

Japan tax newsletter

Ernst & Young Tax Co.

2026 Japan tax reform

Highlights for Inbound Businesses

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On 19 December 2025, Japan's government (a coalition comprised of the Liberal Democratic Party and the Japan Innovation Party) released the 2026 Tax Reform Outline. Traditionally, these proposals are broadly incorporated into the Japanese tax laws following Parliamentary debate in late March.

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

Please click [here](#) to access the overall 2026 Japan tax reform outline as released in the EY Japan tax newsletter.

Please click [here](#) to access another EY 2026 tax reform newsletter that is focused on the requirements for the Permanent Establishment Exemption.

The 2026 tax reform package comes at a critical juncture for Japan's economy. Faced with persistent inflationary pressures, demographic shifts, and global competition for investment, policymakers have prioritized measures that stimulate growth while ensuring fairness and sustainability.

The outline of the 2026 tax reform emphasizes three pillars:

1. Economic revitalization through investment and innovation;
2. Support for households amid rising living costs; and
3. Global tax compliance and digitalization of administration.

There is a focus on making Japan a more attractive location for overseas investment and for investment by individuals into crypto assets, for example. At the same time there may be significant additional administrative burdens for platform companies, and more generally for intra-group transactions (domestic and international).



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Corporate Tax Reforms

(1) New tax incentives to promote investment in specified production facilities

The 2026 tax reform introduces a significant incentive program designed to accelerate domestic capital investment and strengthen Japan's industrial competitiveness. This measure aims to encourage bold, high-value investments that enhance productivity and competitiveness, particularly in sectors critical to Japan's economic resilience.

Under this measure, corporations that obtain approval for an investment plan under the Industrial Competitiveness Enhancement Act ("ICE Act") can access substantial tax benefits in the form of tax credits or full immediate depreciation of the acquired asset. This incentive is available across all industries. All companies with a blue tax return filing status¹ can apply for this tax incentive.

Eligibility Criteria

To qualify, companies must meet strict conditions including, but not limited to:

- A minimum investment threshold of JPY 3.5 billion for large corporations and JPY 500 million for small and medium sized enterprises ("SMEs")².
- The investment is expected to result in a Return on Investment (ROI) of at least 15%.
- Under the ICE Act, approval from the Ministry of Economy, Trade and Industry for the investment plan has to be obtained by 31 March 2029.
- The investment must be executed within five years from the date of approval and used for domestic business purposes.

Tax Benefits

Approved corporations can choose between full depreciation of the qualifying assets or a tax credit depending on the type of the asset. The table below summarizes the main benefits:

Asset	Buildings and structures	Machinery, equipment, tools, software
Depreciation	Immediate 100% depreciation of the qualifying asset. The depreciation expense can be fully deducted from taxable income. If the depreciation results in a net operating loss ("NOL") for the taxpayer, the NOL can be carried forward under general rules.	
Tax credit	4% of the acquisition cost	7% of the acquisition cost
Tax credit limit	The taxpayer can use the tax credit up to 20% of the annual corporate tax liability. Unused tax credits can be carried forward for 3 years in specific cases.	

It should be noted that this new incentive cannot be claimed at the same time as the Carbon neutrality-related tax incentive and/or regional future investment promotion related tax incentives.

¹ Blue tax return filing status means that the company has filed an application with the Tax Office that obliges it to maintain proper tax and accounting records. Please also see below section on New document retention requirements.

² For these purposes, an SME is a company with a share capital of JPY 100m or less, unless at least 50% of the SME's shares are owned by a company with a share capital exceeding JPY 100m, or if at least two thirds of the shares are owned by two or more companies with share capital exceeding JPY 100m.

(2) New R&D Tax Credits for Strategic Technologies

Japanese tax legislation provides various layers of R&D related tax incentives. The 2026 tax reform introduces a new layer of R&D tax incentives for such expenses incurred in strategic industrial technologies.

The measure aims to position Japan as a leader in next-generation technologies, foster domestic innovation ecosystems, and attract inbound investment in high-tech sectors.

Eligibility Criteria

To qualify companies must:

- Conduct R&D activities in designated strategic technology areas, including AI, advanced semiconductors, quantum computing, and related fields.
- Obtain approval for the company's R&D plan from the relevant authority under the ICE framework by 31 March 2029. The new R&D tax credits can be used during the time frame of the approved R&D plan but not later than the financial year, which includes the date, 5 years after the approval date of the R&D plan.

Tax Benefits

The features of the tax credit are as follows

(3) Other R&D tax credit reforms

Area	Strategic industrial technology related R&D	Special strategic industrial technology related R&D (i.e., joint research with specific institutions etc.)
Tax credit rate	40% of R&D expenses	50% of R&D expenses
Tax credit limit	10% of the annual corporate tax liability. Unused tax credits can be carried forward for 3 years in specific cases.	

Open Innovation: The 2026 tax reform expands the scope of eligible R&D expenses using highly skilled personnel for Open Innovation related R&D tax credits.

General R&D tax credit: The calculation formula for general R&D tax credit will also be revised; under the new formula, taxpayers who reduce R&D expenses by 10% or more compared to the previous financial year cannot be eligible for R&D tax credit (currently the threshold is 30%). In addition, there will be new specific restrictions related to R&D activities conducted abroad. Following the 2024 tax reform a Japanese taxpayer cannot utilize R&D expenses incurred through overseas business premises for R&D tax credit purposes. While the cost of outsourcing R&D activities overseas can still be eligible. However, if the 2006 tax reform is enacted then, for financial years starting on or after 31 March 2028, only 50% of such outsourcing costs incurred abroad can be utilized for R&D tax credit purposes. As a transitional measure, the relevant rates will be 70% for financial years starting on or after 31 March 2026 and 60% for financial years starting on or

after 31 March 2027. This restriction will not apply to R&D expenses incurred for clinical trials conducted abroad by pharmaceutical companies.

(4) New Documentation Retention Requirements for Intra-Group Transactions

Introduction

The 2026 tax reform strengthens enforcement regarding certain intra-group transactions. This measure aims to increase compliance by requiring that the entity in Japan retains the necessary documentation to substantiate expenses paid to related parties for those transactions, including the details of the calculation. Often it can be challenging for a Japanese subsidiary to obtain detailed information from overseas entities regarding items such as management fees.

The proposal contains no stated exemptions, which could mean that all companies should comply with these requirements in relation to all intra-group transactions. For example, there would be no exemption from this documentation retention rule for purely domestic transactions or for smaller transactions. Companies with domestic intra-group transactions and who were not subject to contemporaneous Local File requirements will also need to take note of these rules.

If the documentation is not properly maintained, it may result in the revocation of the blue tax return status. This status is beneficial as it confers significant advantages such as the ability to use carried forward losses, obtain tax credits, and have certain protections in a tax audit.

The definition of Related Parties is the same criteria as used in transfer pricing rules.

The following is a simple overview of the definition of Related Parties:

- Parent-subsidiary (50% or greater direct or indirect ownership).
- Sister companies (50% or greater direct or indirect common ownership).

- Substantial control (shared directors, financial dependence, etc.).
- Chains of the above relationships.

Transactions that are covered include:

- Transfer or licensing of industrial property rights, copyrights, or software from related parties.
- Provision of services by related parties, such as R&D, advertising, use of dedicated assets, management, or information provision.

Documentation to be held by Japanese entity:

- The documents that the Japanese entity will be required to hold include purchase orders, contracts, invoices, receipts, quotations, and other similar documents as requested. These documents will need to contain details of the amounts, for example it may be necessary to show how calculations were conducted including cost allocation calculation details where costs of HQ are allocated to the Japan entity.

The change is likely to be effective for financial years commencing on or after 1 April 2026.

Actions to take

In preparation for the implementation the change groups should consider the following:

- Monitor the progress of the reform to enactment as details emerge.
- Confirm your transactions that will be subject to the rules.
- Understand the level of documentation that will be sufficient to meet the requirements.
- Supplement the documentation held by the Japanese subsidiary to comply with the rule, if necessary.
- If the policy and charges are not clear for the transactions, then the group should review their policies and possibly revise the policies and/or charges to ensure that the charges are clear and can be documented in the case of a Japanese tax examination.

Japanese Consumption Tax (“JCT”)

(1) Tax reform of JCT in cross-border electronic commerce (JCT on Low-Value Goods)

The 2026 tax reform imposes new consumption tax obligations on overseas e-commerce (“EC”) sellers. Japan’s consumption tax system is broadly similar to VAT/GST regimes in other countries. Consumption tax of 10% is applicable to most goods and services consumed in Japan. This measure is intended to address a perceived tax leakage in the rapidly growing digital economy and ensure fair competition between foreign and domestic businesses. This proposal also aligns the JCT rules with what are already common practices in other jurisdictions.

Overview of the Change

Today, when overseas EC sellers make a sale of goods to a Japanese customer, output JCT is not imposed on the sale to the extent that the title to the goods is transferred outside Japan. In addition, if the value of imported goods on a “CIF” (“Cost, Insurance and Freight”, which is an Incoterm for a situation where the seller covers such costs when delivering goods to a named destination port) basis is JPY 10,000 or less, i.e., Low-Value Goods (“LVG”), the imported goods are exempt from customs duties and import JCT (certain goods, such as leather goods and knitted apparel do not qualify for the LVG exemption). This allows Japanese consumers to purchase LVG from overseas EC sellers with no JCT being assessed, where title transfers outside of Japan.

Under the expected tax reform, sale of imported LVG to Japanese customers will be subject to output JCT regardless of the place of supply. This would mean that consumers will be required to pay JCT on the purchase of LVG from overseas EC sellers even if title to the good is transferred outside Japan.

Such goods will still qualify for the LVG exemption of customs duties and import JCT. However, to qualify for the import JCT exemption, the overseas EC sellers will need to register as a specified LVG seller and provide registration information to the customs broker filing the import entry.

Further, a change to the calculation formula of the CIF value of goods imported by consumers was also announced. The current rules provide for a mechanism to adjust for differences between wholesale and retail prices, whereby the CIF value of goods imported by consumers is calculated by multiplying the retail purchase price by 0.6. This means that consumers importing goods they purchased for JPY 16,666 may still qualify for LVG ($16,666 \times 0.6 = 9,999$). However, this adjustment mechanism will be terminated. Accordingly, fewer shipments will qualify for LVG going forward.

Key Issues

- Instead of imposing the import JCT on the customers in Japan by the customs authorities, the overseas EC sellers of LVG will have the JCT liability.
- The overseas EC sellers will need to consider the registration option as a specified LVG seller.
- The tax reform should be applicable from 1 April 2028.

(2) JCT Obligation for Overseas Platform Operators

The 2026 tax reform introduces a significant compliance requirement for overseas EC platform operators. This measure is designed to prevent a tax leakage from the overseas sellers and reduce the burden of tax collection by EC sellers due to the JCT taxation on the LVG.

Overview of the Change

Today, some of overseas EC sellers, which are locating their online stores on other big platformer, then transfer the goods to the Japanese customers via a Japanese third party’s warehouse located in Japan. In such a situation, there is a potential JCT leakage from the EC sellers, because the overseas EC sellers should have the JCT liability but may not be reporting the JCT amounts. To prevent such JCT leakage, the platformers used by the overseas EC sellers will have the JCT liability on behalf of the overseas EC sellers to the extent that the annual total amount of the following transactions performed on the platform exceeds JPY 5 billion.

Transactions subject to the change

- The transactions under which the overseas EC sellers transfer the non-LVG in Japan; and
- The transactions under which the EC sellers transfer the LVG.

Key Issues

- The Japanese tax authorities will assign certain platformers as a specified EC platformer. These platformers will be required to submit necessary notification to the tax authorities.
- The assigned platformer will then be required to submit certain notifications to show its status to the EC sellers.
- This change should apply from 1 April 2028.

(3) Changes to the Qualified Invoice System and Applicable Rates

The 2026 tax reform introduces important revisions to the Qualified Invoice System, focusing on adjustments to input tax credit rules and transitional measures for small businesses. These changes aim to ease compliance burdens while ensuring proper tax collection under the JCT regime.

Input Tax Credit Transitional Measures

- For purchases from non-qualified invoice issuers, the deductible portion of JCT will be gradually reduced as follows. This is a significant relaxation and extension of the current transitional input credit relief rules:
 - 70% deductible from October 2026
 - 50% deductible from October 2028
 - 30% deductible from October 2030
- This transitional measure will end in September 2031.

Change for purchases from non-qualified invoice issuers

- For purchases from non-qualified invoice issuers, when the purchase amount from one non-qualified invoice issuer exceeds JPY 100 million in one taxable period, the exceeding portion of the purchase amount cannot be applied to the input tax credit transitional measures.
- This change is expected to apply for tax periods starting from 1 October 2026.

Key Changes for Small Businesses

- For individual small business operators who become qualified invoice issuers and lose eligibility for the exemption threshold, a special transitional measure applies for tax periods in FY2027 and FY2028.
- Under this measure, the amount payable can be reduced by allowing a 70% deduction from JCT calculated on taxable sales.
- Effectively, the tax payable equals 30% of JCT on taxable sales for these periods.
- To apply this treatment, the business must indicate this election in its tax return.

International taxation

(1) Implementation of OECD Pillar Two Rules in Japan

Japan's 2026 tax reform completes the country's alignment with the OECD's Global Anti-Base Erosion ("GloBE") framework, commonly referred to as Pillar Two, which introduces a global minimum tax of 15% for large multinational enterprises ("MNEs"). These rules aim to prevent profit shifting to low-tax jurisdictions and ensure fair taxation across borders. The 2026 changes are to reflect amendments made by the OECD to the Income Inclusion Rule (IIR), specifically in relation to Deferred taxes and the calculation of Adjusted Covered Taxes.

It should be noted that Japan's Pillar Two rules are expected to be changed in the future, because the current rules do not take into consideration the G7 discussions regarding the impact of the "side-by-side" rules that exclude US headed groups from Pillar Two by deeming such groups compliant in certain situations.

As a high-level reminder, Japan's Pillar Two rules have the following scope and impact:

Scope and Applicability

- Applies to multinational groups with consolidated revenue of €750 million or more in at least two of the four preceding fiscal years.
- Japanese parent companies and subsidiaries of foreign groups meeting this threshold are subject to the rules.

Key Components Implemented

1. Qualified Domestic Minimum Top-Up Tax (QDMTT)
 - Japan will impose a domestic top-up tax to ensure that income earned by a Japanese entity is taxed at a minimum effective rate of 15%. This is not expected to be a significant issue for the vast majority of Japanese subsidiaries of foreign groups due to Japan's effective tax rate generally being approximately 31% or more.
 - This prevents other jurisdictions from applying the Undertaxed Profits Rule (UTPR) to Japanese income.

2. Income Inclusion Rule (IIR)
 - Japanese parent entities must include low-taxed income of foreign subsidiaries in their tax base and pay a top-up tax where necessary.
3. Undertaxed Profits Rule (UTPR)
 - Applies when other jurisdictions fail to implement Pillar Two rules. Japanese entities may be allocated additional tax liability to ensure global minimum taxation.

Calculation and Compliance

- The Effective tax rate will be calculated on a jurisdictional basis using the Pillar Two rules.
- If the effective tax rate is less than 15%, a top-up tax applies to increase the rate to 15%.
- Japan will adopt OECD's standardized reporting framework, potentially requiring GloBE Information Returns/Notification of Ultimate Parent Entity.

Effective Date

- The QDMTT and UTPR will apply for fiscal years beginning on or after 1 April 2026. While the IIR applies for periods commencing on or after 1 April 2024.
- Transitional safe harbors (based on simplified calculations) will be available for the first three years.

(2) Amendment to Japanese controlled foreign company rules

Japan's controlled foreign company ("CFC") rules are typically of less impact to foreign headquartered groups with Japanese subsidiaries, as Japan is usually not a holding company jurisdiction for such non-Japanese groups. However, we note that the 2026 tax reform proposals do include an amendment to clarify the treatment of foreign related companies that are entering into liquidation. Further information on this issue is available in EY Tax's [2026 tax reform outline newsletter](#).

| Individual Income Tax Reforms

(1) Capital gains treatment for Crypto Assets

The 2026 tax reform introduces important changes to the taxation of crypto assets. Currently, the income arising from crypto assets is treated as miscellaneous income and taxed at the normal income tax rates. Under the 2026 reform the income or losses from the disposal of crypto assets will be treated separately.

New Tax Rates

- For individual taxpayers, income from the transfer of specified crypto assets through registered exchanges will be taxed separately at a flat 20% rate (15% national income tax plus 5% local inhabitant tax).

Loss Carry-Forward Rules

- Losses arising from the transfer of specified crypto assets can be carried forward for three years, provided certain conditions are met. These losses can only offset future gains from similar crypto asset transactions and cannot be offset against other income sources.
- Losses from derivatives transactions involving specified crypto assets are also eligible for the same three-year carry-forward treatment.

(2) Revision of Basic Deduction and Minimum Guaranteed Amount for Employment Income

The 2026 tax reform introduces adjustments to the basic deduction and the minimum guaranteed amount for employment income to reflect inflationary trends and ensure fairness in the personal income tax system.

Overview of the Change

- The basic deduction for individual taxpayers will be increased by JPY 40,000, raising the standard deduction to JPY 620,000.
- This adjustment aims to offset the impact of rising living costs and maintain the real value of deductions.

Minimum Guaranteed Amount for Employment Income

- The minimum guaranteed amount for employment income deduction will also be revised upward.
- Currently set at JPY 650,000, the threshold will increase to JPY 690,000 under the new rules.

(3) Special national defense taxation

Creation of special national defense taxation which will replace the special income tax for reconstruction that was enacted following the natural disaster in Tohoku in 2011. This will be imposed at a rate of 1% on the income tax amount. In parallel, the tax rate for the special income tax for reconstruction will be reduced by 1%, such that the net impact of this new tax should be neutral.

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