Japan

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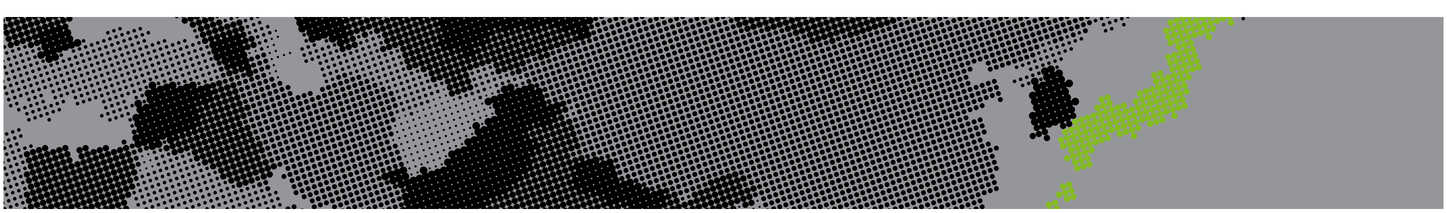
What's new?

Summary of updates/Changes to R&D and government incentives from 1 January 2019 through 31 October 2020

- Special measures regarding certain investments in 5G technology have been implemented for blue form filing companies authorized under the Act on Promotion of the Dissemination of Specified Advanced Information and Telecommunications Systems.
- The requirements for the salary increase (and domestic capital investment) tax credit have been revised.
- The special depreciation rate for the renewable energy facilities tax incentive has decreased from 20% to 14% for facilities acquired on or after 1 April 2020.

Featured government incentives

Incentive name	Description	Maximum percentage	Qualification standards	Key exclusions or issues
Salary increase (and domestic capital investment) tax credit	Tax credit is available to companies that increase salaries (and domestic capital investment for large companies)	15% of increased salary (20% or 25% if other conditions are fulfilled), limited to 20% of the national corporate tax liability	Credit applies to salaries paid to domestic employees, and domestic capital investment for large companies	Capital investment must be at least 95% of the total depreciation costs for large companies
R&D tax credit	Volume-based tax credit and tax credit for special R&D costs are available if certain conditions are fulfilled	Volume-based tax credit: Up to 17% for SMEs and 14% for large companies, limited to 25%, 35% or 40% of the national corporate tax liability Tax credit for special R&D costs: Up to 30%, limited to 10% of national corporate tax liability	Credit applies to R&D expenses that are technological and scientific in nature and incurred by a Japanese entity; tax credit for special R&D costs applies only to blue form tax filers	R&D expenses include service development costs for IT, big data, AI, and similar services
Renewable energy facilities tax incentive	Special depreciation applies on facilities for biomass, geothermal, hydroelectric power, etc.	20% special depreciation (14% for facilities acquired on or after 1 April 2020). Limited to one special depreciation rate	Incentive applies to certain renewable energy facilities with detailed functional requirements	Facilities for solar and wind power generally are excluded from the tax incentive



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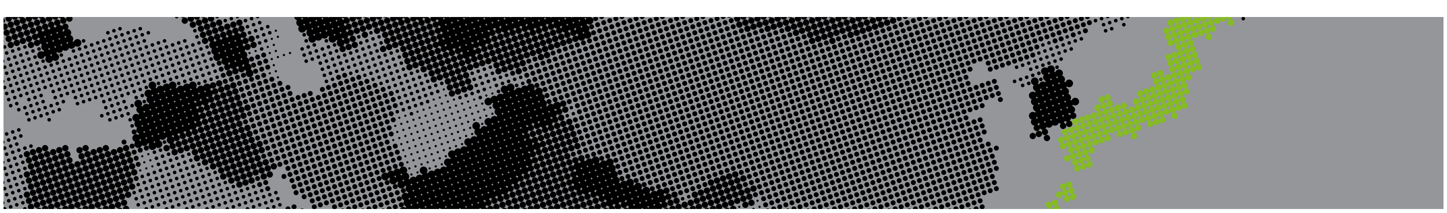
Industries most often affected by government incentives in country

	Technology, Media & Telecom		**Financial Services**
	Telecom, Media & Entertainment		Banking & Capital Markets
●	Technology		Insurance
	Consumer		Investment Management
	Consumer Products		Real Estate
	Retail, Wholesale & Distribution		**Life Sciences & Health Care**
●	Automotive	●	Health Care
	Transportation, Hospitality & Services	●	Life Sciences
	Energy, Resources & Industrial		**Government & Public Services**
●	Power & Utilities		Health & Social Care
	Mining & Metals		Defense, Security & Justice
	Oil, Gas, & Chemicals		Civil Government
	Industrial Products & Construction		International Donor Organizations
			Transport



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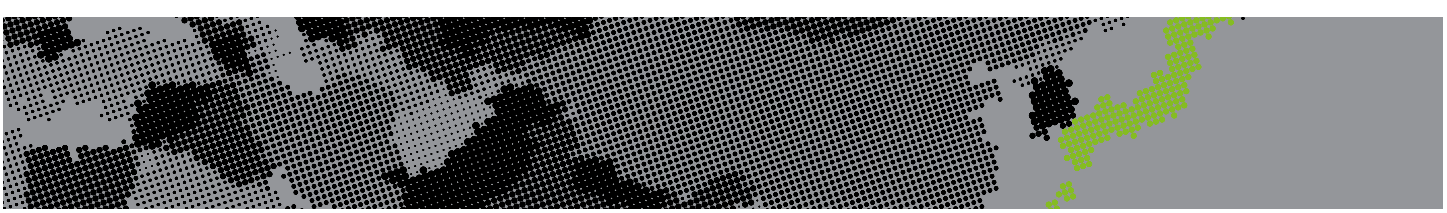
Type	National incentive?	State, provincial, regional or local incentives?[1]	Filing deadlines imposed?	Is the claim made in advance or arrears?[2]	Nature of incentive	Maximum benefit available to large enterprises	Maximum benefit available to small and medium-sized enterprises
Innovation							
Research & development (R&D) volume-based tax credit	Permanent incentive	No	Permanent incentive Not applicable	National: In arrears Local: Not applicable	Tax credit on salary, depreciation, and other costs incurred for R&D. The credit is available to any enterprise incurring R&D costs	6%–4% of qualifying R&D expenditure, limited to 25%, 35%, or 40% of national corporate tax	12%–17% of qualifying R&D expenditure, limited to 25%, 35%, or 40% of national corporate tax
R&D tax credit for special R&D costs	Permanent incentive	No	Permanent incentive Not applicable	National: In arrears Local: Not applicable	Tax credit for blue form taxpayers for joint R&D with a university or public research institution where R&D is contracted to such entities	20%, 25%, or 30% of qualifying costs, limited to 10% of national corporate tax before application of credit and other limitations on R&D credits	20%, 25%, or 30% of qualifying costs, limited to 10% of national corporate tax before application of credit and other limitations on R&D credits
R&D grants	Varies	Varies	Varies	Varies	Various grants supporting R&D in a wide range of fields	Varies	Varies
Special depreciation or tax credit for 5G mobile communication systems	Permanent incentive	Permanent incentive	Permanent incentive Permanent incentive	National: In arrears Local: In arrears	Tax credit or special depreciation for certified mobile network operators to promote the use of 5G mobile communication systems	National tax: 15% tax credit or 30% special depreciation Local tax: 50% deduction on depreciable asset tax for three years	National tax: 15% tax credit or 30% special depreciation Local tax: 50% deduction on depreciable asset tax for three years

Key: = PERMANENT INCENTIVE = TEMPORARY INCENTIVE = NEGOTIABLE = NO = LIMITED APPLICABILITY = NOT APPLICABLE

Notes:

1. Green means that this incentive is currently in effect. Yellow means that the incentive has limited applicability, i.e., the requirements for this incentive limit its value to most companies. Red means that there is no incentive.
2. If the response is advance, this means that the government must approve the award of the incentive prior to the commencement/completion of the project/activity. If the response is arrears, this means that the award of the incentive is determined at the end of the tax period or after the completion of the qualifying project or activity. Most tax incentives are considered to be claimed in arrears because they are reported on tax returns.



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Type	National incentive?	State, provincial, regional or local incentives?[1]	Filing deadlines imposed?	Is the claim made in advance or arrears?[2]	Nature of incentive	Maximum benefit available to large enterprises	Maximum benefit available to small and medium-sized enterprises
Investment							
Employment: Job creation tax credit				National: In arrears Local: Not applicable	National tax credit for companies that increase headcount in local regions and meet other requirements. Local	JPY 900,000 per new employee, limited to 20% of national corporate tax	JPY 900,000 per new employee, limited to 20% of national corporate tax
Employment: Salary increase tax credit				National: In arrears Local: In arrears	Tax credit for companies that increase average salary 3% (1.5% for SMEs) from the previous year and invest certain amounts. Increased salary is deductible from local enterprise tax base	20% of amount of salary increase, limited to 20% of national corporate tax	25% of amount of salary increase, limited to 20% of national corporate tax
Special deduction for promotion of open innovation				National: In arrears Local: Not applicable	Tax deduction for qualifying taxpayers on the acquisition cost of capital investments in specified shares of certain venture companies	25% of acquisition cost	25% of acquisition cost
National strategic zones tax incentives				National: In arrears Local: Not applicable	Special depreciation or tax credit for acquisitions of eligible assets in designated national strategic zones	23%, 25%, or 45% special depreciation depending on type of asset, or tax credit of 7% or 14% of acquisition cost (limited to 20% of national corporate tax)	23%, 25%, or 45% special depreciation depending on type of asset, or tax credit of 7% or 14% of acquisition cost (limited to 20% of national corporate tax)

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Type	National incentive?	State, provincial, regional or local incentives?[1]	Filing deadlines imposed?	Is the claim made in advance or arrears?[2]	Nature of incentive	Maximum benefit available to large enterprises	Maximum benefit available to small and medium-sized enterprises
Environmental sustainability							
Special depreciation/ tax credit on renewable energy facilities	Permanent incentive	Temporary incentive	National: Permanent incentive Local: Not applicable	National: Not applicable Local: Not applicable	Special depreciation or tax credit on acquisitions of certain renewable energy facilities with detailed functional requirements	20% special depreciation rate (reduced to 14% on facilities acquired on or after 1 April 2020)	20% special depreciation rate (reduced to 14% on facilities acquired on or after 1 April 2020), or tax credit of 7% of acquisition cost capped at 20% of national corporate tax
Other							
Incentives for head office relocation/ expansion	Permanent incentive	Permanent incentive	National: Permanent incentive Local: Permanent incentive	National: In arrears Local: In arrears	Special depreciation or tax credit for relocation of head office functions to, or expansion of head office functions within, certain local areas. Minimum investment in buildings, leasehold improvements or construction required	National tax: 4% or 7% tax credit (limited to 20% of corporate tax), or 15% or 25% additional depreciation on buildings, etc. In addition, tax credit of JPY 300,000 per new employee Local tax: 10% discount on real property acquisition tax	National tax: 4% or 7% tax credit (limited to 20% of corporate tax), or 15% or 25% additional depreciation on buildings, etc. In addition, tax credit of JPY 300,000 per new employee Local tax: 10% discount on real property acquisition tax

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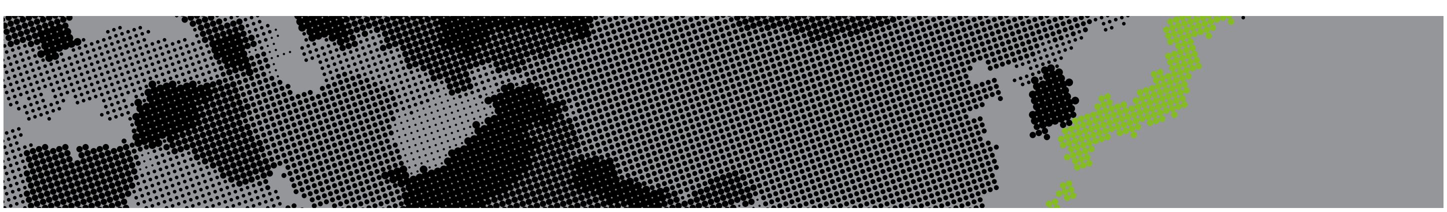

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Country background

The general national corporate income tax rate in Japan is 23.2% for fiscal periods beginning on or after 1 April 2018. Other local corporate income taxes (inhabitants tax and local enterprise tax) also apply when calculating the total corporate income tax liability of a company. The total effective corporate income tax rate including national and local taxes is approximately 30% for periods beginning on or after 1 April 2018 (based on the standard tax rates for large corporations that are subject to factor-based enterprise taxation).

Japan offers a number of incentives for investment, increasing jobs/wages, innovation, etc. to companies meeting the specified requirements.

Innovation Incentives

Research & Development (R&D)

Nature of incentives

Volume-based tax credit

The R&D tax incentives are volume-based, and the tax credit for general R&D costs varies depending on whether the company claiming the credit is an SME (small and medium-sized enterprise) or a large company.

- **SMEs:** An SME is a company with stated capital of JPY 100 million or less. An SME owned by a large company whose stated capital exceeds JPY 100 million, or a company with more than 1,000 employees, does not qualify as an SME for these purposes.

  Further complex ownership rules apply to the definition of an SME for R&D tax credit purposes, and availability of the benefit should be analyzed based on the specific facts and circumstances.

  An SME may claim a tax credit equal to 12% of total R&D expenditure (or up to 17% under transitional measures for fiscal periods beginning on or after 1 April 2019 through 31 March 2021, where the R&D cost has increased from the average of the prior three years' expenditure by more than 8%). The credit is capped at 25% (or 35% under transitional measures) of the company's national corporate tax liability before the credit is applied.

- **Large companies:** The tax credit for large companies is 6% to 10% of total R&D expenditure (14% under transitional measures, where the R&D cost has increased from the average of the prior three years' expenditure by more than 8%). The credit is capped at 25% (or 35% under transitional measures for the above period if certain conditions are fulfilled) of the company's national corporate tax liability before the credit is applied.

Credit limitations

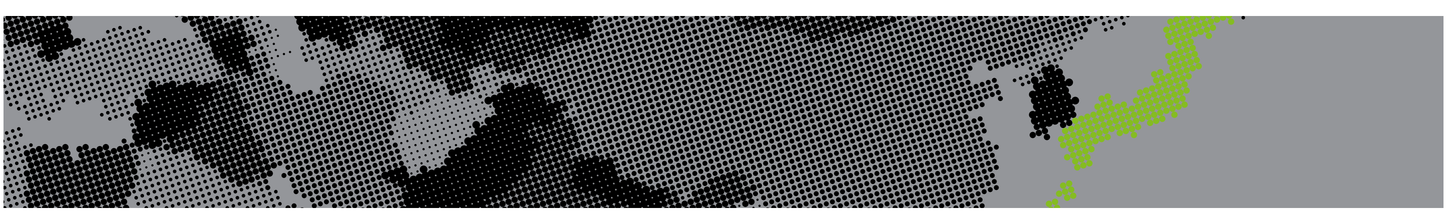
The credit limitation generally is 25% of the national corporate tax liability. However, the volume-based tax credit limitation is increased as follows: if R&D expenditure for an SME has increased by more than 10% from the average of the prior three years' expenditure, the credit limitation is increased by 10% (i.e., to 35% of the national corporate tax liability). If R&D costs for large companies exceed 10% of average sales, the credit limitation may be increased by up to 10% (i.e., up to 35% of the national corporate tax liability). For periods starting on or after 1 April 2019, the tax credit limitation is raised to 40% for venture companies established within the last 10 years that have net operating loss carryforwards (other than subsidiaries of large corporations whose stated capital is at least JPY 500 million).

Tax credit for special R&D costs

A 30% credit is granted for joint R&D with a university or public research institution where the R&D is contracted to such entities (20% where the R&D is with other non-public entities, and 25% where the R&D is with certain other venture companies). This provision applies to "blue" tax return filers (see below), which include both SMEs and large companies. The credit is limited to 10% of the company's national corporate tax liability before the credit is applied, and this limitation is in addition to the other limitations on research credits.

Qualification: The R&D tax credit is available to blue tax return filers. Blue form tax return status is obtained by submitting an application to the appropriate tax office and complying with certain record-keeping substantiation requirements.

Carryforward: Unused tax credits may not be carried forward.



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Eligible industries and qualifying costs
Research credits are not limited to specific industries, although the activity must be technological and scientific in nature. As a result, research conducted in nontechnical fields generally does not qualify for the research credit.

The expenses must be incurred by the Japanese entity. Research expenses funded by other entities (government agencies, customers, suppliers, etc.) are not eligible for the research credit.

To qualify for the credit, the expense must be incurred to:

a) Manufacture products or to improve, design, formulate, or invent technology; or
b) Service development in relation to the "fourth industrial revolution" (business using IT, big data, artificial intelligence, etc.).

Expenses included in a) must be incurred in relation to technological and scientific R&D. Expenses incurred in relation to humanities or social science research do not qualify. For example, costs incurred to achieve efficiency of the business or to improve sales techniques are not eligible for this tax credit. Expenses included in b) must be incurred in relation to the development of services that are for sale to a third party.

R&D costs incurred to support an entity's own operations do not qualify as a) or b).

Qualifying expenditure includes in-house labor costs, supplies, overhead, depreciation on fixed assets, and contract costs. Only tax-deductible R&D expenses incurred by the Japanese entity are eligible for the credit.

Salaries generally mean amounts paid to employees who are engaged exclusively in R&D activities; however, segregation of activities may be permitted if clearly documented. Labor costs relating to the performance of qualifying activities may be allowable for R&D credit purposes to the extent details of the activities are clearly documented. Documentation should indicate the time spent by each employee on qualifying R&D activities, with details of appropriate calculations for the labor costs. The legislation is silent on how to determine the applicable labor costs.

Intellectual property (IP) and jurisdictional restrictions
Japanese law does not expressly require that companies claiming research tax incentives own the IP created through their R&D activities.

The qualifying costs incurred by a Japanese company are eligible for the research credit even if the research is conducted outside of Japan.

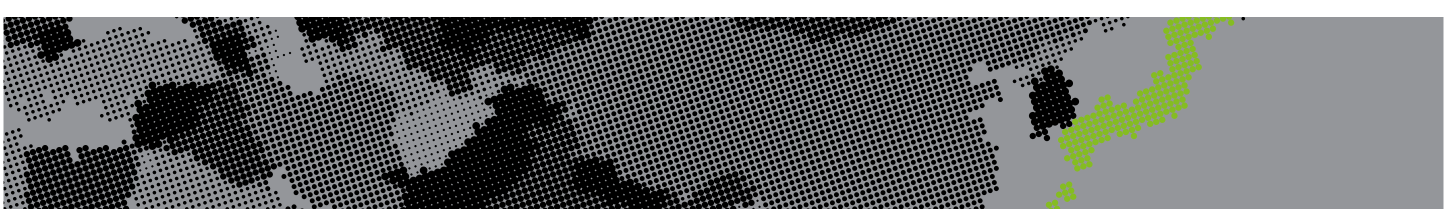
Other concerns
Prior approval is not required from the government or regulatory agencies.

The credit must be claimed on the tax return for the relevant period. Claims on amended tax returns generally are not accepted.

Disallowance of certain tax incentives for large companies
If a large company does not fulfill either of the following conditions, it may not enjoy certain tax incentives:

- Average wage payments in the current year have increased from the average wage payments of the previous fiscal year; or
- The domestic capital investment is more than 30% of the total depreciation costs. However, no restriction applies if the company's profit is less than or equal to the profit from the previous fiscal year. The restriction is intended to prevent large profitable companies from applying certain tax incentives if they do not invest sufficiently.

Tax incentives subject to this disallowance are the R&D tax credit, promoting future investment in local economies incentives, 5G mobile communication systems incentives, and information collaboration software tax incentives.



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R&D grants

Japan offers many different grants for R&D across a wide range of fields. For example, the Small Business Innovation Research (SBIR) program encompasses cash grants from several government ministries (e.g., internal affairs and communications (for strategic IT development); education, culture, sports, science, and technology (for the development of medical equipment); health, labor, and welfare (for the development of self-support equipment for disabled persons); agriculture, forestry, and fisheries (for the development of IT technologies for cultivation); economy, trade, and industry (for the development of robots for practical uses); land, infrastructure, transport, and tourism (for the development of construction technology); and environment (for the development of CO2 reduction technologies)).

Investment Incentives

Special depreciation/tax credit for revitalization of local economies

Tax incentives are available to encourage the revitalization of regional economies through the relocation of head office functions from large cities to local regions, and the expansion of head office functions at existing regional facilities. Special depreciation of 25% of the acquisition cost of buildings may be available in the case of relocation, and 15% in the case of expansion. Alternatively, a tax credit (capped at 20% of the national corporate tax liability) may be taken for 7% of the acquisition costs in the case of relocation, and 4% of the acquisition costs in the case of expansion. In both cases, the minimum investment amounts are JPY 20 million (JPY 10 million for certain SMEs). In addition, a tax credit of JPY 300,000 per new employee is available if employees increase at head office functions in local regions. A 10% discount on real property acquisition tax also is available.

Special depreciation/tax credit in national strategic special zones

Special depreciation or a tax credit may be available for acquisitions of eligible assets in designated national strategic special zones.

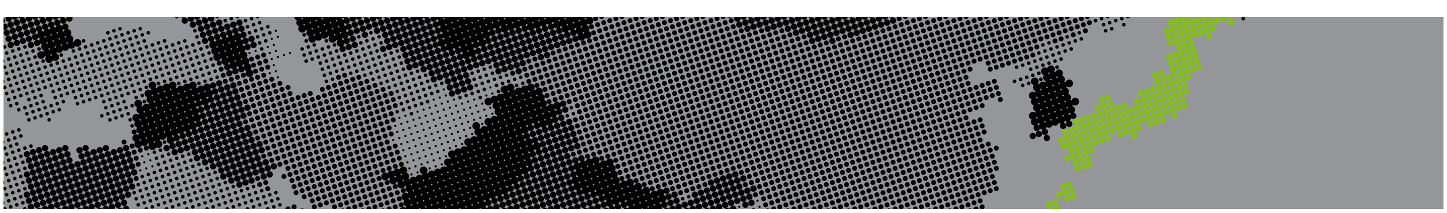
Special depreciation depends on the type of asset acquired: 23% for buildings and structures and 45% for machinery and R&D equipment/fixtures used in specified businesses within zones conducive to international competitiveness, or the formation of hubs for international business, if the assets are acquired from 1 April 2019 through 31 March 2022. Alternatively, a tax credit (capped at 20% of the national corporate tax liability) may be taken for 7% of the acquisition costs of buildings and structures and 14% for the costs of machinery and R&D equipment/fixtures used in specified businesses if the assets are acquired in the above period. To qualify for special depreciation or the tax credit, the eligible assets must be detailed in an approved business plan and exceed certain minimum acquisition amounts. The incentives are for assets acquired and put into use before 31 March 2022.

Job creation tax credit

To encourage companies to increase headcount in local regions, a credit of up to JPY 900,000 for each new employee hired generally is available where the following conditions are satisfied, and the company is not engaged in certain restricted businesses:

- There is at least a 5% increase in the number of employees (at least two new employees) in the current year as compared to the prior year in connection with moving the office from Tokyo to a local region (an 8% increase is required for expanding the local office);
- Current year total salary is greater than the prior year total salary (with certain adjustments);
- No employees have been made redundant during the current and prior years; and
- Authorization is obtained from governors on the plan to improve offices in local regions.

The amount of the credit is capped at 20% of the national corporate tax and is available for years beginning on or after 1 April 2018 to 31 March 2022.



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Salary increase tax credit

A tax credit is available to companies that increase salaries (and capital investment for large companies) and meet certain requirements. The creditable amount for large companies is 15% of the increase in current year salary from the prior year. There is an extra tax credit of 5% of the increase in the current year salary over the previous year's salary provided the amount of training costs is greater than the average of the two preceding years by at least 20%. The credit is capped at 20% of the national corporate tax.

The creditable amount for SMEs is 15% of the increase in the current year salary from the prior year. There is an extra tax credit of 10% of the increase in the current year salary over the previous year's salary provided (i) the current year salary is greater than the prior year salary by at least 2.5%; and (ii) either training costs increase from the prior year by at least 10% or the SME has a certified business enhancement plan. The credit is capped at 20% of the national corporate tax. The requirements are as follows:

- The percentage increase in the current year total salary compared to the prior year is at least 3% (1.5% for SMEs);
- The current year salary is greater than the prior year's salary; and
- For large companies, the amount of the domestic capital investment is greater than or equal to 95% of the total depreciation costs in the current year.

The credit is available for years commencing between 1 April 2018 and 31 March 2021.

Special depreciation/tax credit on energy saving facilities

Special depreciation or a tax credit may be available for acquisitions of energy saving facilities. Facilities qualifying for these tax incentives include renewable energy facilities (biomass, geothermal, hydroelectric power, etc.) with detailed functional requirements and depend on the type of certified company. Facilities for solar and wind power generally do not qualify for the tax incentives. Special depreciation of 20% of the acquisition cost of qualifying assets is allowed (the special depreciation rate is 14% on facilities acquired on or after 1 April 2020). Alternatively, SMEs may claim a tax credit of 7% of the acquisition cost (capped at 20% of the national corporate tax liability).

The incentives are available for purchases made on or after 1 April 2018 to 31 March 2022.

Special deduction for promotion of open innovation

Blue form taxpayers meeting certain requirements and engaging (or expecting to engage) in certain specified business activities (e.g., those with high productivity, etc.) are allowed a deduction of 25% of the acquisition cost of capital investments in the specified shares of certain venture companies. The total investment cost must be JPY 100 million or more (JPY 500 million or more for foreign company investments) for large companies and JPY 10 million or more for SMEs. Additionally, the taxpayer must hold the venture company shares for a certain period, or risk having to reverse all or a portion of the deduction and add the amount back to its taxable income.

Special depreciation/tax credit for 5G communication systems

A law enacted as part of the 2020 tax reform promotes the use of 5G mobile communications systems by allowing a 15% tax credit or 30% special depreciation on capital investments in such systems by certified mobile network operators, where the systems are acquired and used for domestic businesses between the effective date of the law and 31 March 2022. Local tax incentives also apply.