

Japan tax newsletter

Ernst & Young Tax Co.

2026 Japan tax reform outline

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On 19 December 2025, Japan's ruling party (a coalition comprised of the Liberal Democratic Party and Japan Innovation Party) released the 2026 Tax Reform Outline (below "the Outline"). This newsletter provides an overview of the major amendments and revisions contained in the Outline.

This will be the first set of tax reforms that the Takaichi administration will be involved in, which set sail under a new coalition with the Japan Innovation Party.

In response to high prices and inflation, a mechanism will be established to raise basic deductions in conjunction with rising costs, and the starting threshold for income tax burdens for all taxpayers will be raised to JPY1.78 million in consideration of low- and middle-income earners.

In addition, to support the realization of a "strong economy," tax measures will be implemented to encourage bold capital investment, including the strengthening of the R&D tax system.

As part of efforts to create an environment that ensures fair and smooth tax compliance, various tax systems including those related to cross-border transactions, the valuation methods for rental real estate under the inheritance tax, and transitional measures associated with the introduction of the qualified invoice system will be reviewed, and a new special individual income tax for national defense (tentative name) will also be introduced.

Please note that the contents of this newsletter may be partially revised, deleted or added in response to future Diet deliberations on the reform bill.



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Corporate taxation

1. Establishment of a tax incentive system to promote investment in specified productivity-enhancing equipment and facilities

In order to realize a “strong economy” through investments targeting crisis management and growth, and from the perspective of promoting high value-added capital investment within Japan, a tax incentive system to promote investment in specified productivity-enhancing equipment and facilities will be established. This system will apply to all industries and is designed to promote large-scale, high value-added capital investments that are not covered by existing tax incentive schemes.

Requirements	Where a corporation obtains approval from the Minister of Economy, Trade and Industry between the effective date of the amended Industrial Competitiveness Enhancement Act and 31 March 2029, acquires certain productivity-enhancing equipment and facilities within five years from the date of such approval, and uses such equipment in its business operations in Japan, the corporation may elect to apply one of the following tax benefits to the eligible assets.	
System details	<ul style="list-style-type: none"> ■ Immediate depreciation or tax credit of 7% of acquisition cost (4% for buildings, facilities attached to buildings, and structures) <ul style="list-style-type: none"> *Maximum deduction: 20% of corporate tax liability ■ Response to the impact of sudden business environment changes (carryforward of tax credits) <ul style="list-style-type: none"> *For businesses that have obtained approval for a plan to address the impact of rapid changes in their business environment - such as significant changes in conditions affecting import and export transactions - the carry forward of tax credits will be permitted for up to three years. 	
Eligible capital assets	Eligible capital assets consist of any of the following assets (*1) that form part of production or similar facilities and constitute specified productivity-enhancing equipment and facilities	
Machinery and equipment	■ Acquisition cost of JPY1.6 million or more per unit	
Tools, appliances, and fixtures	<ul style="list-style-type: none"> ■ Acquisition cost of JPY1.2 million or more per unit, or ■ Acquisition cost of JPY400,000 or more per unit, where the total acquisition cost during a single fiscal year is JPY1.2 million or more 	
Buildings	■ Acquisition cost of JPY10 million or more per building	
Facilities attached to buildings	<ul style="list-style-type: none"> ■ Acquisition cost of JPY1.2 million or more per item, or ■ Acquisition cost of JPY600,000 or more per item, where the total acquisition cost during a single fiscal year is JPY1.2 million or more 	
Structures	■ Acquisition cost of JPY1.2 million or more per structure	
Software	■ Acquisition cost of JPY700,000 or more per item	
(*1) Refers to depreciable assets that are directly used for the corporation's business. Used assets, assets held for leasing, office furniture and fixtures, and buildings such as head offices, dormitories, and welfare facilities do not qualify.		

<p>Specified productivity-enhancing equipment and facilities</p>	<p>“Productivity-enhancing equipment and facilities” refers to productivity-enhancing equipment and facilities under the Industrial Competitiveness Enhancement Act that have obtained approval from the Minister of Economy, Trade and Industry as meeting the following criteria:</p> <ol style="list-style-type: none"> 1. The total acquisition cost of productivity-enhancing equipment and facilities, as stated in the capital investment plan for the introduction of such equipment or facilities, is JPY3.5 billion or more (*2). 2. The capital investment plan is expected to achieve an average annual investment return of 15% or more. 3. The capital investment plan specifies the means of financing or fund raising necessary to achieve the plan. 4. The capital investment plan is based on a decision made by an appropriate decision-making body, such as the board of directors. 5. In addition to the above, the plan satisfies other requirements, including that the introduction of productivity-enhancing equipment and facilities will increase the corporation’s capital investment. <p>(*2) For small and medium-sized enterprises (SMEs), the threshold is JPY500 million or more.</p>
<p>Other</p>	<ul style="list-style-type: none"> ■ Eligible corporations are blue return filing corporations. ■ A corporation that has obtained approval an investment plan for productivity-enhancing equipment and facilities may not apply the following tax incentive schemes during the period covered by the investment plan: <ol style="list-style-type: none"> 1. Special depreciation or tax credit system for the acquisition of specific business machinery and equipment within the promotion zones of regional economy advancement projects (tax incentives for investment in the future of the region) 2. Tax incentive to enhance the business of SMEs (excluding the carry forward tax credit) 3. Carbon neutral investment promotion tax incentive
<p>Disqualification criteria</p>	<p>For corporations other than SMEs (excluding those classified as ineligible SME operators), this tax incentive scheme shall not apply (excluding the carryforward tax credit) in any fiscal year in which taxable income exceeds that of the previous fiscal year, unless either of the following conditions is satisfied:</p> <ol style="list-style-type: none"> 1. Amount of wages paid to continuously employed persons \geq Amount of reference wages paid to employees with continuous employment \times 101% (If stated capital is JPY1 billion or more and the number of regularly employed employees is 1,000 or more, or if the number of regularly employed employees exceeds 2,000, the threshold is 102% or more.) 2. Domestic capital investments $>$ 30% of total depreciation cost in current fiscal period (If stated capital is JPY1 billion or more and the number of regularly employed employees is 1,000 or more, or if the number of regularly employed employees exceeds 2,000, the threshold is over 40%.)

This system introduces strong incentives such as immediate depreciation and high tax credit rates, and has the potential to be widely applicable to blue return filing corporations. As it serves as an effective option to promote large-scale, high value-added capital investment, EY recommends proactive consideration of its use.

2. Revision of R&D tax rules

(1) Establishment of a tax credit system for key industrial technology R&D expenses (new strategic technologies category)

For corporations certified under a Key R&D Plan (tentative name) pursuant to the amendments to the Industrial Technology Enhancement Act for R&D in strategic technology domains, during the period from the effective date of the amended Act through 31 March 2029, if such corporations incur key industrial technology R&D expenses (*1) in any fiscal year that includes a day within the applicable period (from the date of certification through the date five years thereafter), the tax credit set forth below may be applied.

1. 40% of the key industrial technology R&D expenses incurred by the certified R&D corporation for R&D in strategic technology domains conducted by the corporation itself in accordance with the certified plan may be credited against its corporate tax liability.
2. Of the R&D activities described in 1 above, where a certified R&D corporation conducts joint or contracted research and development with a certified research hub in accordance with the certified plan, 50% of the special key industrial technology R&D expenses (*2) shall be credited against the corporation's corporate tax liability.

The maximum deduction is capped at 10% of corporate tax for the current fiscal year, and any excess amount beyond the limitation may be carried forward for up to three years (*3) (*4).

(*1) Key industrial technology R&D expenses refers to R&D expenses incurred by a certified R&D corporation during the applicable period for specified key R&D conducted in accordance with a certified key R&D Plan.

Specified key R&D refers to research and development projects that are expected to be commercialized at an early stage and that have been certified as meeting certain criteria from among the categories listed below.

1. AI and advanced robotics
2. Quantum technologies
3. Semiconductors and telecommunication
4. Biotechnology and healthcare
5. Fusion energy
6. Space

(*2) Special key industrial technology R&D expenses

"Special key industrial technology R&D expenses" refers to the portion of key industrial technology R&D expenses that relates to R&D conducted jointly with, or commissioned to, a priority industrial technology joint R&D institution (tentative name) under the Industrial Competitiveness Enhancement Act.

(*3) The carryforward tax credit system is available only where the amount of R&D expenses for the fiscal year in which the carryforward is applied exceeds the amount of R&D expenses for the immediately preceding fiscal year.

(*4) For corporations subject to the group relief system, necessary measures will be implemented with respect to the above carryforward tax credit.

(2) Revisions to the credit rate and limitation of the general R&D tax credit

1. Tax credit rate

With respect to the tax credit rate for general R&D expenses, for fiscal years beginning on or after 1 April 2027, the credit rate will be revised based on the ratio of increase or decrease in experiment and research spending (the "E&R ratio").

In addition, the application period of the special measure that sets the maximum credit rate at 14% (standard: 10%) will be extended by three years.

Current system (on or after 1 April 2026)		Proposed reform (on or after 1 April 2027)	
E&R ratio	Tax credit rate	E&R ratio	Tax credit rate
Less than 0	$8.5\% + (\text{E\&R ratio} \times 8.5 \div 30)$	3% or less	$8.5\% + (\text{E\&R ratio} - 3\%) \times 8.5 \div 13$
0% or more and 12% or less	$11.5\% - (12\% - \text{E\&R ratio}) \times 0.25$	More than 3% and 15% or less	$8.5\% + (\text{E\&R ratio} - 3\%) \times 0.25$
More than 12%	$11.5\% + (\text{E\&R ratio} - 12\%) \times 0.375$ (Maximum: 14%)(*1)	More than 15%	$11.5\% + (\text{E\&R ratio} - 15\%) \times 0.375$ (Maximum: 14%)

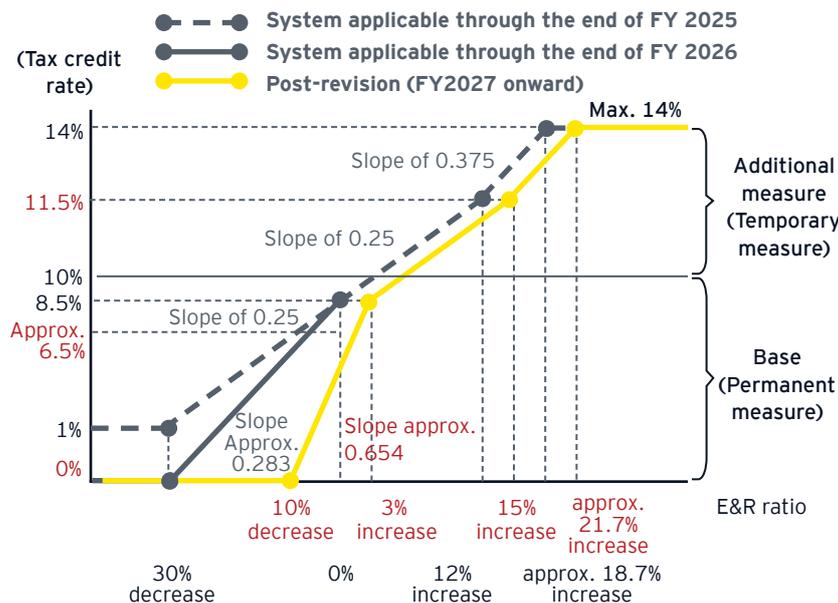
(*1) Although the statutory provision specifies fiscal years beginning on or before 31 March 2026, Ministry of Economy, Trade and Industry materials and other references present this special measure as continuing to apply to fiscal years beginning on or after 1 April 2026, suggesting an extension.

2. Upper limit of tax credit

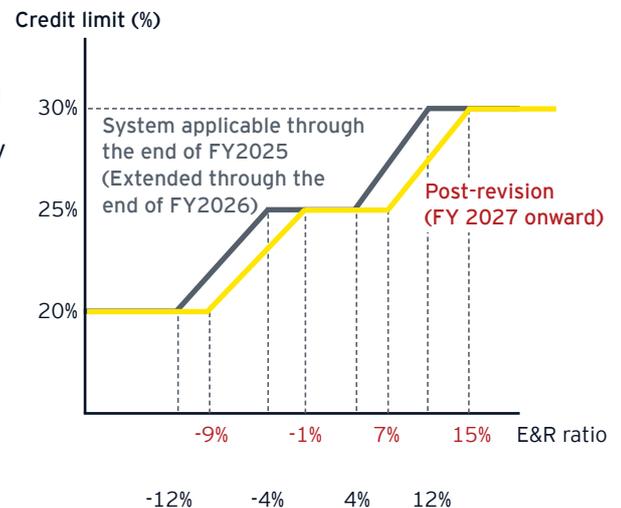
With respect to the upper limit on tax credits for general R&D expenses, revisions will be made based on the E&R ratio for fiscal years beginning on or after 1 April 2027, and the application period of the special measures will be extended by three years.

Current system (on or after 1 April 2026)		Proposed reform (on or after 1 April 2027)	
Standard	Pre-adjusted corporate tax \times 25%	As indicated at left	
E&R ratio more than 4%	Pre-adjusted corporate tax \times $\{(\text{E\&R ratio} - 4\%) \times 0.625\}$ *Added to the standard rate, capped at 5%	E&R ratio more than 7%	Pre-adjusted corporate tax \times $\{(\text{E\&R ratio} - 7\%) \times 0.625\}$ *Added to the standard rate, capped at 5%
E&R ratio under -4%	Pre-adjusted corporate tax \times $\{(- \text{E\&R ratio} - 4\%) \times 0.625\}$ *Deducted from the standard rate, capped at 5%	E&R ratio under -1%	Pre-adjusted corporate tax \times $\{(- \text{E\&R ratio} - 1\%) \times 0.625\}$ *Deducted from the standard rate, capped at 5%

Illustrative diagram of the tax credit rate curve



Illustrative diagram of the tax credit upper limit



Source: Prepared by EY based on "FY 2026 Tax reforms related to economic and industrial matters" published by the Ministry of Economy, Trade and Industry)

3. Additional Measures where R&D expenses exceed 10% of average sales

The applicable period of the special measures that provide special tax credit rates and an increased upper limit on the amount of tax credits, in cases where R&D expenses exceed 10% of average sales, will be extended by three years.

(3) Revisions to the requirements of the open innovation tax credits (tax credit rules pertaining to special R&D expenses)

1. With respect to R&D expenses incurred for joint research with universities, etc., or for research commissioned to universities, etc., the current requirement that such expenses be audited and confirmed by the relevant university or institution will be revised.

For universities or similar institutions that have been designated by the Minister of Economy, Trade and Industry as meeting certain requirements, the eligible amount will be the amount certified by the head of the relevant university or institution.

2. With respect to R&D that is conducted by newly appointed highly skilled R&D professionals to whom labor expenses are paid, the following revisions will be made.

- The scope of newly appointed highly skilled R&D professionals will be expanded to include individuals who have been awarded a doctoral degree, provided that they become an officer or employee of the corporation within five years of receiving the degree and that less than five years have elapsed since they assumed such position.
- The requirement that proposals related to the content of the R&D be publicly solicited, or broadly solicited among the corporation's employees, will be revised so that such proposals need only be solicited broadly among employees exclusively engaged in R&D.
- The requirement that the content be proposed by newly appointed highly skilled R&D professionals engaged in the relevant R&D will be revised so that the content may instead be proposed by employees exclusively engaged in the relevant R&D.

(4) Restrictions on overseas contracted research

With respect to R&D commissioned to third parties (limited to R&D conducted outside Japan pursuant to a contract or agreement) the amount eligible for the tax credit shall be determined according to the following categories:

- a. R&D expenses related to clinical trials conducted to confirm the efficacy and safety of pharmaceuticals, medical devices, or regenerative medicine products (limited to trials for which scientific quality and reliability of results are ensured): 100% of the relevant R&D expenses
- b. R&D expenses other than those described in (a): 50% of the relevant R&D expenses (*1)

(*1) For fiscal years beginning between 1 April 2026 and 31 March 2027, 70% of the relevant R&D expenses shall be eligible. For fiscal years beginning between 1 April 2027 and 31 March 2028, 60% of the relevant R&D expenses shall be eligible.

In order to create a "strong economy," these measures aim to prioritize R&D investment in strategically important technology domains through the establishment of a strategic technologies category. While promoting research in key fields, the reforms also strengthen incentives to increase overall R&D expenditures and impose certain restrictions on overseas contracted research. Through these measures, Japan seeks to maintain and strengthen domestic research talent and R&D bases, supporting its revitalization as a science- and technology-driven nation.

3. Revision of tax measures to promote wage increases

(1) Measures for large enterprises

These measures will be abolished as of 31 March 2026, ahead of their originally stipulated end dates.

(2) Measures for medium-sized enterprises (corporations with 2,000 or fewer regularly employed employees)

These measures will be abolished upon the arrival of the application deadline on 31 March 2027. For fiscal years beginning between 1 April 2026 and 31 March 2027, the requirements will be strengthened to further encourage wage increases, as outlined below:

- a. The requirements for applying the standard tax credit rate (10%) will be revised so that the wage increase ratio of wages paid to continuous employees compared to the reference wages paid must be 4% or more (current requirement: 3% or more).
- b. The current measure under which an additional 15% is added to the tax credit rate when the increase ratio above is 4% or more will be revised as follows: +5% if the increase ratio is 5% or more, and +15% if the increase ratio is 6% or more.
- c. The additional tax credit measure related to education and training expenses will be abolished.

(3) Measures for small and medium-sized enterprises

The current system will be maintained, and necessary revisions will be considered upon the arrival of the application deadline. However, the additional measure for education and training expenses will be abolished.

At present, wage growth is at its highest level since the bubble economy period, significantly exceeding the thresholds required under this tax system. As corporate wage-increase conditions have changed substantially, certain revisions will be implemented accordingly.

4. Strengthening of non-applicability measures of specified tax credit rules

From the perspective of encouraging behavioral change among companies that are reluctant to invest or raise wages, the following revisions will be made to the non-applicability measures of specified tax credit rules, and the application deadline will be extended to 31 March 2029.

- (1) The scope of the non-applicability measures will be expanded to include measures related to key industrial technology R&D expenses under the R&D tax system (as discussed in Section 2 above), excluding the carryforward tax credit system. In addition, non-applicability measures have also been introduced for the tax incentive system to promote investment in specified productivity-enhancing equipment and facilities. (See Section 1, Establishment of a tax incentive system to promote investment in specified productivity-enhancing equipment and facilities)
- (2) The requirements related to wages paid to continuous employees will be revised as follows:
 - a. Amount of wages paid to continuously employed persons \geq Amount of reference wages paid to employees with continuous employment \times 101% (current: wages paid to employees with continuous employment $>$ reference wages paid to employees with continuous employment)
 - b. For cases where stated capital is JPY1 billion or more and the number of regularly employed employees is 1,000 or more, or the number of regularly employed employees exceeds 2,000, and certain income conditions are satisfied, the additional measure will be: Amount of wages paid to continuously employed persons \geq Amount of reference wages paid to employees with continuous employment \times 102% (current: 101%)

(3) For the following tax credit systems, the current condition requiring non-compliance with both the wage payment requirement and the domestic capital investment requirement will be revised so that non-compliance with either one will result in non-applicability:

- Tax credit system for Investment promotion tax incentive in the promotion zone of regional economy advancement projects (regional future investment promotion taxation system)
- Tax credit system for carbon neutral investment promotion tax incentive
- Tax credit system for tax credit to promote domestic production in strategic industries

Because the specific non-applicability measures differ by system, confirming compliance in advance for each individual system will be particularly important.

5. Revision of tax incentive to promote open innovation

The tax incentive to promote open innovation will be revised and extended by two years.

- (1) For shares of domestic corporations acquired by corporations other than SMEs, the minimum acquisition cost requirement will be raised to JPY200 million (currently JPY100 million).
- (2) For specified shares acquired by purchase from persons other than the issuing corporation that result in ownership of more than 50% of total voting rights, the following revisions apply:
 - a. The acquisition cost requirement will be raised to JPY700 million (currently JPY500 million).
 - b. Where it is clearly demonstrated that the issuing corporation's business has grown and developed, and a merger is conducted in which the acquiring corporation becomes the surviving entity and the issuing corporation the absorbed entity, the balance of the special account related to the absorbed corporation will be evenly reversed into taxable income over five years, beginning with the fiscal year following the fiscal year that includes the merger date.
- (3) Eligible specified shares will be expanded to include shares of special new business development entities acquired by purchase from parties other than the issuing corporation, where it is expected that the acquiring corporation will hold more than 50% of the total voting rights of the issuing corporation within three years from the acquisition date (excluding cases where the acquiring corporation already held more than 50% of the total voting rights immediately prior to the acquisition). Where an amount not exceeding 20% of the acquisition cost of such specified shares is recorded as a special account amount, the total amount recorded may be deducted as an expense, up to the amount of income for the relevant fiscal year. (*1) (*2)

(*1) The acquisition cost requirement for specified shares is JPY300 million or more, with an upper limit of JPY20 billion.

(*2) Upon the lapse of three years from acquisition, the special account balance must be reversed into taxable income, unless majority voting rights are acquired within that three-year period from the acquisition date. Additionally, revisions similar to those described in (2)b above have been made with respect to special-account reversals upon mergers.

Originally, the system assumed immediate acquisition of a majority of voting rights; however, it has now been revised to allow phased acquisitions, provided that reaching a majority within three years is expected. In such cases, the deductible amount is limited to 20% of the acquisition cost. The method for reversing special accounts where the investee corporation is extinguished through an absorption-type merger has also been revised.

6. Mandatory document retention for transactions within corporate groups

- (1) Where a Japanese corporation engages in specified transactions with related parties, and transaction-related documents lack sufficient detail to clarify matters such as the assets or services provided and the calculation of consideration, the corporation must obtain or prepare and retain documents (including electronic records) that clarify such matters.
- (2) Failure to retain these documents in accordance with applicable laws and regulations constitutes grounds for revocation of blue tax return status.

Related parties	Determined based on the same criteria as those for related parties under the transfer pricing taxation system.
Specified transactions	<p>The following transactions are considered as transactions giving rise to selling, general and administrative or other expenses.</p> <ol style="list-style-type: none">1. Transfers or leases of industrial property rights, etc. conducted by a related party to a Japanese corporation.2. Provision of services by a related party to the Japanese corporation, including:<ol style="list-style-type: none">a. Business activities conducted pursuant to a contract or agreement between a Japanese corporation and the related party, falling under either of the following categories:<ol style="list-style-type: none">(i) Business activities such as research and development or advertising, carried out by utilizing the related party's managerial resources, including its industrial, commercial, or academic knowledge and experience.(ii) Allowing a Japanese corporation to use specialized assets owned by the related party, as well as the maintenance and management of such specialized assets.b. Management, supervision, guidance, provision of information, or similar services provided by the related party to a Japanese corporation, where such services are performed based on the related party's industrial, commercial, or academic knowledge and experience.
Transaction-related documentation	Documents such as purchase orders, contracts, delivery notes, invoices, receipts, estimates, or equivalent documents (including electronic records containing information ordinarily included in such documents) that are received or issued in connection with transactions and are required to be retained under the Corporate Tax Act or related regulations.

For specified transactions between related parties, corporations are required to retain documents that clearly evidence the transaction details and the basis for payment amounts. Failure to retain such documents result in revocation of blue tax return status, accordingly, careful compliance is essential.

7. Revision of the investment book value adjustment system

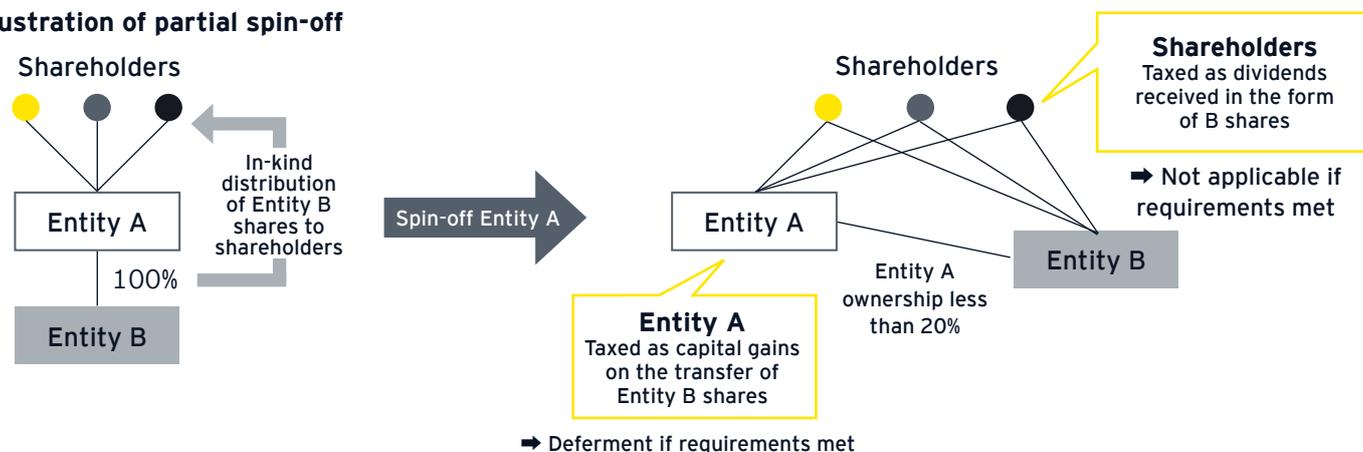
Under the group relief regime, the scope of adjustment transactions subject to additions to the adjustment account corresponding amount has been revised. Specifically, transfers of shares of withdrawing subsidiaries conducted prior to the date on which complete control relationships arise will exclude cases where complete subsidiary status is achieved through acquisition resolutions for shares with total acquisition clauses.

However, this exclusion will not apply where the value of shares received through such acquisition resolutions is not considered approximately equivalent to the value of the transferred shares.

As a result, in squeeze-out transactions conducted pursuant to such acquisition resolutions, it will be possible to add acquisition premiums to book value.

8. Revision of partial spin-off tax rules

Illustration of partial spin-off



Source: Prepared by EY based on "FY 2026 Tax reforms related to economic and industrial matters" published by the Ministry of Economy, Trade and Industry)

With respect to the special tax treatment for certified share distributions, in cases where a corporation that has obtained certification of a business restructuring plan under the Industrial Competitiveness Enhancement Act on or after 1 April 2026 conducts an in-kind distribution as a specified surplus dividend under the same Act that results in the transfer of shares of a wholly owned subsidiary, such distribution shall be treated as a share distribution. Furthermore, among such in-kind distributions, those that satisfy the following requirements will be treated as qualified share distributions:

- a. The distribution consists solely of shares of the wholly owned subsidiary and is made in proportion to the shareholdings of the distributing corporation's shareholders.
- b. Immediately after the in-kind distribution, the number of shares of the wholly owned subsidiary held by the distributing corporation is less than 20% of the total issued shares.
- c. The distribution satisfies requirements equivalent to those applicable to qualified share distributions, including the non-control requirement, the continuity of specified officers requirement, and the continuity of employee requirement.
- d. The distributing corporation and the wholly owned subsidiary are both expected to achieve business growth and development, and satisfy the following conditions:
 - i. Among the businesses conducted by the distributing corporation prior to the in-kind distribution, the corporation has identified one or more businesses on which it will concentrate its management resources, and such identified business(es) are expected to continue to be conducted after the distribution by the distributing corporation (including entities with which it has a certain relationship and over which it is recognized as exercising substantive management control).

- ii. The principal business conducted by the wholly owned subsidiary prior to the in-kind distribution is other than the business identified in (i) above, and such principal business is expected to continue to be conducted by the wholly owned subsidiary after the distribution.
- iii. With respect to the principal businesses conducted by both the distributing corporation and the wholly owned subsidiary, it is expected that the in-kind distribution will contribute to the achievement of productivity-improvement objectives.

In order to promote not only the creation of startups but also the reorganization of business portfolios that allow corporations to focus on businesses to which management resources should be allocated, these requirements are expected to be revised, and the measure is expected to be converted into a permanent measure with no fixed expiration date.

9. Other

1 Revision/extension of special measures for the expensing of small-scale depreciable assets acquired by SMEs

- The threshold for acquisition costs for the special measures for the expensing of small-scale depreciable assets acquired by SMEs 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.
- In addition, corporations with more than 400 regularly employed employees will be excluded from the scope of eligible corporations.

2 Revision/extension of tax rules for the strengthening of regional business locations

- With respect to the special depreciation or tax credit system for the acquisition of specific business machinery and equipment within the promotion zones for the strengthening of regional business locations, certain revisions will be implemented, and the application period will be extended by two years.
- The tax credit system based on increases in the number of employees will be abolished upon its expiration.

3 Revision/extension of carbon neutral investment promotion tax incentive

- After revising the special depreciation rates and tax credit rates, the application period of this system will be extended by two years.

4 Extension of system for reserves for loss on overseas investments

- The application period of this system will be extended by two years.

5 Revision/extension of the special measure for replacement of specific assets

- Following certain revisions, the application period of this special measure will be extended by three years.

International taxation

1. Aligning with global minimum tax rules

With respect to IIR (Income Inclusion Rule), the following revisions will be made.

- (1) In calculating the adjusted covered taxes for fiscal years prior to the transition year, the following deferred tax assets or deferred tax liabilities shall be treated as non-existent:
 - A. Deferred tax assets arising due to arrangements related to tax credits or similar incentives entered into with the national government or local governments on or after 1 December 2021 for the purpose of increasing the amount of such deferred tax assets, or due to other similar reasons.
 - B. Deferred tax assets or deferred tax liabilities recognized as a result of assets or liabilities being measured at fair value under laws or regulations of jurisdictions outside Japan concerning taxes equivalent to corporate income tax, where such laws or regulations were enacted between 1 December 2021 and the day immediately preceding the start of the transition year.

The reversal of deferred tax assets arising from tax incentives provided by the government on or after 1 December 2021 may, in certain cases, be excluded from adjusted covered taxes when calculating IIR, potentially resulting in additional top-up tax liabilities.

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

The following revisions will be made to the JCFC rules:

These revisions will apply to controlled foreign company (“CFC”) for fiscal years beginning on or after 1 April 2026.

- (1) Establishment of a special measure for dissolved partially covered foreign companies and foreign financial subsidiaries
 1. Where a CFC qualifies as a liquidated partially covered foreign company (*1) or a *liquidated foreign financial subsidiary, etc. (*2), the JCFC rules shall apply to the special liquidation fiscal year (*3) by deeming such corporation to be a partially covered foreign company or a foreign financial subsidiary, respectively.
 - (*1) “Liquidated partially covered foreign company” refers to a dissolved CFC that qualified as a partially covered foreign company in each fiscal year beginning within two years prior to the fiscal year that includes the date of dissolution.
 - (*2) “Liquidated foreign financial subsidiary, etc.” refers to a dissolved CFC that qualified as a foreign financial subsidiary, etc. in each fiscal year beginning within one year prior to the fiscal year that includes the date of dissolution.
 - (*3) “Special liquidation fiscal year” refers to a fiscal year that includes a date within the period from the end of the first fiscal year in which the CFC ceases to qualify as a partially covered foreign company or foreign financial subsidiary due to dissolution, through the date three years thereafter, in principle.
 2. For a special liquidation fiscal year, the total assets, personnel expenses, and accumulated depreciation used as the basis for calculating the deductible amount from abnormal income subject to partial income inclusion rules shall be those amounts from the preceding fiscal year in which the CFC last qualified as a partially covered foreign company or foreign financial subsidiary.
 3. Where a CFC qualifies as a liquidated foreign financial subsidiary, etc. in special liquidation fiscal years, income attributable to abnormally high levels of capital shall be deemed non-existent for purposes of calculating the amount subject to partial inclusion taxation applicable to financial subsidiaries.

4. If a tax authority requests submission of documents proving that a CFC qualifies as a liquidated partially covered foreign company or liquidated foreign financial subsidiary, or that a fiscal year qualifies as a special liquidation fiscal year, and such documents are not submitted by the prescribed deadline, the CFC and fiscal year shall be presumed not to qualify.
5. The existing special rules for liquidated foreign financial subsidiaries will be abolished.

Previously, CFCs undergoing liquidation after the cessation of business activities could be subject to taxation as paper companies, creating a burden for globally operating companies.

Under the revised rules, CFCs that previously had substantive business activities and ceased the business by dissolution will not be treated as paper companies for three years following dissolution, and deductible amounts in calculating abnormal income will remain at levels comparable to those prior to dissolution, thereby reducing the tax burden to some extent.

However, as the burden of proof regarding eligibility for these revisions rests with the taxpayer, careful attention is required.

(2) Revision of the asset ratio requirements pertaining to the special measure for paper companies in the determination of specified foreign related companies

With respect to the asset ratio requirement under the paper company exception used in determining whether a CFC qualifies as a specified foreign related company, where the total assets recorded on the balance sheet at fiscal year-end are zero, the asset ratio test for that fiscal year will be deemed unnecessary.

Under the current law, with respect to the asset ratio requirement under the paper company exception used in the determination of a specified foreign related company, where the amount of total assets as the denominator was zero, the CFC could still be treated as a specified foreign related company even if the other requirements were met.

$$\frac{\text{Subsidiary shares, dividends receivable, interest receivable, cash and deposits, real estate, etc.}}{\text{Total assets}} \} > 95\%$$

Under the revisions, even CFCs with zero total assets will not be treated as paper companies, provided that they are recognized as business-necessary and pose a low tax-avoidance risk.

(3) Revision of the special measure for calculating the tax burden ratio

With respect to the special measure allowing the highest applicable tax rate to be used in calculating the effective tax rate where foreign corporate tax rates increase depending on income amount, the rule will not apply if its application is deemed clearly inappropriate due to circumstances such as:

- The highest tax rate is not ordinarily expected to apply;
- The income range to which the highest tax rate applies is extremely limited; or
- Other similar circumstances.

Although cases affected by this revision are expected to be limited, affected taxpayers may be subject to income inclusion taxation rules.

3. Revision of special provisions for taxation on foreign partners of investment partnership

The following measures will be revised with respect to the special exemption from taxation provided to foreign partners of investment partnerships.

In connection with these revisions, necessary changes will also be made to the application for special tax measures and related procedures.

- (1) The requirement that a foreign partner's ownership interest in partnership assets be less than 25% will be revised to less than 50% for limited partners of partnerships that establish certain committees composed of limited partners.
- (2) The requirement that the foreign partner not engage in execution of partnership business will be revised so that actions excluded from "approvals of execution" are limited to approvals of conflict-of-interest transactions, rather than the current approvals of self-dealing transactions by business executors.
- (3) The requirement that the foreign partner have no permanent establishment-attributable income other than partnership business income will be abolished.

The special tax treatment for foreign partners allows certain foreign limited partners investing in funds with a Japanese general partner to be exempt from Japanese taxation on Japan-source income earned through the fund, notwithstanding the general rule that such partners are treated as having a permanent establishment in Japan and subject to Japanese taxation.

As the previous requirements were considered overly restrictive and a barrier to inbound investment, these revisions are intended to align the rules more closely with actual investment practices.

As a result, foreign investors are expected to have greater opportunities to utilize this special tax treatment.

Individual income taxation

1. Revision of the so-called “annual income barrier”

- 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 JPY740,000, 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, the maximum basic deduction will be JPY1,040,000, and the minimum guaranteed employment income deduction will be JPY740,000. Accordingly, the starting threshold for income tax burdens for taxpayers with employment income (the total amount of the basic deduction and employment income deduction) will be JPY1.78 million or higher.

Basic deduction

	Current system (2025)	Proposed reform (2026-2027)
Total income	Deduction	Deduction
Up to JPY1.32 million	JPY950,000	JPY1,040,000
Over JPY1.32m to JPY3.36m	JPY880,000	
Over JPY3.36m to JPY4.89m	JPY680,000	JPY670,000
Over JPY4.89m to JPY6.55m	JPY630,000	
Over JPY6.55m to JPY23.5m	JPY580,000	JPY620,000
Over JPY23.5m to JPY24m	JPY480,000	JPY480,000
Over JPY24m to JPY24.5m	JPY320,000	JPY320,000
Over JPY24.5m to JPY25m	JPY160,000	JPY160,000
Over JPY25m	JPY0	JPY0

Minimum guaranteed employment income deduction

	Current system (2025)	Proposed reform (2026-2027)
Minimum guaranteed employment income deduction	JPY650,000	JPY740,000

- These changes will be applied through year-end adjustments for income earned in 2026 and through withholding at source for salary paid on or after 1 January 2027.
- From 2028 onward, the system is expected to be reviewed again based on CPI trends under the 2028 tax reform.

2. Expansion of NISA scope and duration

- To support next-generation asset building activities, the eligible age for the accumulation-type framework will be expanded down to age 0, alongside enhanced financial and economic education. For account holders aged 0 to 17, the annual investment limit will be set at JPY600,000 and the tax-free holding limit will be set at JPY6 million.

	Expanded sections from 2027		
	Accumulation-type framework	Accumulation-type framework	Growth-type framework
Age	0 to 17 years old	18 and over	
Annual investment	JPY600,000	JPY1.2 million	JPY2.4 million
Maximum tax-free holding amount	JPY6,000,000	JPY18,000,000	
		<div style="display: flex; align-items: center;"> <div style="border: 1px solid black; padding: 2px;">Automatic transition</div> <div style="margin-left: 10px;"> <div style="border: 1px solid black; padding: 2px;">JPY12 million (included amount)</div> </div> </div>	

Source: Created by EY, partially modified from the Ministry of Finance's 'Draft Tax Reform for 2026.'

- Withdrawals from NISA accounts are not permitted until the age of 18, except for the following cases:
 1. Under 12 years old: If there is disaster-related loss of housing, etc.
 2. 12 years old and above: If there is consent from the child and the reason for withdrawal is for payment of educational or living expenses, etc.
- This applies to NISA accounts opened on or after 1 January 2027.

3. Creation of special individual 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 individual income tax for reconstruction will be reduced by 1%. The taxation period for the special income tax for reconstruction will be extended for an additional 10 years until 2047 in order to not impact reconstruction activities.

Current	Proposed reforms (2027 onward)
Special individual income tax for reconstruction Income tax amount × 2.1%	<div style="background-color: #ffff00; padding: 5px;"> [New] Special individual income tax for national defense (tentative name) Income tax amount × 1.0% </div> <div style="background-color: #cccccc; padding: 5px;"> Special individual income tax for reconstruction Income tax amount × 1.1% </div>

- As the 1% special individual income tax for national defense (tentative name) is enacted and the special income tax for reconstruction of 1% is abolished, there is no immediate change in tax burden.
- However, the special individual income tax for reconstruction will be extended until 2047, resulting in an overall increase in long-term tax burden due to the extension of taxation period.

4. Revision/extension of the housing loan tax credit

- The period for the housing loan tax credit will be extended for an additional 5 years until 31 December 2030.
- For purchasers of certain pre-owned homes (certified housing, ZEH-level energy-saving housing, and housing compliant with energy-saving standards), the tax credit period will be extended from 10 years to a maximum of 13 years. In addition, for purchasers of certain pre-owned homes (certified housing and ZEH-level energy-saving housing), the maximum loan amount eligible for the tax credit will be increased from the current JPY30 million to JPY35 million (JPY45 million for certain child-rearing households, etc.).
- With respect to the floor area requirement as well, the scope of application of the special measure that relaxes the requirement to 40 m² will be expanded to include pre-owned homes (however, it will not apply in years in which total income exceeds JPY10 million).
- From the perspective of ensuring safe and secure housing, newly built homes constructed in areas with high disaster risk will be excluded from eligibility for the housing loan tax credit.

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 transfers of crypto assets will be taxed separately at a flat rate of 20% (15% individual 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.

This revision will apply to transfers of crypto assets conducted on or after 1 January of the year following the year in which the amended Financial Instruments and Exchange Act comes into effect; however, the specific effective start date is currently undecided.

6. Revision of measures for the optimization of the tax burden of high-net-worth individuals

- Measures seeking additional tax burdens on high-net-worth individuals will be reviewed and expanded to a broader group.

Current system (2025 onwards)	Proposed reforms (2027 onwards)
1. Base income tax amount* 2. (Base income amount* - special deduction (JPY330 million)) × 22.5% The difference is paid via final return only if 2 exceeds 1	1. Base income tax amount* 2. (Base income amount* - special deduction (JPY165 million)) × 30% The difference is paid via final return only if 2 exceeds 1

*Base income tax amount: the total of (1) and (2) below (including the special income tax for reconstruction)

1: The amount of income tax shown on the return when calculated by the ordinary method

2: Withholding tax on income exempted from final tax return filing requirements

*Base income amount: the total of overall income and various income amounts subject to separate taxation

(including dividend income from listed shares, etc. and gains from the transfer of listed shares, etc. that are exempt from final tax return filing requirements)

Source: Created by EY, partially modified from the Ministry of Finance's Draft Tax Reform for 2026.

The current system has been in effect since income earned in 2025, and the present revision therefore constitutes a consecutive revision. As this revision is expected to increase the number of persons subject to the system, particular caution is required in cases where substantial capital gains from the transfer of shares or real estate arise.

7. Revision of the blue return special deduction

- With respect to the blue return special deduction, certain revisions will be made from the perspective of promoting digitalization, and the deduction amounts will change from a three-tier structure of JPY100,000 / JPY550,000 / JPY650,000 to a three-tier structure of JPY100,000 / JPY650,000 / JPY750,000.
- If an individual whose deduction amount prior to the revision was JPY550,000 submits the final tax return in paper form, the deduction amount will be reduced to JPY100,000.

Until now, even in the case of paper filing, it was possible to apply the JPY550,000 deduction by submitting documents such as a profit and loss statement and balance sheet; however, under this revision, in order to claim a deduction of JPY650,000 or more, electronic filing (e-Tax) will be mandatory. Paper filing will be subject to a maximum deduction of JPY100,000.

8. Other

- For the hometown tax donation program, an upper limit on the amount deductible from individual inhabitant tax will be created, considering particularly for individuals with annual incomes of JPY100 million or more.
- With respect to automobile commuting allowances and employer-provided meal subsidies, the non-taxable limits will be increased.
- Interest on corporate bonds received by shareholders of family companies will be included aggregate taxation even when the interest is received via a third party (specified corporation) interposed between the shareholder and the 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

Under the fair market value principle of the Inheritance Tax Act, and in light of discrepancies between market prices and inheritance tax values for rental properties, the following revisions will be made to account for the realities of such transactions:

1. For certain rental properties acquired or newly constructed by the decedent, etc. through transactions involving consideration within five years prior to the valuation date, such properties will be valued at an amount equivalent to the ordinary transaction price at the valuation date.

With respect to the amount equivalent to the ordinary transaction price at the valuation date, provided there is no adverse effect for tax purposes, the property may be valued at 80/100 of the amount calculated based on the acquisition cost of the rental property acquired, etc. by the decedent, etc., taking into consideration changes in land prices and other factors.

Note: The above revision shall apply to the valuation of property acquired by inheritance, etc. on or after 1 January 2027. However, it shall not apply to buildings newly constructed by the decedent, etc. on land owned by the decedent, etc. (limited to land owned from five years prior to the prescribed date), including buildings under construction as of that date, until the date specified in Basic Property Valuation Circular.

2. For fractionalized rental real estate products, regardless of acquisition date, valuation for the tax period will be based on the ordinary transaction price at that time.

With respect to the above amount equivalent to the ordinary transaction price at the valuation date, provided there is no adverse effect for tax purposes, valuation may be based on an amount determined with reference to appropriate disposal prices or buy-back prices presented by the operator upon request from investors, appropriate comparable transaction prices known to the operator, or real estate prices stated in periodic reports, etc. transaction prices known to the operator, or real estate prices stated in periodic reports, etc. However, where none of these are considered applicable, valuation shall be conducted in accordance with 1 above, taking into account the time of acquisition and valuation safety.

Note: The above revision shall apply to the valuation of property acquired by inheritance, etc. on or after 1 January 2027.

These measures are introduced to close the gap between the market prices of rental housing real estate, which are primarily formed based on profitability, and the valuation amounts of rental housing real estate under the Basic Property Valuation Circular, which take into account restrictions on use arising from tenants' control rights and other factors.

2. Other

- The tax breaks for lump-sum gifts of educational funds will be abolished upon expiration of the applicable period (March 2026).
- With respect to the inheritance tax and gift tax payment deferral system for business assets of individuals, the deadline for submission of the specially approved succession plan shall be extended by two years and six months.
- In regard to the special rules for a grace period for inheritance/gift tax on unlisted shares, the deadline for submission of the specially approved succession plan will be extended by one year and six months.

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, a system 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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