a lump-sum old-age benefit payment on or after 1 January 2026, and to retirement payments that are to be paid on or after the same date.

With respect to the "five-year rule" for retirement pensions, the existing regulations allow for the full use of the retirement income deduction for both a lump-sum payment from a defined contribution pension and a subsequent retirement lump-sum payment, provided that more than five years have passed between the two. However, in light of a growing number of instances where individuals receive retirement lump-sum payments at age 65 or later due to increases in the mandatory retirement age, the rule is set to be revised to a "ten-year" timeframe to assure fair taxation.

(5) Revisions to the taxation of trusts subject to corporate taxation

For certain shares belonging to the trust property of a trust subject to corporate taxation which are without beneficiaries or similar parties, if beneficiaries are newly decided and the trust no longer qualifies as a trust subject to corporation taxation, and if the trust is a specified trust subject to corporate taxation, the calculation of the income for such beneficiaries will be based on the value (fair market value) at the time the trust ceased to qualify. The beneficiaries will be deemed to have acquired the shares at their value at the time the trust ceased to qualify, and the economic benefits derived from acquiring those shares will be subject to taxation as employment income for each relevant year.

Currently, executives and others who acquire shares through a stock grant scheme using a trust subject to corporate taxation can benefit from a deferral of taxation. With this revision, the difference between the fair market value and the book value of the shares will be taxed as employment income.

(6) Revision of the reinvestment period under the angel investor tax rules

To promote reinvestment in startups, a carryback refund system will be introduced which permits a deduction equivalent to the investment amount from the capital gains realized in the year they occurred, provided that the reinvestment is made in the subsequent year. As a result, the reinvestment period will be extended.

However, given that this is a highly unusual provision that diverges from the norm of annual income taxation, measures to ensure its proper utilization are necessary. Thus, if shares acquired through the reinvestment tax exemption are sold by the end of the subsequent year to their acquisition, they will become taxable.

(Note) The above revisions will apply to acquisitions made on or after 1 January 2026.

(7) Revision of the special tax measures for corporate business succession (gift tax)

With the aim of addressing the pressing challenge of enhancing productivity via the seamless generational handover of small and medium-sized businesses, the board membership requirement for the special deferral of gift tax on non-listed shares will be updated. The individual must be an executive or similar position within the company approved for the special measure for gift succession immediately prior to the gift (as opposed to the current requirement of continuous service for at least three years up to the date of the gift).

(Note) The above revisions apply to gift taxes related to property acquired by gift on or after 1 January 2025.

(8) Revision of measures for the exemption from gift taxes of lump-sum gifts of marriage and child-rearing funds

Given that we are currently within the intensive focus period (through fiscal year 2026) for the "Children's Future Strategy," and it is a critical time for implementing comprehensive policies for children and parenting, the deadline for applying the gift tax exemption for one-time gifts received from direct lineal ascendants for marriage and child-rearing purposes will be extended by an additional two years.

Consumption taxation

Revisions to consumption tax exemption rules for foreign tourists

The consumption tax exemption rules for foreign tourists will be revised as follows, starting from 1 November 2026.

(1) Revision of the tax exemption methodology

(i) When a business operator managing a duty-free shop transfers duty-free goods to a tax-free purchaser, and the tax-free purchaser has their purchase confirmed by the director-general of a customs house at the port of departure within 90 days from the date of purchase, the transfer of those duty-free goods will be exempt from consumption tax, provided that the business operator preserves the information that such confirmation was made.

(ii) Tax-free purchasers must present their passport or similar documentation and receive confirmation from the director-general of a customs house at the time of departure, and they must take the confirmed duty-free goods out of the country.

(iii) The director-general of a customs house will provide customs confirmation to the business operator managing the duty-free shop for each purchase record via the National Tax Agency's duty-free sales management system.

(2) Revision of scope of eligible duty-free goods

(i) The daily purchase limit (JPY500,000) for consumable goods by tax-free purchasers at the same store and the requirement for special packaging will be abolished, along with the distinction between general goods and consumable goods.

(ii) The requirement that goods not used by consumers in their daily lives are excluded from tax-free sales will be abolished. Additionally, a system will be established to individually specify goods that are excluded from tax-free sales due to a high risk of being purchased for illicit purposes, such as gold bullion.

(3) Revision of duty-free sales procedures

(i) In the duty-free sales procedures for individuals with permission to land as a cruise ship tourist, presentation of the landing permit and passport will be required. Business operators managing duty-free shops will provide purchase record information based on the passport number.

(ii) For tax-free purchasers with Japanese nationality who have not had a residence in Japan for two years or more, the My Number Card will be added as a document to prove their residential status. In regard to current required verification documents, it will no longer be necessary to include a certain address on the family register. Furthermore, business operators managing duty-free shops will be required to transmit the type of verification document and other information, such as the date the consumer moved overseas, as a part of the purchase record information, and it will no longer be necessary to retain the verification documents.

(iii) For duty-free goods priced at JPY1 million (excluding tax) or more, information to identify the duty-free goods (such as serial numbers) will be added to the details transmitted within purchase record information.

(iv) In the case of the "direct shipping" duty-free sales approach, where tax-free purchasers enter into a shipping agreement at the duty-free shop and immediately transfer the goods to the shipping company, consumption tax can now be exempted under the export tax exemption provisions outlined in Article 7 of the Consumption Tax Law, replacing the traditional method.

(v) In the case of duty-free goods purchased by a tax-free purchaser at an export goods sales point, if the tax-free purchaser does not carry the duty-free goods at the time of departure due to so-called "separate delivery" (where the goods are separately delivered abroad), the handling of confirming that the goods were exported by the documents related to the delivery of the duty-free goods will be abolished.

Regarding the consumption tax exemption rules for foreign tourists, measures are being taken to eliminate abuse and alleviate the duty-free shops from the burden of combating such misuse. The current system will transition to a refund method, based on the policies in the 2024 tax reform outline. Under this revised system "refund system", goods are sold inclusive of the consumption tax amount, and the consumption tax exemption is granted upon verification that the goods are taken out of the country. Subsequently, the duty-free shop refunds the amount equivalent to the consumption tax to the foreign tourists upon confirmation of their departure.

Tax rules and measures to secure funds for national defense build-up

In order to ensure a stable source of funding for a substantial build-up of Japan's defense capabilities, the following measures have been adopted as a result of deliberations guided by the fundamental principles set forth in the 2023 tax reform outline, which address tax measures for funding the strengthening of defense capabilities.

(1) Corporation income tax

A new surtax of 4% (tentatively the "special corporation income tax for national defense") will be imposed on the standard corporation income tax amount of corporations. To limit the impact on SMEs, JPY5 million will be deducted from the corporation income tax amount, which is the tax base.

(Note) The foregoing revision is applicable to corporation income tax for fiscal years beginning on or after 1 April 2026.

The establishment of the "special corporation income tax for national defense" will result in a slight increase in the effective corporation income tax rate. For this reason, careful consideration will be necessary in calculations for accounting for income taxes.

(2) Individual income tax

Regarding individual income tax, ongoing consideration will be given in accordance with the fundamental approach in the 2023 tax reform outline. This includes assessing the implications of increasing the so-called "JPY1.03 million wall" and taking into account the financial needs for the restoration and rebuilding efforts following the Great East Japan Earthquake.

(3) Tobacco tax

To address the tax difference between heated tobacco products and traditional cigarettes, the taxation methodology of heated tobacco products will be adjusted as follows to ensure fairness.

- The methodology will be changed to be solely based on weight, eliminating the price element.
- To prevent tax inequities due to product lightening, items below a certain weight will be taxed as a single traditional cigarette.

  (Note) The above revisions will be implemented in two stages, in April and October of 2026.

Subsequently, the national tobacco tax rate will be increased by JPY0.5 per cigarette in three stages: April of 2027, April of 2028, and April of 2029.

In 2022, the government set forth a policy for a fundamental build-up of defense capabilities and determined that approximately JPY43 trillion would be required for defense expenses over a five-year period starting from 2023. As a source of funding, taxes on corporation income, individual income, and tobacco would be raised, aiming to secure over JPY1 trillion by 2027. The 2025 tax reform maintained the ongoing evaluation of potential new surtaxes on individual income tax, making upcoming decisions in this area a subject of keen interest.

Tax administration

The following revisions will be made to improve convenience for and ensure fairness for taxpayers.

1. Revision of the electronic book preservation act (e-retention) rules

The record-keeping system for electromagnetic records (electronic transaction data) related to transaction information of electronic transactions will be revised as follows.

(1) Certain electronic transaction data that are preserved in accordance with the following requirements will be excluded from the scope of an additional 10% heavy penalty tax assessed on returns filed after the due date,etc., based on concealed or falsified acts.

(i) A specified electronic data processing system that conforms to certain standards set by the Commissioner of the National Tax Agency for the transmission and retention of the electronic transaction data is used.

(ii) For electronic transaction data (related to monetary amounts) that have been corrected or deleted and recorded in electronic ledgers, a specified electronic data processing system that allows for the tracking and verification of the corrections or deletions is used for transmitting and retaining such data.

(iii)The transmission and retention of electronic transaction data using the specified electronic data processing systems mentioned in and must be able to be verified.

(iv)The ability to cross-reference and verify the relationship between the electronic transaction data that would normally be included in important documents and the electronic ledgers must be maintained.

(2) In line with the revisions in (1) above, those who use a specified electronic data processing system to retain certain electronic transaction data in accordance with the requirements of (1) will now be able to treat such retention as meeting the requirements for the JPY650,000 deduction amount for the blue return special deduction for individual income tax (which stipulates the retention of electromagnetic records that contribute to the proper fulfillment of national tax obligations, in regard to the journals and other accounting books, under certain conditions).

(Note) The revisions in (1) above apply to national taxes for which the statutory filing deadlines arrive on or after 1 January 2027, and the revisions in (2) apply to income taxes for 2027 and thereafter.

2. Enhanced convenience of e-Tax

In relation to the criteria for sending the contents of filings and attachments as electromagnetic records (commonly referred to as "image data"), which are produced by scanning and other methods via e-Tax, the subsequent measures will be introduced:

(i) The requirements for producing such image data will be set to have a grayscale with 256 shades or more (currently: the gradation of red, green, and blue must each have 256 shades or more).

(ii) The JPEG (JPG) file format will be added to the acceptable file formats.

(Note) Revision (ii) will be come into effect from 1 January 2028.

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

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