27 December 2021

Japan tax newsletter

Ernst & Young Tax Co.

2022 Japan tax reform outline

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The ruling parties (a coalition comprised of the Liberal Democratic Party and Komeito) released an outline of the 2022 tax reforms (hereinafter, "Outline") on 10 December 2021. This newsletter provides an overview of the major amendments and revisions contained in the Outline.

The Kishida Cabinet, which was formed in October aims to establish a new form of capitalism under the concepts of "a virtuous cycle of growth and distribution" and "developing a new post-COVID-19 society." To this end, it is vital that companies achieve sustainable growth by increasing investments such as R&D and personnel, and returning profits to a diverse range of stakeholders. It was from such a perspective that it was decided through the 2022 Japan tax reform to further enhance tax reduction measures for companies that proactively increase employee wages. The tax incentive to promote open innovation will also be enhanced to encourage business transformation and encourage increasing the added value of companies.

The new tax regimes, incentives, etc. that will be enforced in the upcoming months will also be partially revised or enhanced. The investment tax book value adjustment rules, which is part of the group profit and loss sharing regime (the group relief system), will be revised. Out of consideration for the plight of business operators, a grace period of 2 years will be granted in regard to the obligation to retain electronic transaction data that is scheduled to start from January 2022. Measures in preparation of the consumption tax invoice system, which is scheduled to be enforced in October 2023, will be implemented. As for tax administration, new measures will be introduced to address flagrantly malevolent unrecorded expenses and taxpayers that do not fulfill their book-keeping obligations. Meanwhile, the consideration of revisions to revise the financial income taxation was postponed to the next fiscal year or thereafter.

In October, under the OECD/G20 Inclusive Framework on BEPS, an international agreement was reached concerning new international taxation rules. It is declared in the Outline that Japan will also establish tax rules in accordance with the international agreement. The government states that it will deliberate on revising domestic law to fulfill this objective while keeping in mind its effects on existing rules in order to avoid placing excessive burdens on Japanese companies.

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

This newsletter is a translation of the comprehensive Japanese explanation of the 2022 tax reform that was issued by EY on 27 December 2021. For an explanation focused on aspects of the tax reform important to inbound companies in Japan, please see our other newsletter issued on 15 March 2022.

EY

Building a better working world

Corporate taxation

1. Enhancement of the tax incentives to encourage wage increases

In order to realize "a virtuous cycle of growth and distribution," the tax incentives to encourage wage increases will be revised in the manner described below to encourage companies to proactively increase wages for each individual from a long-term perspective and to encourage companies to boost returns to various stakeholders such as employees and transaction counterparts, in addition to shareholders.

(1) Fundamental revisions of the tax incentive for securing human resources for large enterprises

In the tax credit measures available for companies that increase wages such as salaries, the measure for newly-employed persons will be revised into a measure that grants tax credits to companies that increase wages such as salaries paid to all employees during any fiscal year that begins between 1 April 2022 and 31 March 2024.

Fundamental revisions of the tax incentive for securing human resources

- The current rules will fundamentally be revised to encourage companies to proactively increase wages for each individual from a long-term perspective, and a system will be established to provide companies that increase total wages paid to continuously employed persons by a specified rate with a tax credit totaling a maximum of 30% of the year-on-year increase in the amount of total wages paid to all employees. (This is a temporary measure lasting 2 years.) A requirement for large enterprises above a specified size who wish to obtain this tax credit is that they have declared adoption of a style of management that benefits multiple stakeholders.
- An additional tax credit rate will be granted to companies that proactively increase wages and investments in personnel (education and training expenses).

		Current rules:	Reform proposal:
Application requirements			
Percent increase in total wages		Total wages paid to newly-employed persons: Year-on-year wage growth (in percent) 2% or more	Total wages paid to continuously-employed persons: Year-on-year wage growth (in percent) 3% or more
Multiple stakeholders receive benefits (*1)		–	A declaration that profits will be returned to employees and that transaction counterparts will receive benefits has been made
Tax credit		Maximum credit rate of 20%	Maximum credit rate of 30%
Amount against which the tax credit rate is multiplied		Total wages paid to newly-employed persons	Year-on-year increase in the amount of total wages paid to all employees
Tax credit rate	Standard	15%	15%
	Addition (wage increase)	–	+10%: Total wages paid to continuously-employed persons increased by 4% or more year-on-year
	Addition (education and training expenses)	+5%: Education and training expenses(*2) increased by 20% or more year-on-year	+5%(*3): Education and training expenses increased by 20% or more year-on-year
Maximum credit		20% of corporate tax liability for the current fiscal year	20% of corporate tax liability for the current fiscal year

*1: This is a requirement for a large enterprise with stated capital of JPY1 billion or more and full-time employees of 1,000 or more and such an enterprise must submit a notification to the Minister of Economy, Trade and Industry stating that it has posted details of its declaration in its company website.
*2: A detailed statement of education and training expenses must be attached to the final tax return. (The reform proposal states that retention of such a statement will be required.)
*3: A total of 20%, if the company is not eligible for the measure to add a tax credit rate of 10%.

Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

(2) Revisions to the tax credit for encouraging salary growth at SMEs

From the perspective of facilitating continued employment at small and medium enterprises (SME) while encouraging proactive wage increases and investments in personnel, this measure will be extended by a period of 1 year (to 31 March 2024) subsequent to revisions to the requirements for obtaining the additional tax credit rates, which will significantly raise the maximum tax credit rate available to 40%.

Revisions to the tax credit for encouraging salary growth at SMEs

	Current rules:		Reform proposal:	
Application requirements				
Percent increase in total wages	Total wages paid to all employees increased by 1.5% or more year-on-year		(Unchanged)	
Tax credit	**Maximum tax credit of 25%**		**Maximum tax credit of 40%**	
Amount against which the tax credit rate is multiplied	Year-on-year increase in the amount of total wages paid to all employees		(Unchanged)	
Tax credit rate: Standard	15%		15%	
Tax credit rate: Addition (wage increase)	+10%	Total wages paid to all employees: An increase of 2.5% or more year-on-year and [*1]	+15%	Total wages paid to all employees: An increase of 2.5% or more year-on-year
Tax credit rate: Addition (education and training expenses)	+10%	Fulfillment of the requirement for increasing education and training expenses, etc.	+10% [*2]	Education and training expenses increased by 10% or more year-on-year
Maximum credit	20% of corporate tax liability for the current fiscal year		(Unchanged)	

*1: Fulfillment of the requirement for increasing education and training expenses entails satisfaction of either one of the following requirements:

a. Education and training expenses increased by 10% or more year-on-year
   ↳ A detailed statement concerning education and training expenses must be attached to the final tax return. (**The reform proposal states that such a statement must be retained.**)

b. Certification of management capability enhancements conducted in accordance with a management capability enhancement plan under the Small and Medium-sized Enterprises Business Enhancement Act. (**The reform proposal states that the aforementioned requirement will be abolished.**)

*2: A total of 25%, if the company is not eligible for the measure to add a tax credit rate of 15%.

Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

(3) Revision of the rules concerning the deduction of the increase in salary payment from the taxable base of the added value tax component

The rules concerning the deduction of the taxable base of the added value tax component in the event salary payments have increased will be redesigned in the following manner: If a company pays salaries to domestic employees during any fiscal year that begins between 1 April 2024 and 31 March 2026 and fulfills the requirement for increasing the wages paid to all continuously-employed persons by 3% or more in comparison with the reference wages paid to continuously-employed persons, then said company will be permitted to deduct the increase in wages paid to employees eligible for the deduction (i.e., the year-on-year increase in the amount of total wages paid to all employees) from the taxable base of the added value tax component.

(4) Revision of the measure which provides for the suspension of the application of specified tax credit incentives

The application of tax credit incentives set forth by the Act on Special Measures Concerning Taxation to large enterprises that exhibit a notable unwillingness to increase both wages and investments despite growing profits will be revised as follows:

Revision of the measure which provides for the suspension of the application of specified tax credit incentives

Overview of the current rules:

If a large enterprise does not fulfill any of the following requirements, then said enterprise will not be eligible for the R&D tax incentives and certain other tax credit incentives (specified tax credits*).
(Effective until 31 March 2024.)

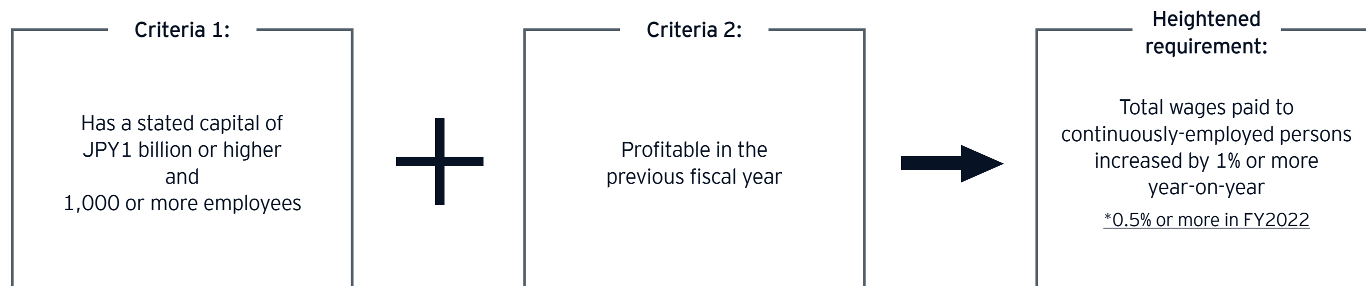
a. In the case of a large enterprise, the total wages paid to continuously-employed persons exceed the total wages it paid to continuously-employed persons in the previous fiscal year

b. The domestic capital investment made by the large enterprise exceeds 30% of the depreciation expenses it incurred in the same fiscal year.

However, a large enterprise whose income is less than its income of the previous fiscal year is exempt from these rules.

Specified tax credits: Tax credits provided under special tax incentives relevant to the enhancement of productivity (i.e., R&D tax incentives, the tax incentive to encourage investment in the future of regions, the tax incentive to encourage investment in 5G infrastructure, the digital transformation (DX) investment promotion tax incentive and the tax incentive to promote carbon neutrality investments) excluding measures that target specific regions, industries or SMEs.

Reform proposal: The above requirement a. will be made more stringent if both criteria 1 and 2 depicted below apply.



Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

- This incentive, through the provision of a maximum of 30% of the year-on-year increase in the amount of total wages paid to all employees to large enterprises and a maximum of 40% of the same to SMEs, will provide the highest tax credit rates ever offered in the form of a tax measure tied to wage increases.
- The measure for large enterprises is similar to the wage increase tax rules introduced through the 2018 tax reform.
- The aim is to induce large enterprises of a certain size to distribute profits to a more diverse set of stakeholders by making it a requirement for them to have declared adoption of a style of management that benefits multiple stakeholders.
- The measure which provides for the suspension of the application of specified tax credit incentives will be enhanced toward companies that exhibit an unwillingness to distribute profits to stakeholders.

2. Extension and enhancement of the tax incentive to promote open innovation

From the perspective of further encouraging collaboration between startups and established companies, the open innovation tax incentive, which provides deduction from taxable income for a certain portion of the investments made, will be extended by two years subsequent to enhancements of the following items:

- More companies are expected to use this tax incentive as a result of the above enhancements. Refer to the link below for precautions to take in relation to application of the tax incentive under the current rules.

Precautions to take when applying the open innovation tax incentive | EY Japan

3. Revisions to the group profit and loss sharing regime (the group relief system)

The following revisions will be implemented in conjunction with the enforcement of the group profit and loss sharing regime:

(1) Revisions to investment tax book value adjustments, other revisions

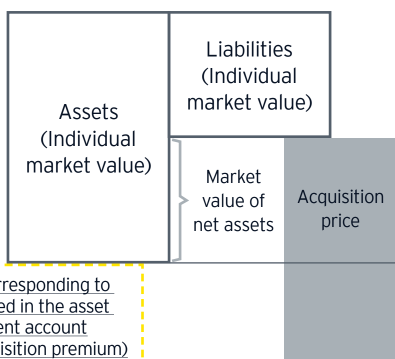
a. Revisions to investment tax book value adjustments

In regard to the investment tax book value adjustment rules, a measure will be introduced to allow any group company that owns shares of a group subsidiary to, upon the withdrawal of said subsidiary from the group, add an amount corresponding to that recorded in its asset adjustment account (said amount is similar to the value of an asset adjustment account prepared in relation to a non-qualified merger) to the tax book value of the net assets of the group subsidiary; this tax book value is the amount that is treated as the book value of the shares of a subsidiary upon its withdrawal.

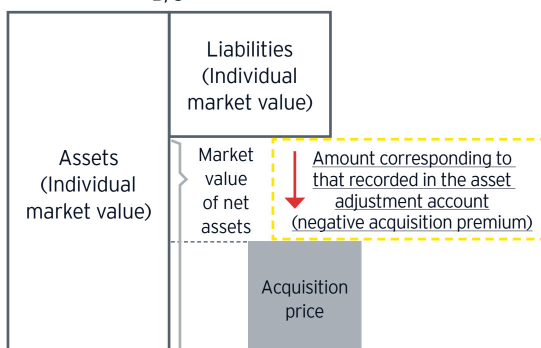
Revisions to investment tax book value adjustments

- In regard to the investment tax book value adjustment rules, a measure will be introduced to allow any group company that owns shares of a group subsidiary to, upon the withdrawal of said subsidiary from the group, add an amount corresponding to that recorded in its asset adjustment account to the tax book value of the net assets of the group subsidiary (this tax book value is the amount that is treated as the book value of the shares of a subsidiary upon its withdrawal), provided that each relevant group company attaches a detailed statement concerning the calculation of the amount corresponding to that recorded in its asset adjustment account related to the subsidiary shares to the final tax return, etc. of the fiscal year in which the withdrawal takes place, and retains documents depicting items that form the basis of those calculations.

Acquisition price > Market value of net assets



Market value of net assets > Acquisition price



Book value of the shares of the group subsidiary at the time of withdrawal
= Tax book value of net assets at the time of withdrawal
+ Amount corresponding to that recorded in the asset adjustment account (acquisition premium)

- The "amount corresponding to that recorded in the asset adjustment account" refers to an amount corresponding to an amount that would have been calculated as the value of an asset adjustment account or liability adjustment account if a non-qualified merger had taken place with a profit and loss sharing group subsidiary as the acquired company at the time of acquisition and the acquisition price of the shares of said group subsidiary upon entry into an existing profit and loss sharing group or prior to the initial application of the regime (i.e., consideration for the merger) had been treated as the merger price.
- In the event that acquisition of shares of said subsidiary is conducted in increments or through multiple companies within the profit and loss sharing group acquiring such shares, the amount is equivalent to the sum of all the amounts calculated by multiplying (i) the amount corresponding to that recorded in the asset adjustment account at the time of each acquisition conducted by each relevant group company against (ii) the ratio of the relevant number of shares acquired.
- In the event that a non-qualified merger, etc. is conducted where the group subsidiary is the acquired company, etc., the amount corresponding to that recorded in the asset adjustment account is equal to zero.
- Eligible group profit and loss sharing subsidiaries will not include companies that will be subject to built-in gains taxation upon withdrawal from the group due to the projection that they will not succeed the primary business.
- The measure will also apply to subsidiaries present during the group's transition from the consolidated taxation regime to the profit and loss sharing regime, regardless of their status as an established subsidiary or a newly joining subsidiary.

b. With respect to the built-in gains taxation rules for assets applicable upon withdrawal, etc. from the profit and loss sharing regime, assets excluded from built-in gains taxation will exclude goodwill of book values less than JPY10 million.

c. Amounts granted and received between group companies that are considered equivalent to interest taxes will be excluded from the group tax effect amount, which is not included in taxable income or treated as deductible expenses.

d. With respect to the limit on net operating losses (NOLs) that can be carried over when group companies enter or withdraw from a profit and loss sharing group, the 5-year control relationship continuity criteria will be revised in relation to the following: (i) the requirement for group companies that do not satisfy the joint venture criteria, etc. to forfeit NOLs, (ii) the special measure for group companies that do not satisfy the joint venture criteria, etc. to be permitted to offset NOLs against taxable income and (iii) the requirement for exemption from the application of the non-deductibility of losses on transfers, etc. of specified assets of group companies.

e. In regard to offsetting carried-forward NOLs of group companies that are eligible for the special measure concerning the maximum deduction of carried-forward NOLs, which is made available to companies whose business adaption plans have been certified pursuant to the Industrial Competitiveness Enhancement Act, the calculation method for the allocation of non-specified excess deductible amounts will be revised.

- The revision of the investment tax book value adjustments will address an issue that presently occurs when a subsidiary withdraws from a group, namely that acquisition premiums cannot be included in the share transfer costs.
- Even if the revision of the investment tax book value adjustments is not applied, built-in gains taxation will be applied to the goodwill of book values less than JPY10 million if the primary business that is carried out prior to the withdrawal from a profit and loss sharing regime is not projected to be continued.

(2) Revisions to the foreign tax credits under the group profit and loss sharing regime

a. If, after conducting an audit, the tax authorities reach the conclusion that a group company is recognized as having to apply the measure for fiscal year-in-progress adjustment, then the authorities will explain the details of the audit results (including the amount for which said measure should be applied and the reasons therefor) to the group company.

b. If the amount stated as the amount for which the measure for fiscal year-in-progress adjustment was applied (i.e., an amount equivalent to an insufficient tax credit or an excess tax credit) in documents attached to the tax return filed within the deadline of the fiscal year in which falls the date when the explanation in a. above was provided differs from the details of the explanation, then the measure for leaving the initial tax return unchanged will be deemed inapplicable in relation to the amount equivalent to an insufficient tax credit or an excess tax credit for that fiscal year.

c. If, during that fiscal year (i.e., when the measure for leaving the initial tax return unchanged pertaining to the tax credit, etc. (a tax credit or an amount equivalent to an insufficient tax credit or an excess tax credit) was deemed inapplicable), an amended tax return is filed or a correction is made to the tax amount of that fiscal year because said measure was deemed inapplicable, then reapplication of the measure for leaving the initial tax return unchanged will be permitted, provided that the amount stated as the tax credit, etc. in said amended tax return or in the notice of correction sent by the tax authorities in relation to said correction is employed.

- Due to application of the measure to prevent other group companies from being affected by the tax adjustments of a single group company implemented between profit and loss sharing companies of the same group, if amendments or corrections are made, then the tax credit reported in the initial final tax return will not be revised (hereinafter, "measure for leaving the initial tax return unchanged"). Furthermore, if amendments or corrections are made, then the foreign tax credits of past fiscal years must be recalculated and the excess or insufficient amount must be reflected in the tax amount of the fiscal year in progress (hereinafter, "measure for fiscal year-in-progress adjustment"). Therefore, this year's reform clarifies how to treat amendments or corrections during a tax audit.

4. Other

(1) Revision of the calculation method of deemed dividends

The treatment of dividends of surplus sourced from both retained earnings and capital surplus (hereinafter, "mixed-source dividends") will be revised in accordance with a decision issued by the Supreme Court of Japan on 11 March 2021 as described below.

Revision of the calculation method of deemed dividends in relation to the repayment of capital

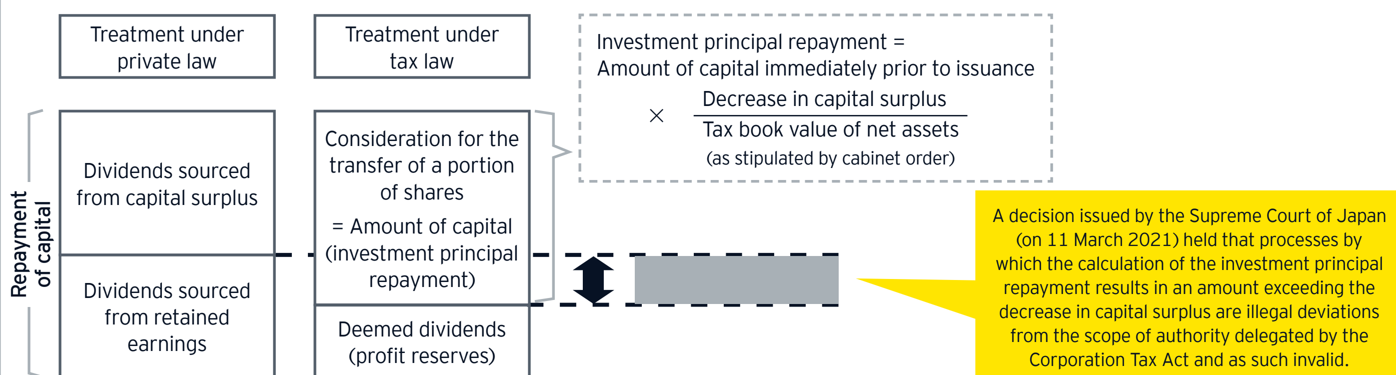
Current rules:

In concern to transfers of assets which are not classified as distributions of cash, etc. to shareholders conducted through the dividend procedures set forth by the Companies Act and related laws yet which do confer economic benefits identical to those of dividends, e.g., the acquisition of treasury shares, certain amounts of said assets are deemed to be dividends in calculations performed pursuant to tax law. Furthermore, any such asset transfers whose treatment is to be differentiated from that given to pure distributions of profit, such as the repayment of capital, are to be considered deemed dividends, even if they are conducted through the dividend procedures set forth by the Companies Act and related laws; pursuant to tax law, the amount to be treated as dividends is the portion of any issued amount that exceeds that corresponding to the repayment of investment principal (hereinafter, "investment principal repayment").

The investment principal repayment pertaining to the repayment of capital is the amount calculated by multiplying the amount of capital immediately prior to the repayment against the reduced capital surplus ratio.

**In the case when a company that issues two or more classes of shares repays capital, the calculation of the investment principal repayment must be conducted in the same manner as indicated above.*

In the case where dividends of surplus are sourced from both retained earnings and capital surplus, and the tax book value of net assets immediately prior to the issuance is less than the amount of capital:



Revision proposal:

- The portion of the repayment of capital which may be classified as investment principal repayment will be limited to the decrease in capital surplus.
- In the case when a company that issues two or more classes of shares repays capital, the investment principal repayment as employed to calculate deemed dividends must be calculated based on the amount of capital related to said repayment of capital for each class of shares.

**Enforcement date: 1 April 2022.*

Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

- The treatment of mixed-source dividends had been indicated in the notice section of the National Tax Agency website whose link is provided below, but this year's reforms provide clarification regarding the following points:
  a. The investment principal repayment, which serves as the basis for calculating deemed dividends related to the repayment of capital, and the amount of reduced capital, which serves as the basis for calculating the amount of capital, will be capped at the amount of capital surplus that decreased after said repayment of capital.
  b. In the case when a company that issues two or more classes of shares repays capital, the investment principal repayment, which serves as the basis for calculating deemed dividends, and the amount of reduced capital, which serves as the basis for calculating the amount of capital, must be calculated based on the amount of stated capital of each class of shares related to said repayment of capital.

The treatment of dividends of surplus sourced from both retained earnings and capital surplus in accordance with a decision issued by the Supreme Court of Japan on 11 March 2021

(2) Extension of the non-deductible entertainment expense rules

The application period of the non-deductible entertainment expense rules will be extended by two years and the application period of the special measure for the deduction of hospitality-based food and drink expenses will also be extended by two years.

(3) Low-value depreciable assets/lump-sum depreciable assets

In regard to the special measure for deduction of the acquisition price of low-value depreciable assets and the special measure for deduction of lump-sum depreciable assets, any such assets used for leasing (excluding that conducted as a primary business) will be excluded from the scope of assets eligible for said measures.

(4) Reserves for loss on foreign investments

Application of the measure for reserves for loss on foreign investments (a measure which allows the accumulation of reserves in preparation for the risk of project failure, etc. when undertaking foreign resources exploration and development, as well as the deduction of said reserves as expenses) will be extended by 2 years.

(5) Revision and extension of the regional center enhancement tax incentive

a. With regard to the special depreciation and tax credit rules pertaining to the acquisition of specified property (office buildings, etc.) in regions specified as revitalization regions, the acquisition timing and acquisition price requirements will be revised and the application period will be extended by a period of 2 years.

b. With regard to the tax credit rules applicable when the number of employees in regions specified as revitalization regions is increased (employment promotion tax incentive), the requirement regarding eligible employees will be revised and the application period will be extended by a period of 2 years.

c. The requirement to receive certification for a plan to develop specified business facilities in regions specified as revitalization regions will be revised based on the assumption that relevant laws and regulations will also be revised.

(6) Extension of the tax incentive concerning investment in 5G facilities (5th generation mobile communication systems)

With regard to the special depreciation and tax credit rules pertaining to the acquisition of certified facilities utilizing specified advanced information and communication technologies, the scope of eligible facilities and the tax credit rate will be revised and the tax incentive itself will be extended by a period of 3 years.

(7) Registration and license tax

Application of the measure to reduce the registration and license tax rate for registrations conducted pursuant to certified reorganization plans, etc. as set forth in the future version of the Industrial Competitiveness Enhancement Act to be released after revision of the reorganization plan certification requirements will be extended by a period of 2 years.

- Twelve plans and eleven plans under this tax reduction measure were certified in 2019 and 2020, respectively (reduction amount: JPY4.2 billion in 2019 and JPY4.9 billion in 2020; based on the "Ministry of Economy, Trade and Industry (METI) FY2022 Tax Reform Requests").
- The Outline does not describe the revision proposal of the certification requirements. However, the requirement is envisaged to be revised according to the "Ministry of Economy, Trade and Industry (METI) FY 2019 Tax Reform Requests," which states that with respect to the eligibility requirement of this special measure, a. return on assets (ROA) be revised to return on invested capital (ROIC), which is more suitable for evaluating business segments, and b. against the backdrop of progresses made in digitalization, software—which is not a tangible fixed asset—also be taken into account when determining the tangible fixed asset turnover rate.

(8) Revision of the reduced corporate enterprise tax rate

With respect to the income-based taxation of the corporate enterprise tax of companies subject to business scale taxation, the reduced tax rate levied on income equal to or less than JPY8 million per annum will be disallowed to companies subject to business scale taxation.

International taxation

1. Revisions to the special measure on tax book value reduction of subsidiary shares

The special measure on tax book value reduction of subsidiary shares, a measure introduced via the 2020 tax reform in the interest of preventing acts of tax avoidance conducted through a combination of dividends received from subsidiaries and subsidiary share transfers, will be revised as described below.

(1) Assessment of the exemption criteria (the criteria concerning the retained earnings amount as defined in relation to the specified control date)

a. If the retained earnings of a subsidiary from whom eligible dividends are received has increased during the period between the day following the final day of the most recent fiscal year that ended prior to the resolution date, etc. of the eligible dividends (hereinafter referred to as the "immediately preceding fiscal year") and the date the eligible dividends were received (referred to as the "eligible period" within section a.), and if any one of the record dates pertaining to the dividends received from said subsidiary by the shareholder, etc. of said subsidiary during the eligible period falls on the day following the immediately preceeding fiscal year or thereafter, then the shareholder, etc. of said subsidiary will be permitted to add the retained earnings that increased during the eligible period (i.e., the sum of the retained earnings of said subsidiary that increased during the eligible period and the decrease in the retained earnings of said subsidiary which corresponds to the dividends received from said subsidiary by the shareholder, etc. of said subsidiary during the eligible period) to the retained earnings that were recorded in the balance sheet of the immediately preceding fiscal year.

However, application of the above requires the retention of documents that certify the amounts mentioned below.

(i) The retained earnings amount that increased during the eligible period

(ii) The retained earnings amount that increased during the fiscal year prior to the specified control date*

**The "retained earnings that increased during the fiscal year prior to the specified control date" refers to the sum of (a) the retained earnings of said subsidiary that increased during the period between the first day of the fiscal year in which falls the specified control date and the day immediately preceding the specified control date (hereinafter referred to as the "applicable period prior to the specified control date" in (ii)) and (b) the decrease in the retained earnings of said subsidiary which corresponds to the dividends received from said subsidiary by the shareholder, etc. of said subsidiary during the applicable period prior to the specified control date, on condition that (a) the retained earnings of said subsidiary has increased during the applicable period prior to the specified control date and that (b) the shareholder, etc. of said subsidiary has received dividends from said subsidiary (limited to those whose record date falls within the applicable period prior to the specified control date).*

b. In the case of receiving application of a. above, the retained earnings recorded in the balance sheet of the most recent fiscal year that ended prior to the specified control date will be added to the retained earnings that increased during the fiscal year prior to the specified control date.

Tax reform requests had been made by the industrial circle to address the following issue: since the profit earned in the fiscal year during which dividends are distributed (the retained earnings that increased during the fiscal year) is not taken into account under the current rules, in the event that dividends are distributed during the fiscal year sourced by retained earnings that increased during the fiscal year, there remains a possibility that the special measure on tax book value reduction of subsidiary shares may become applicable. Due to revision a. above, companies are permitted to add retained earnings that increased during the fiscal year.

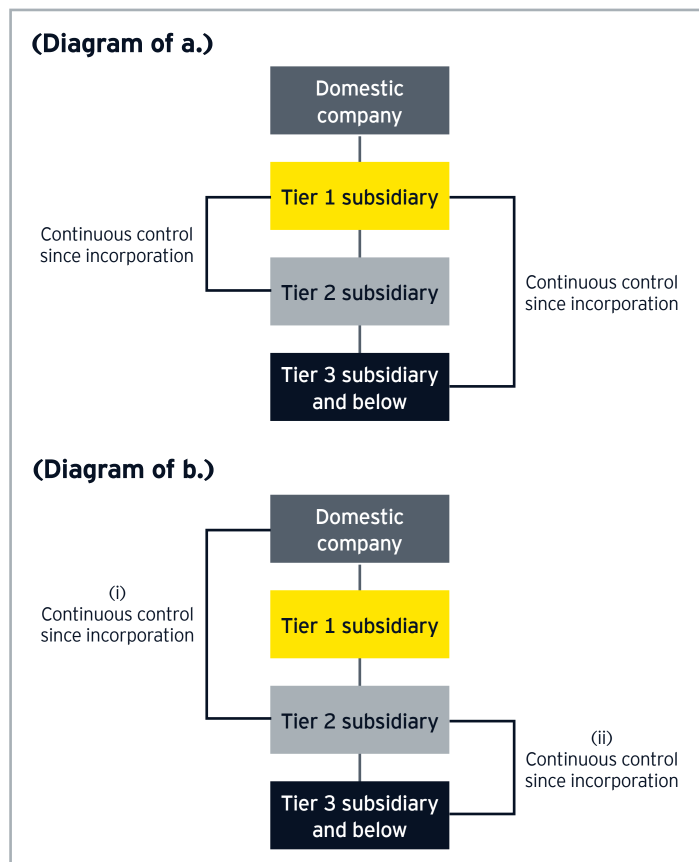
In the case of applying a. above, the retained earnings that increased during the fiscal year mentioned in b. above must also be added.

(2) Measure to prevent the avoidance of the aforementioned measure through the use of dividends through subsidiaries that fulfill the exemption criteria (the anti-avoidance measure)

The anti-avoidance measure will not be applied when any of the following criteria are met:

a. Special control relationships were established between a Tier 1 subsidiary and the subsidiaries of said Tier 1 subsidiary (hereinafter referred to as the "Tier 2 subsidiary, etc.") within 10 years prior to the record date pertaining to the eligible dividends, and each of the special control relationships between said entities has been continuous during the period between the incorporation date of each Tier 2 subsidiary, etc. (referred to as a continuously-affiliated company in a.) and the relevant record date (in the case of a Tier 2 subsidiary, etc. with whom a special control relationship has ceased to exist prior to the relevant record date, then immediately prior to the latest date when that special control relationship ceased) (excluding mergers where the Tier 1 subsidiary or the Tier 2 subsidiary, etc. is the acquiring company and the acquired company is a company other than a continuously-affiliated company).

b. In cases when all of the following criteria are met
   - (i) A special control relationship exists continuously between a parent company and a Tier 2 subsidiary from the incorporation date of said Tier 2 subsidiary to the record date pertaining to the dividends paid by the Tier 2 subsidiary to the Tier 1 subsidiary; and
   - (ii) Special control relationships were established between a Tier 2 subsidiary and the subsidiaries of said Tier 2 subsidiary (hereinafter referred to as the "Tier 3 subsidiary, etc.") within 10 years prior to the record date pertaining to the eligible dividends, and each of the special control relationships between said entities has been continuous during the period between the incorporation date of each Tier 3 subsidiary, etc. (referred to as a continuously-affiliated company in (ii)) and the relevant record date (in the case of a Tier 3 subsidiary, etc. with whom a special control relationship has ceased to exist prior to the relevant record date, then immediately prior to the latest date when that special control relationship ceased) (excluding mergers where the Tier 2 subsidiary or the Tier 3 subsidiary, etc. is the acquiring company and the acquired company is a company other than a continuously-affiliated company).



Tax reform requests had been made by the industrial circle to address the following issue: under the current rules, there is a possibility that the special measure on tax book value reduction of subsidiary shares may become applicable even if the parent company had incorporated Tier 2 subsidiaries and below by itself. They will no longer be subject to the anti-avoidance measure due to revisions in sections a. and b. above.

Revision a. above applies to cases where Tier 2 subsidiaries and Tier 3 subsidiaries are incorporated by Tier 1 subsidiaries, while revision b. above applies to cases where Tier 3 subsidiaries and below are incorporated by Tier 2 subsidiaries. Cases where domestic companies transfer Tier 1 subsidiaries to other Tier 1 subsidiaries in exchange for in-kind contributions, which converts them into Tier 2 subsidiaries after the in-kind contributions, do not fulfill requirements a. above, but fulfill requirements b. above.

(3) Application period

Reforms (1) and (2) above will apply to eligible dividends received in fiscal years beginning on or after 1 April 2020.

2. Other

(1) Revisions to the earnings stripping rules

The earnings stripping rules will apply to income related to the following types of domestic source income subject to the corporate tax of foreign companies.

a. Domestic source income not attributable to permanent establishment (PE) generated by foreign companies that have a PE in Japan.

b. Domestic source income generated by foreign companies that do not have a PE in Japan.

(2) Revision of the Japanese controlled foreign company (J-CFC) rules

In regard to the determination of specified foreign-affiliated companies which are eligible for application of the special measure for insurance consignors, the requirement of being a foreign-affiliated company whose outstanding shares are directly or indirectly wholly owned by an insurance company or an insurance company that has a specified capital relationship with the aforementioned insurance company will be revised.

Individual taxation, asset taxation and consumption taxation

1. Revisions to the housing loan tax credit

The application of this tax credit will be extended by 4 years to 2025, but the tax credit rate will be decreased from 1% to 0.7%. In addition, the credit period attributable to newly-constructed housing or housing that was purchased and then resold (with certain exceptions) will be 13 years. The following measures will also be introduced:

a. A cap on the year-end balance of housing loans, etc. (borrowing limit)

(i) In the case of newly-constructed housing or housing that was purchased and then resold

	Start of residence	
	2022 and 2023	2024 and 2025
Certified housing	JPY50 million	JPY45 million
ZEH grade energy-saving housing	JPY45 million	JPY35 million
Housing that fulfills energy efficiency standards	JPY40 million	JPY30 million
Other housing	JPY30 million	JPY20 million*

*Credit rate: 0.7%; credit period: 13 years (10 years only for *)*

(ii) In the case of used housing

	Start of residence	
	2022 and 2023	2024 and 2025
Certified housing ZEH grade energy-saving housing Housing that fulfills energy efficiency standards	JPY30 million	
Other housing	JPY20 million	

Credit rate: 0.7%; credit period: 10 years

Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

b. The income limit will be decreased to JPY20 million or less (currently JPY30 million or less).

c. This special measure will also be applied to acquisitions of newly-constructed housing or housing that has never been used as a residence whose floor space equals or is greater than 40m^2 and is less than 50m^2 and that receive building confirmation on or prior to 31 December 2023. Eligible taxpayers will be able to apply the special measure in years in which their total income is JPY10 million or less.

d. In concern to housing provided for residential use that receive building confirmation on or after 1 January 2024 (excluding those whose construction date as indicated in the property registry is 30 June 2024 or earlier) or housing provided for residential use that has not received building confirmation but whose construction date as indicated in the property registry is 1 July 2024 or thereafter, this special measure will not be applied to acquisitions of newly-constructed housing not fulfilling certain energy efficiency standards or such housing that have never been used as a residence.

e. In regard to eligible used housing, the years since construction requirement will be repealed, while new requirements will be added for used housing to be provided for residential use that fulfill the new earthquake resistance standards. Housing whose construction date as indicated in the property registry is on or after 1 January 1982 will be deemed as housing provided for residential use that fulfill the new earthquake resistance standards.

f. Reforms b. and e. above will be applied to housing that is acquired, etc. and subsequently provided for residential use on a date on or after 1 January 2022.

Observations were made by the Board of Audit of Japan that there are many cases where the interest rate of housing loans are lower than the tax credit rate and that the housing loan tax credits exceed interest payments, and the tax credit rate was revised as a measure to address this issue.

2. Revisions to the consumption tax invoice system

(1) Revision of the procedures required to register as a qualified invoice issuer

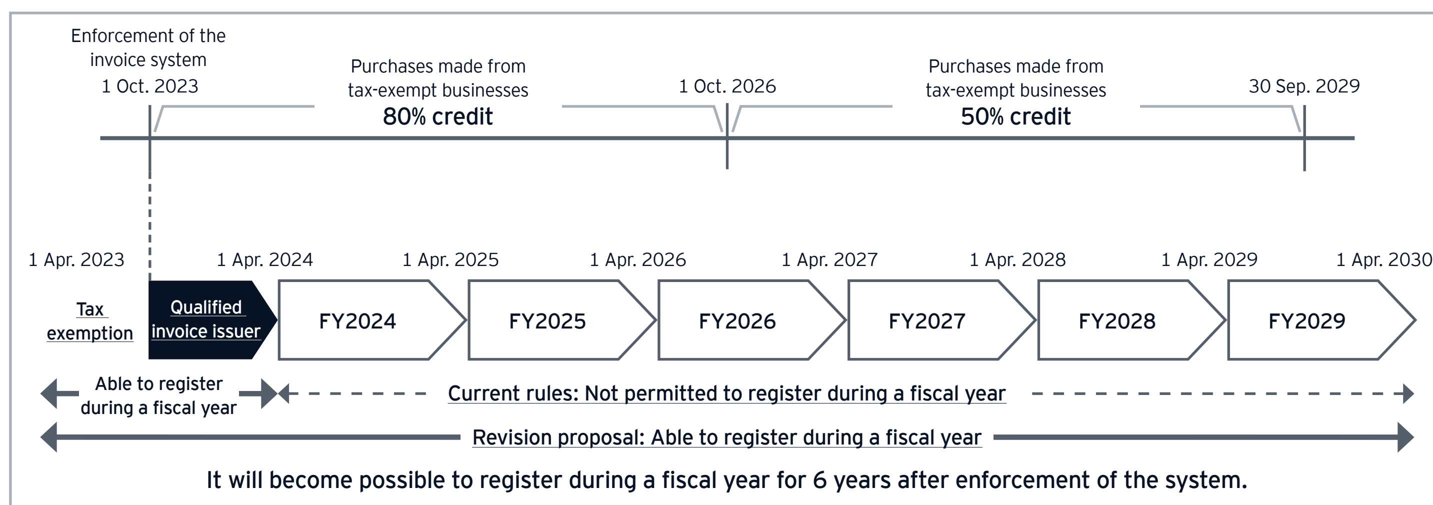
The revisions below will be made concerning the registration procedures for becoming a qualified invoice issuer.

a. **Current rules:**

If a tax-exempt business becomes registered as a qualified invoice issuer during a taxable period that contains the date of 1 October 2023, then, due to a transitional measure, said business will become a qualified invoice issuer as of the registration date even if that date is during a taxable period; however, for subsequent taxable periods, no such businesses will be permitted to register during a taxable period.

b. **Revision:**

For the purpose of enabling tax-exempt businesses to become qualified invoice issuers under a flexible schedule while being given enough time to consider the necessity of registering, such businesses will be permitted to register during a taxable period provided that said taxable period contains any date between 1 October 2023 and 30 September 2029. In the event tax-exempt businesses register during a taxable period by applying this measure, they will not be permitted to apply the tax-exempt regulations provided to businesses until the taxable period which contains the date when 2 years have passed since the registration date (excluding cases when the registration date falls within the taxable period that contains the date of 1 October 2023).



Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

(2) Other revisions

a. Preservation of separate accounting invoices issued by tax-exempt businesses will be required in order to be eligible for application of the transitional measure for purchases made from tax-exempt businesses (80% credit and 50% credit); however, only hard copies of separate accounting invoices are permitted under the current rules. For domestic taxable purchases made on or after 1 October 2023, application of the transitional measure will be permitted even if the separate accounting invoice is retained in electronic form.

b. In regard to the adjustment tax measure for inventories owned by tax-exempt businesses that have converted into taxable businesses, the current rules stipulate that 80% or 50% of the consumption taxes for inventories are creditable during the period when the transitional measure for such purchases is in effect, but due to this year's revisions, 100% of such consumption taxes will be usable as input tax credit.

3. Other

(1) Revision of the criteria defining major shareholders

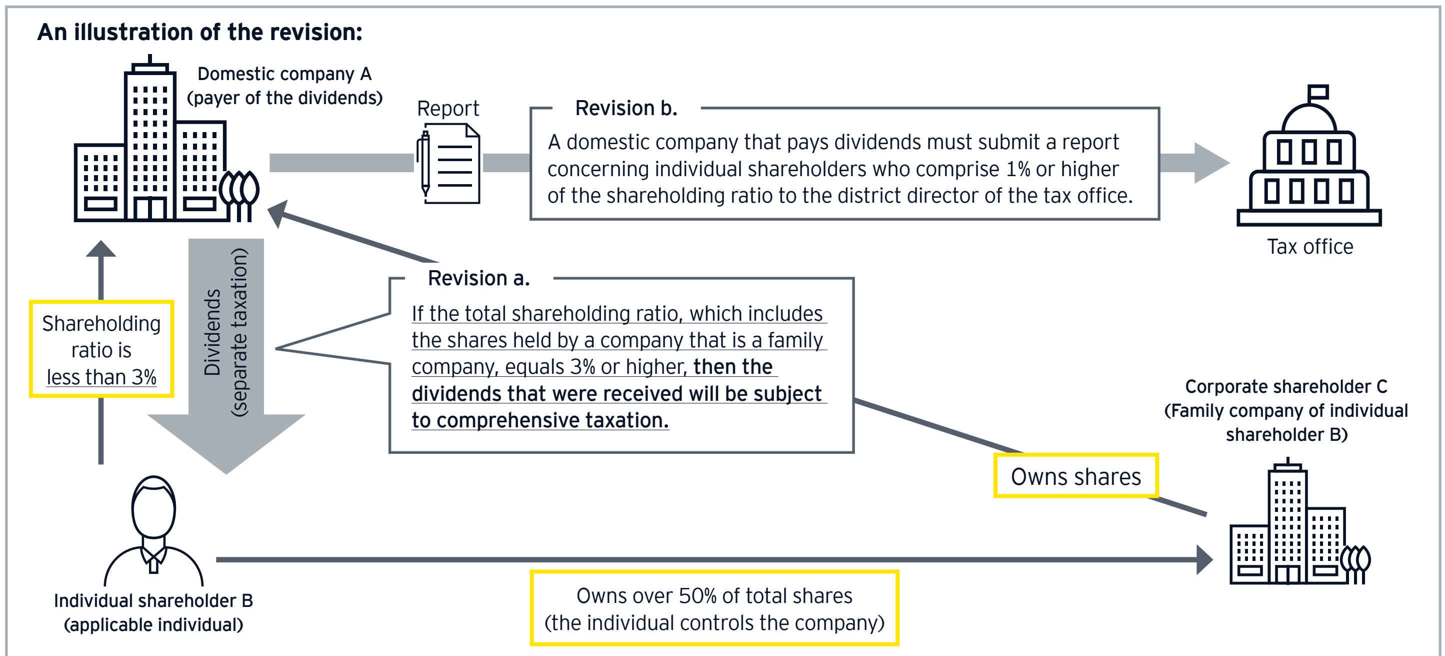
The measures described below will be implemented with respect to the criteria defining major shareholders of the special measure concerning the taxation of dividend income related to listed shares

a. **Current rules:**
Dividends of listed shares that major shareholders of said listed shares receive are subject to comprehensive taxation, but shares of relevant listed companies indirectly owned by said shareholders through family companies, etc. are not taken into account when determining whether a party is a major shareholder (i.e., a shareholding ratio of 3% or higher).

b. **Revision:**
If the ratio of outstanding shares that is owned by individuals who receive dividend payments related to listed shares from a domestic company and a company that is deemed as a family company in the event that said individuals are selected as the main shareholders to evaluate whether it is a family company against total shares of said domestic company (shareholding ratio) equals 3% or higher, then the dividends received by said individuals will be subject to comprehensive taxation.

A domestic company that pays dividends related to listed shares must submit a report, which includes the names, etc. of individual shareholders who comprise 1% or higher of the shareholding ratio as of the record date pertaining to the payment of those dividends, to the district director of the tax office within 1 month from the date the payment was finalized (i.e., resolution date).

Note: This revision will apply to dividends related to listed shares paid on or after 1 October 2023.



Source: Created using materials from the Liberal Democratic Party Research Commission on the Tax System

The revision depicted in the above figure, "Revision a.", will be implemented based on Board of Audit of Japan observations concerning taxation inequity between major individual shareholders and individual shareholders who substantially own a shareholding ratio of 3% or higher via a company that is controlled by said individual through the ownership of a majority of voting rights.

(2) Revision of income tax pertaining to dividends received from wholly-owned subsidiaries

Tax rules will be revised to ensure income tax is not levied on dividends depicted below that are received by certain domestic companies, and income tax will not be withheld at source in relation to those dividends.

a. Dividends related to the shares of wholly-owned subsidiaries (i.e., 100% shareholding ratio)

b. Dividends related to the shares of another domestic company whose shares are directly owned by a domestic company (limited to those owned with the domestic company as the registered holder; same hereinafter), provided that the ratio of outstanding shares against the total shares of that other domestic company exceeds one-third as of the record date related to the payment of dividends.

Note: The above revision will apply to dividend payments received on or after 1 October 2023.

Observations were made by the Board of Audit of Japan concerning the temporary fund burden of taxpayers and the administrative burden of tax offices which arise as a result of having to withhold taxes on dividends related to the shares of wholly-owned subsidiaries and affiliated companies, since these dividends are generally not subject to corporate taxation. This revision will be implemented to address this issue. Against a backdrop of the projection that tax revenue will decrease in 2023 as a result of this revision, the central government is planning to deliberate measures necessary to ease its impact in the upcoming 2023 tax reform.

(3) Burden adjustments relating to fixed asset taxes and city planning taxes levied on land

As a temporary measure limited to 2022, the taxable base of commercial land (limited to land whose burden ratio is less than 60%) for the current fiscal year will be set as the sum of 2.5% (c.f. 5% under the current rules) of the assessed value for the current fiscal year and the taxable base of the previous fiscal year. (However, if said sum exceeds 60% of the assessed value, then an amount equivalent to 60% must be used. On the other hand, if said sum is below 20% of the assessed value, then an amount equivalent to 20% must be used.)

(4) 2-year extension of the special measure for stamp duties

The application period of the special measure for the tax rate of stamp duties pertaining to agreements, etc. related to the transfers of real estate will be extended by 2 years.

(5) Revision of the measure for the exemption from gift taxes levied on funds received as a gift from a lineal ascendant for the acquisition of a residence

The application period, which is currently 31 December 2021, will be extended by 2 years to 31 December 2023. The maximum tax exemptions afforded will individually be set forth as shown below depending on the below category of property for residential use that was newly constructed, etc. using the funds that were received as a gift for the acquisition of a residence, irrespective of the conclusion date of the agreement related to the acquisition of said property for residential use.

a. Earthquake-resistant, energy-saving or barrier-free property for residential use: JPY10 million (c.f. JPY15 million under the current rules)

b. Property for residential use other than the above: JPY5 million (c.f. JPY10 million under the current rules)

The above revision will be applied to gift taxes related to funds that were received as a gift for the acquisition of a residence on or after 1 January 2022.

Tax administration

1. Electronic ledger retention (e-retention) rules

(1) Safe harbor rules to facilitate a smooth transition to the electronic data retention system for transaction data pertaining to electronic transactions

In regard to the system for retaining electromagnetic records concerning transaction data pertaining to electronic transactions, a revision was implemented via the 2021 tax reform to repeal the measure to permit the retention of printed versions of electromagnetic records starting from 2022.

The 2022 tax reform will introduce a transitional measure to allow the retention of electromagnetic records concerning transaction data pertaining to electronic transactions conducted between 1 January 2022 and 31 December 2023 by a party obligated to retain data related to individual income tax and corporate tax, irrespective of the retention criteria set forth for such data, provided that the district director of the presiding tax office acknowledges that said party obligated to retain the electromagnetic records cannot do so in accordance with the retention criteria due to reasons deemed unavoidable and said party is also permitted to present or submit printed versions of the electromagnetic records (limited to those output in a systematic manner and clear format) based on requests made in accordance with tax officers' authority to make inquiries and inspections.

Note 1: This revision will apply to transaction data of electronic transactions conducted on or after 1 January 2022.

Note 2: The above measure for the retention of electromagnetic records for transaction data of the above electronic transactions in cases when such electromagnetic records are retained in their printed versions, etc. was applied out of consideration for the current situation of businesses who are facing difficulty fulfilling the criteria of retaining of electromagnetic records, i.e., from an operational point of view, appropriate consideration has been given to enable parties obligated to retain electromagnetic records to continue retaining printed versions, etc. thereof without having to conduct any procedures related to the district director of the presiding tax office.

On page 10 of the "Frequently Asked Questions (Nov. 2021)," the National Tax Agency makes the statement shown below as part of supplementary explanations to the "Q&A about the Act concerning Preservation of Electronic Books," which was published after the 2021 tax reform.

Supplementary explanation 4: Q&A related to electronic transactions: Question No. 42

In the event of retaining a portion of electronic data in printed form without electronically saving that portion, questions have been asked whether the approval of filing blue returns will be canceled and whether relevant expenditures will not be accepted during tax audits as a result of the recent revisions concerning the obligation to retain electromagnetic records of transaction data for electronic transactions.

With respect to treatment of this issue, in accordance with the former rules, for example, so long as those transactions are properly recorded in the books and reflected in tax returns, and the details of transaction data that must be retained can be confirmed from things other than electronic data such as printed documents, then your blue return filing approval will not immediately be canceled and your expenditures of cash will not immediately be deemed as non-existent despite the absence of other special reasons.

(2) Establishment of the scanned document preservation rules due to introduction of the timestamp system certified by the central government

In regard to the timestamp requirement under the scanned document preservation rules pertaining to national tax-related documents and the system for retaining electromagnetic records concerning transaction data pertaining to electronic transactions, the current rules stipulate that timestamps related to businesses certified by the Japan Data Communications Association must be appended to items recorded as electromagnetic records in relation to national tax-related documents or electromagnetic records concerning transaction data pertaining to electronic transactions. However, national tax-related documents or electromagnetic records concerning transaction data pertaining to electronic transactions retained on or after 1 April 2022 must be appended with timestamps related to time certification businesses certified by the Minister for Internal Affairs and Communications.
In regard to electromagnetic records concerning national tax-related documents or transaction data pertaining electronic transactions retained between 1 April 2022 to 29 July 2023, a transitional measure will be introduced to continue allowing the appendage of timestamps related to businesses certified by the Japan Data Communications Association.

2. Measures addressing flagrantly malevolent taxpayers and taxpayers that do not fulfill their book-keeping obligations

(1) Establishment of a penalty measure to enhance the fulfillment of book-keeping obligations by levying additional taxes in relation to underreported tax returns or failure to file tax returns

If an employee of the National Tax Agency, etc. requests a taxpayer to present or submit certain ledgers (Note 1) prior to submission of an amended tax return pertaining to individual income tax, corporate tax or consumption tax in relation to items that should be entered in those ledgers, then an amount equivalent to 10% or 5% of the individual income tax, corporate tax or consumption tax related to the failure to file that arose in relation to the items that should have been entered in those ledgers will be added to the additional tax that is normally levied depending on the status of failure to record entries into books or lack of ledgers (see the figure below) (excluding cases occurring due to reasons not attributable to the taxpayer).

<table>
<tr><th colspan="2">Ledger status</th><th>Ratio of penalty added onto additional tax</th></tr>
<tr><td colspan="2">Failure to record into books or lack of (presentation or submission of) ledgers</td><td rowspan="2">10%</td></tr>
<tr><td rowspan="2">Book entry errors (Ledger was retained (or submitted))</td><td>Non-entry of one-half or more of sales</td></tr>
<tr><td>Non-entry of one-third or more but less than one half of sales</td><td>5%</td></tr>
</table>

Note 1: "Certain ledgers" refer to those recognized as being required during audits concerning the entries of sales, etc. out of the ledgers listed below.

a. Journal books and general ledgers that blue return filers of individual income tax or corporate tax must retain

b. Ledgers that parties other than blue return filers in a. above must retain for individual income tax or corporate tax purposes

c. Ledgers that businesses under the Consumption Tax Act must retain

Note 2: This framework will be applied in concern to national taxes for which the statutory filing due date arrives on or after 1 January 2024.

(2) Treatment of unrecorded expenses for which evidentiary documents do not exist

During a given a year (or fiscal year) when a taxpayer of individual income tax or corporate tax has (i) falsified or concealed facts or (ii) failed to file a return, the cost of goods sold (COGS) (excluding those that are directly linked to the sale or transfer of assets) and expenses or losses that were not included in the basis for calculating taxable income in the final tax return will not be included in the category of necessary expenses (deductible expenses), excluding those that fall under the following conditions:

a. In cases when ledgers and other related documents, which clearly indicate that said COGS, expenses or losses have been incurred (including cases when the taxpayers prove that they were not permitted to retain specific ledgers and other related documents–whose retention is obligated under the Income Tax Act or the Corporation Tax Act–due to natural disasters or other unavoidable circumstances), are retained

b. In cases when it is clear who the transaction counterparts are in relation to said COGS, expenses or losses as evidenced by the ledgers and other related documents that are retained or in cases when it is surmised that the transactions were conducted based on other evidentiary information, etc., provided that the district director of the tax office recognizes that the transactions were conducted after conducting confirmations with third-party contacts, etc.

Note: The above revision is applicable to individual income tax for 2023 onward for individual taxpayers, and to corporate tax pertaining to taxable income for fiscal years beginning on or after 1 January 2023 for corporate taxpayers.

3. Other

(1) Revision of the report of assets and liabilities system

In addition to individuals who are required to submit the report of assets and liabilities under the current rules (i.e., individuals with an income in excess of JPY20 million and total assets worth JPY300 million or more, or individuals with securities worth JPY100 million or more), individuals with total assets worth JPY1 billion or more (without any income criteria) will be obligated to submit such a report. The submission deadline will be revised to 30 June of the following year (c.f. 15 March of the following year under the current rules). This revision will apply to reports that must be submitted on or after 1 January 2024 (i.e., reports for 2023 onward).

(2) Digitization of local tax procedures (eLTAX)

With respect to the filing of returns or applications via eLTAX, procedures carried out by companies (filing of corporate inhabitant tax and corporate enterprise tax returns, etc.) have been the focus, but measures that are necessary for permitting the carrying out of procedures in relation to the filing of all returns or all applications via eLTAX to local municipalities will be implemented. In addition, electronic payments of taxes via eLTAX have centered on tax items required by companies until today and tax payments could only be conducted through financial institutions. Going forward, however, measures which are necessary to expand the scope to include all tax items and to allow taxes to be paid through mobile payment apps, credit cards and other mediums of payment will be implemented.

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