Deloitte.
デロイト トーマツ

Japan Tax & Legal Inbound Newsletter

2021 Tax Reform Proposals - Announced

25 December 2020, No.64

In Brief

On 10 December 2020, proposals for the 2021 tax reform were announced by the Liberal Democratic Party ("LDP") and the New Komeito Party and were posted on the LDP's website. (Japanese / PDF)

With the background of economic recovery from COVID-19, this year's proposals include the establishment of tax incentives for investments in digital and green technologies, both areas of focus which the Japanese government has identified going forward. In addition, R&D tax credits, tax administrative procedures, and certain financial industry related provisions, among others, will be amended.

This newsletter highlights some of the key items that may affect foreign headquartered companies doing business and individuals residing in Japan. It should be emphasized that these proposals have not been enacted and could change prior to becoming law.

TABLE OF CONTENTS

1. Corporate Tax 2
(1) Establishment of tax incentives for investments in digital transformation ... 2
(2) Establishment of tax incentives for investments in becoming carbon neutral ... 3
(3) Temporary removal of limitations on NOL utilization ... 4
(4) Revision of R&D tax credits ... 5
(5) Revision of tax credits for wage and investment increases ... 6
(6) Extension of disallowance of R&D and certain other tax incentives for large companies by three years ... 6
(7) Relaxation of requirements on deductibility of certain profit-linked director compensation to promote Japan as a financial hub ... 7
(8) Introduction of the tax provisions for promoting newly introduced share acquisition regime using equity considerations under the revised Companies Act ... 8

2. International Tax 10
(1) Revisions to earnings stripping rules ... 10
(2) Revision of calculation of non-deductible interest on debt allocable to a Japanese permanent establishment 10

3. Consumption Tax 10
(1) Integrated resorts related taxation ... 10

4. Individual Income Tax 10
(1) Preferential measure & Re-examination of credit limitation on housing loan credit ... 10
(2) Tax exemptions to aid child-rearing ... 11
(3) Tightened measure of taxation on retirement income ... 11
(4) Additional tax settlement obligation from mutual legal assistance borne on recipients of overseas assets without compensation ... 11
(5) Clarifying taxation of carried interest on partnerships ... 11

(6) Integrated resorts related taxation 12

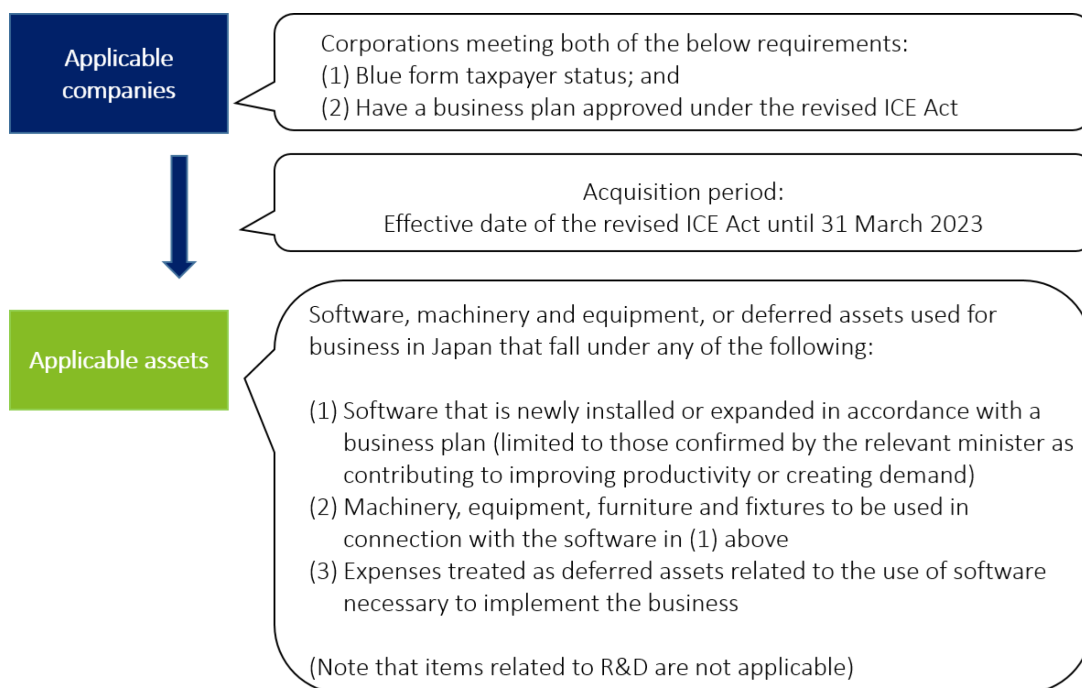
5. Inheritance Tax 12
(1) Exemption on overseas assets transferred to foreigners residing in Japan 12

6. Tax administration 13
(1) Amendments to the obligation to affix seals in tax-related documents 13
(2) Amendments to the electronic preservation system for books and records 13
(3) Expansion of the tax representative system 15

1. Corporate Tax

(1) Establishment of tax incentives for investments in digital transformation

Tax incentives will be established for the acquisition of cloud-based systems to create new demand and improve productivity through the development of new products, and/or the introduction of new production/sales methods. Applicable corporations that qualify for the incentives may choose to take either special depreciation of 30% or a tax credit of 3% (5% if data is linked to external party) of the cost of applicable assets acquired based on a plan certified under the revised Industrial Competitiveness Enhancement Act (the " ICE Act"). The illustration below details the types of corporations and assets eligible for the incentives.

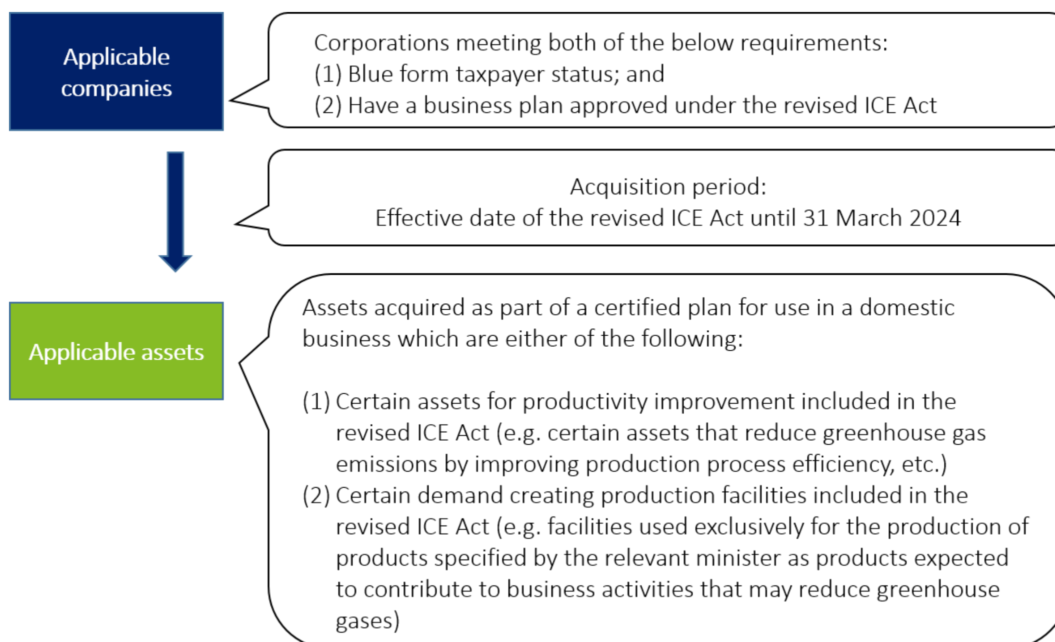


For applicable companies identified above, the details of the incentives offered under this system are as follows:

Incentives available	① Special depreciation of 30%, or tax credit of 3%*, of acquisition cost of applicable assets ② Special depreciation of 30%, or tax credit of 3%*, of deferred asset amount * 5% if data is linked to party outside the group
Acquisition limit	Total value of assets (including deferred assets) up to JPY 30 billion
Credit limit	20% of corporate tax (total combined sum of this credit and tax credit for becoming carbon neutral as described in (2) below)

(2) Establishment of tax incentives for investments in becoming carbon neutral

In order to achieve the goal of carbon neutrality by 2050, tax incentives will be established for investments in assets that make production processes carbon neutral and in assets for manufacturing carbon neutral products. Applicable corporations that qualify for the incentives may choose to take either special depreciation of 50% or a tax credit of 5% (10% for certain assets that significantly contribute to the reduction of greenhouse gases) of the acquisition cost of such assets, if acquired based on a plan certified under the revised ICE Act. The illustration below details the types of corporations and assets eligible for the incentives.



For applicable companies identified above, the details of the incentives offered under this system are as follows:

Incentives available	Special depreciation of 50%, or tax credit of 5%*, of acquisition cost of applicable assets * 10% for assets which significantly contribute to the reduction of greenhouse gases
Acquisition limit	Total value of assets up to JPY 50 billion
Credit limit	20% of corporate tax (total combined sum of this credit and tax credit for digital transformation as described in (1) above)

Deloitte's view

As companies continue to adapt to the new environment created by COVID-19, this year's tax reforms may offer certain opportunities. In particular, companies moving towards a more digital workplace, and planning to invest in internal software to achieve such goal, may find tax relief under the new incentive system for investments in digital transformation. However, proper planning should be done in order to ensure that the requirements are met.

Further, the new tax incentives for investments in becoming carbon neutral are a positive sign that Japan is taking its commitments to environment seriously. The special depreciation or tax credits available under this system are larger in scale than certain other incentives, and although the credit limit for both investments in digital transformation and in carbon neutrality are combined, this now gives companies added motivation to move towards greener technologies.

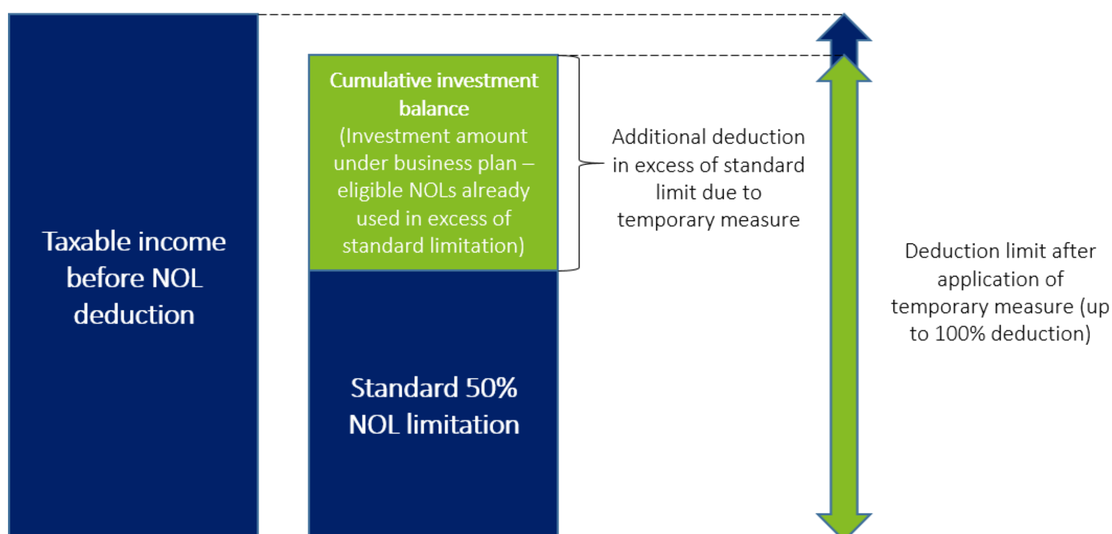
(3) Temporary removal of limitations on NOL utilization

For companies with an approved business plan and engaging in a range of certain investments, such as those in digital transformation and carbon neutrality, the limitation on the utilization of net operating losses ("NOLs") arising during a period affected by COVID-19 will be temporarily lifted to allow the utilization of NOLs to offset up to 100% of taxable income for a certain period.[1] The limitation on NOL utilization will be removed in accordance with the following requirements for eligibility:

Applicable corporations	Corporations are eligible for the incentive if they meet the following requirements: 1. Blue form taxpayer; 2. Receive certification of a plan under the revised ICE Act within one year after the effective date of the revised ICE Act; and 3. The plan is implemented by a certified business under the revised ICE Act (limited to corporations meeting certain standards)
Eligible NOLs	NOLs generated in tax years which include any date during the period from 1 April 2020 to 1 April 2021 (or in certain cases, tax years ending between 1 February 2020 and 31 March 2020 or the following tax year)
Applicable fiscal year	An applicable fiscal year is a fiscal year: 1. Starting within 5 years from the beginning of the "base year" (the first fiscal year in which income arises after a fiscal year in which eligible NOLs are generated) 2. Included in the certified plan 3. Beginning before 1 April 2026

Note that some limitation on the utilization of NOLs may still apply, as the amount of NOL that can be used to offset taxable income in a given year is limited to the "cumulative investment balance" (i.e., the difference in the amount of investment made in accordance with the certified plan and the amount of eligible NOLs already used to offset taxable income in excess of the normal 50% limitation).

[1] Under the current system, corporations filing blue form tax returns are permitted to carryforward unused NOLs for up to 10 years and use them to offset taxable income in future periods. The amount of NOLs that can be used to offset taxable income in a given year is generally limited to 50% (100% for certain small and medium-sized enterprises and newly established corporations) of taxable income in said year.



Deloitte's view

While the potential for expanded use of NOLs beyond the standard limitations is an attractive proposition, its applicability may be limited due to the narrow scope of eligibility. Nevertheless, for companies negatively impacted by COVID-19, and which show a commitment to change by investing in new technologies, this may offer yet another opportunity for tax relief.

(4) Revision of R&D tax credits

The credit rates and credit limits will be amended for ordinary corporations as follows:

	Current			Proposed		
	R&D cost increase (%)	Tax credit (% of R&D costs)	Range	R&D cost increase (%)	Tax credit (% of R&D costs)	Range
Credit rate (%)	≦8%	9.9% - (8% - % of increased R&D costs) x 0.175	At least 6%	**≦9.4%**	**10.145%** - (**9.4%** - % of increased R&D costs) x 0.175	**At least 2%**
	>8%	9.9% + (% of increased R&D costs – 8%) x 0.3	Up to 10% (up to 14%)	**>9.4%**	**10.145%** + (% of increased R&D costs – **9.4%**) x **0.35**	Up to 10% (up to 14%)
	If R&D costs exceed 10% of the average revenue, the following rate will be added to the rate calculated above: Above rate x (R&D costs / average revenue – 10%) x 0.5 (up to 10%)			If R&D costs exceed 10% of average revenue, the following rate will be added to the rate calculated above:. Above rate x (R&D costs / average revenue – 10%) x 0.5 (up to 10%)		
Credit limit	25% of corporate tax for the current fiscal year, however will be raised to 40% for certain venture companies ("certain venture companies" for these purposes are venture companies established within the last ten years which have NOL carryforwards for the current fiscal year – other than subsidiaries of large corporations) In addition, if R&D costs exceed 10% of average revenue, the following is available: (R&D costs/average revenue – 10%) x 2 (up to 10%)			25% of corporate tax for the current fiscal year, however: ■ 40% for certain venture companies (same as current) ■ **30% for non-venture companies with**: 1. A decrease in sales ratio compared to the "base year" (i.e., the last business year ending before 1 February 2020) of 2% or more, and 2. Current year R&D expenses greater than R&D expenses in the base year		

In addition to the credit rates and limits, the scope of R&D costs eligible for the tax credits will also be amended as follows:

Item	Revisions

Additions to the scope of eligible R&D expenses	R&D expenses recorded as expenses and included in the acquisition cost of assets for non-R&D purposes, and as a result R&D costs constituting the acquisition cost of internal-use software will be added to the scope of eligible expenses. (Note 1) The term "non-R&D assets" as used above means inventories, fixed assets and deferred assets not used for R&D purposes when placed into service. (Note 2) In accordance with the above, depreciation, transfer losses, and disposal losses of non-R&D assets whose cost of sales and acquisition value include amounts recorded as losses for R&D expenses will be excluded from the eligible scope, and with regard to non-R&D assets whose acquisition value includes amounts recorded as losses for R&D expenses, the taxpayer may choose to apply either R&D credit or special depreciation.
Exclusions from eligible R&D expenses	Costs related to reverse engineering (e.g. costs that do not fall under the category of R&D expenses to obtain new knowledge, or to develop new applications for available knowledge) are excluded.
Clarification of identifying parties involved in joint research	In cases where a company conducts trials of a technology under development, even if the technology contributes to the improvement of the company's business, if the R&D is related to engineering or natural science, the expenses required would be eligible R&D expenses.

(5) Revision of tax credits for wage and investment increases

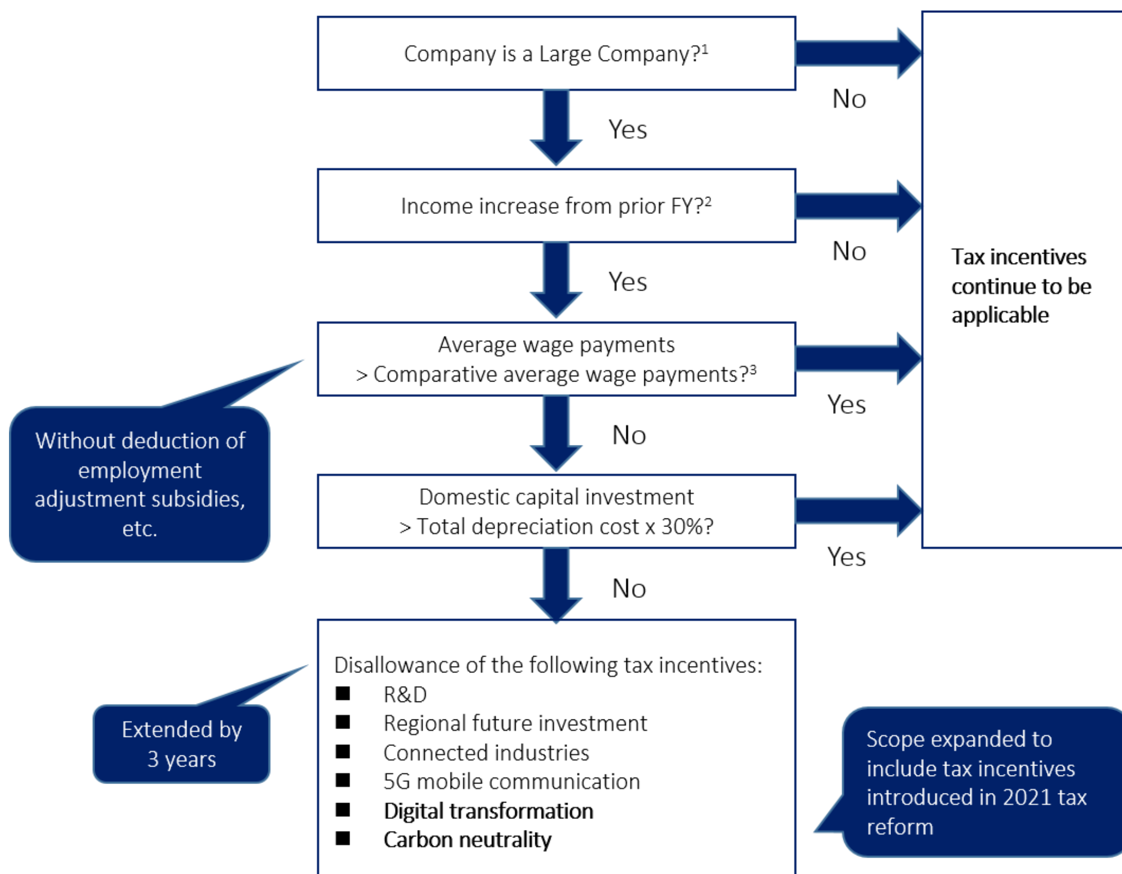
The tax incentives for promoting wage and investment increases for large companies will be revised to allow corporations which have increased salaries for certain new hires or increased training costs in Japan from fiscal years beginning 1 April 2021 to 31 March 2023 to be eligible for the tax credit. The details of the relevant revisions are as follows:

		Current	Proposed
Requirements	(1) Wage requirements	1) Salaries and remuneration paid increases compared to the previous fiscal year 2) Salaries and remuneration paid to workers employed for a continuous period increases by 3% or more from the previous fiscal year	1) Salaries and remuneration paid increases compared to the previous fiscal year 2) Salaries and remuneration **paid to certain new employees** (within one year from the date of employment) increases by **2%** or more from the previous fiscal year
	(2) Domestic capital investment requirement	Gross domestic investment ≧ Depreciation × 95%	Abolished
	(3) Education and training requirements (For additional tax credit)	Education and training expenses increase by 20% or more compared to the average amount of education and training expenses for the previous two fiscal years	Educational and training expenses increase by 20% or more compared to the average amount of educational and training expenses for the **previous fiscal year**
Credit	If requirements (1) and (2) are met	(Salaries paid – Salaries paid in the previous fiscal year) x 15%	**Certain salaries paid to new employees** x 15%
	If the applicable requirements (1), (2) and (3) are met:	(Salaries paid – Salaries paid in the previous fiscal year) x 20%	**Certain salaries paid to new employees** x **20%**
	Credit limit	20% of taxable income for the year	
Applicable corporations		Corporations filing blue for tax returns (not applicable for newly estaiblished corporations)	

(6) Extension of disallowance of R&D and certain other tax incentives for large companies by three years

The tax credits for promoting investment in digital transformation and carbon neutrality will be added to the scope of disallowed tax credits if additional requirements are not satisfied, and the applicability of disallowances for large companies, which was set to expire on 31 March 2021, will be extended by three years.

The objective tests to determine eligibility for the tax incentives is outlined in the below flowchart:



Notes:

[1] A company is generally a large company for this purpose if any of the following is met:

- Stated capital is over JPY100 million
- 50% or more of its shares are owned by a company with stated capital of over JPY100 million
- Two thirds or more of its shares are owned by two or more companies with stated capital over JPY100 million;
- 100% controlled by a company with stated capital of JPY500 million or more;
- Within a 100% group in which issued shares or capital is wholly owned by more than one company with stated capital of JPY500 million or more; or
- Its average profit for the last three fiscal years is over JPY1.5 billion (for fiscal years beginning on or after 1 April 2019)

[2] This is profit before the utilization of NOLs carried forward and after certain adjustments

[3] If continuously employed employees, which is the basis for calculation “average wage payments” and “comparative average wage payments”, do not exist, this condition is deemed to be met.

(7) Relaxation of requirements on deductibility of certain profit-linked director compensation to promote Japan as a financial hub

One of the conditions under the current regime for profit-linked director compensation requires disclosure of the calculation method, etc. in an annual securities report, but for some companies that do not prepare annual securities reports in Japan (e.g., unlisted investment firms, etc.), they would be unable to satisfy such requirements. Under the proposed revisions, profit-linked compensation paid to directors of certain investment firms may still be deductible if certain conditions are met.

To be eligible for the new provision, a corporation must file blue form tax returns and qualify as a "special investment manager.[2]" Additional requirements include that profit-linked compensation paid to directors (limited to objective compensation based on indicators related to profits generated from investment transactions) during each fiscal year beginning in the period from 1 April 2021 to 31 March 2026 must be pre-approved by investors[3], and the calculation method (along with certain other required information) regarding the compensation must be disclosed on the Financial Services Agency website without delay after the day on which the compensation committee determines the calculation method, etc.

Deloitte's view

Japan has made clear its intention to promote itself as a financial hub in Asia and this year's tax reforms are evidence of some initial progress. The ability for certain profit-linked compensation paid to directors of financial firms, without the requirement of a published securities report, is a small step in leveling the playing field for certain investment companies, and where applicable such taxpayers should look into compensation schemes which may offer deductibility under these new rules. However, in order to compete with the likes of Hong Kong and Singapore in terms of attracting global talent in the financial industry, Japan will require more expansive changes in the upcoming years, which gives good reason to keep an eye on potential opportunities in future tax reforms.

(8) Introduction of the tax provisions for promoting newly introduced share acquisition regime using equity considerations under the revised Companies Act

As per the revised Companies Act published in December 2019, *"Kabushiki-Koufu" was* newly introduced and it will be effective on and after 1 March 2021. *"Kabushiki-Koufu"* is defined as the delivery of own shares by a *Kabushiki-Kaisha* (the "KK") in exchange for the acquisition of shares of another KK with a view to making such another KK a subsidiary of the KK.

Aligning with the revision of the Companies Act, existing tax-deferral regimes available for shareholders of the target with respect to the share acquisition using equity consideration under the ICE Act will be reorganized as follows.

	Current	Proposed
Main requirement	Approval of special business restructuring plan pursuant to the ICE Act	Acquisition by way of *"Kabushiki-Koufu"* pursuant to the revised Companies Act.
Consideration	Limited to shares in a corporate buyer	Assets other than shares in Buyer Co (the "Boot") is allowed up to 20% of the value of consideration

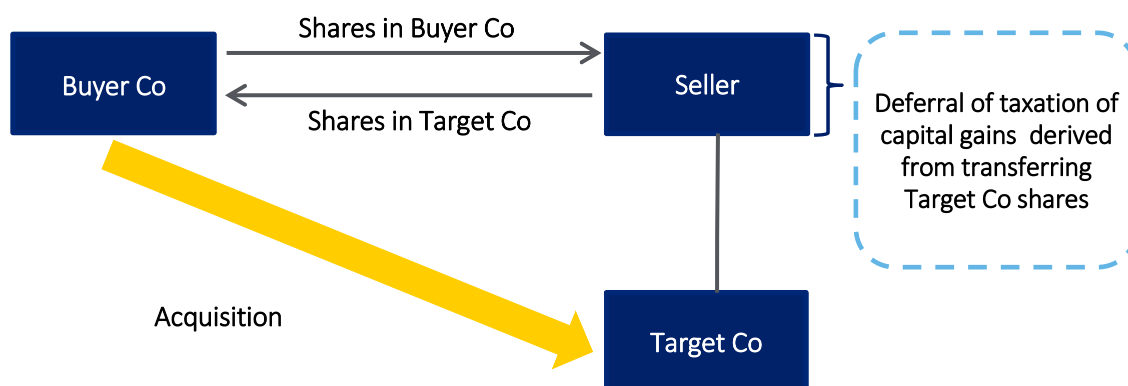
[2] For purposes of the revisions, a "special investment manager" is a corporation (excluding companies submitting an annual securities report and their wholly owned subsidiaries) whose ratio of total profits from certain specially permitted businesses to total profits for the current year is 75% or more.

[3] To be eligible under the amendment, pre-approval by investors must meet one of the following requirements:

1. Provisions stating that the profit-linked compensation will be paid and its method for calculation must be included in the fund contract, etc.
2. Prior to the start of the fiscal year in which the provision will apply, the payment of the profit-linked compensation and its calculation method is reported at a meeting of the investment firm's members pertaining to the investment of assets, and there is no record in the meeting minutes of any members' objection to the report.

1) Tax-deferral on capital gains arising from the transfer of Target Co shares by Sellers

Capital gains on shares transferred by a seller (the "Seller") will be deferred if the Seller transfers its shares in a Japanese KK (the "Target Co") in exchange for shares in another Japanese KK (the "Buyer Co") by way of *"Kabushiki-Koufu"* pursuant to the revised Companies Act.



2) Taxation on Boot received by Sellers

- The value of shares in Buyer Co must account for 80% or more of the entire value of assets received as consideration in exchange for shares in Target Co to apply for the tax-deferral regime at Seller.
- When the seller receives Boot, capital gains deferral on Target Co shares will only be applicable to the portion of such gains allocable to the Buyer Co shares received, provided that the above condition for value ratio is satisfied.

3) Attachments

Buyer Co will be required to attach certain documents relating to the *"Kabushiki-Koufu"* to its corporate income tax return.

4) Application to foreign corporation

Where the Seller is a foreign corporation, tax-deferral is only applicable to the portion of capital gains on Target Co shares held and managed by its permanent establishment in Japan.

Deloitte's view

In 2019, the Companies Act has introduced the *Kabushiki-Koufu* as a permanent measure allowing the use of buyer's shares as part of the consideration in M&A situations, which provided flexibility for acquisitions of less than 100% shares of the Japanese target company. This new regime should provide more opportunities in M&A transactions, improve cash efficiency of growing companies, in particular, in its start-up phase, and provide to the seller the benefit of enjoying synergies between target company and the buyer company.

In order to promote the *Kabushiki-Koufu,* tax-deferrals in the hands of the sellers are critical because (i) sellers may not have enough cash to make tax payment and (ii) the withholding tax obligor may not have sufficient funds to withhold taxes in case shares are delivered to individual sellers who elected to pay tax through a withholding system for shares held in specific investment account. The 2021 tax reform is expected to address these issues inherent in newly established *Kabushiki-Koufu* regime.

However, there are still issues though regarding this new rule under the Companies Act which potentially needs to be resolved in order the *Kabushiki-Koufu* to be widely recognized and utilized as an effective M&A option. These include, for example, that the *Kabushiki-Koufu* cannot be used for non-Japan target companies nor for existing subsidiaries in which the buyer already holds more than 50% of the shares.

2. International Tax

(1) Revisions to earnings stripping rules

The scope of interest payments subject to earnings stripping rules will be amended to exclude the below interest related to insurance policies:

- Expected interest to be transferred to an insurance premium reserve under life insurance or casualty (non-life) insurance policies
- Expected interest to be transferred to a refund reserve under casualty (non-life) insurance policies

Further, interest income from bond investment trusts will be added to the scope of interest income for purposes of calculating net interest expense.

(2) Revision of calculation of non-deductible interest on debt allocable to a Japanese permanent establishment

The interest used in calculating non-deductible interest on debt attributed to a Japanese permanent establishment of a foreign company for thin capitalization and earnings stripping purposes will be expanded to include "other financing" related to the interest.

3. Consumption Tax

(1) Integrated resorts related taxation

The sales related to the casino is out of scope for Japanese Consumption Tax. Generally, the input credit for taxable purchases for the business relating to casino is restricted with certain exceptions.

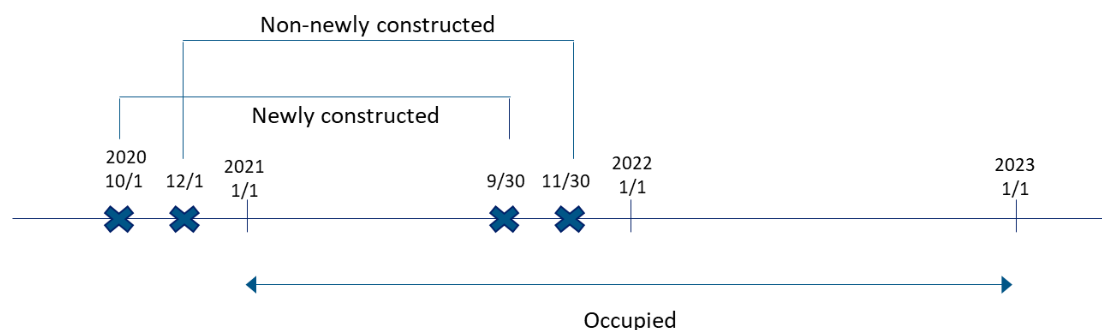
4. Individual Income Tax

(1) Preferential measure & Re-examination of credit limitation on housing loan credit

<u>Preferential measure</u>
Individuals who meet the following requirements on their mortgage contracts can apply preferential measures to extend their tax credit period to 13 years:

- 10% consumption tax was applied on purchased property
- Physically began living in purchased property between 1 January 2021 and 31 December 2022
- Contract is entered either between 1 October 2020 and 30 September 2021 (if the property is newly constructed), or between 1 December 2020 and 20 November 2021 (if the property had previously not been in use since its original construction, is second-hand, or is already in residential use that will undergo renovation/expansion).

Aforementioned requirements can be illustrated in a diagram as follows:



This preferential measure also applies to housing with surface area between 40 and $50m^2$. However, during the extended 13-year credit period, this credit cannot be applied during the tax year when taxable income exceeds JPY 10,000,000.

Applying pre-existing rules, any amount that exceeds the credit limitation to deduct national taxes will be carried over to deduct the following year's local taxes subject to a certain limitation (i.e. no change as in the past in this respect).

Re-examination of credit limitation

Discussions are underway to revise 2022 tax law to consider adjusting the current credit limitation (currently 1% of year-end mortgage balance). Since individuals can currently enter into a mortgage contract at annual interest rates below 1%, future credit limitation may be adjusted (i.e. decrease limitation and lower creditable amount) to reflect this situation under the current economy.

(2) Tax exemptions to aid child-rearing

Currently, government-sponsored (both national and municipal) child-rearing expenses such as fees related to baby-sitting and day-care facilities are considered taxable. To reduce the financial burden on households from child-rearing, discussions are ongoing to exempt such expenses from individuals' income and local inhabitants' taxes.

(3) Tightened measure of taxation on retirement income

Considering the nature of retirement income as a lump-sum payment made as a result of long-term performance, this income paid to individuals for employment period lasting five years or less cannot apply preferential tax treatment on amounts exceeding JPY 3,000,000 effective 2022.

A sample calculation considering an individual receiving JPY 10,000,000 for employment period of 4 years is as follows (*retirement income deduction = JPY 400,000 multiplied by 4 years = JPY 1,600,000):

Retired by 31 December 2021	Retired from 1 January 2022
(10,000,000 – 1,600,000(*)) x 1/2 = 4,200,000	(10,000,000 – 1,600,000(*) – 3,000,000) + 3,000,000 x 1/2 = 6,900,000

(4) Additional tax settlement obligation from mutual legal assistance borne on recipients of overseas assets without compensation

Even though taxes have been collected by other participating country based on the Convention on Mutual Administrative Assistance in Tax Matters, there might still be outstanding tax dues levied by Japan. In such cases, if the outstanding tax dues have arisen from the transfer of overseas assets for free of charge one year prior to the statutory due date for national tax, the recipient of the assets will owe the tax payment obligation on behalf of the taxpayer. This law is effective on outstanding tax dues that have become overdue after 1 January 2022 (excluding cases related to transfers made before this date).

(5) Clarifying taxation of carried interest on partnerships

Discussions are ongoing in an attempt to clarify proper treatment of taxes on fund managers' carried interests that are distributed through partnerships. If certain conditions (e.g. deemed economically reasonable based on the distribution ratio) are met, an argument is made that this income should not be taxed aggregately as compensation for service, but separately as capital gain income based on shares.

(6) Integrated resorts related taxation

To maintain international competitiveness among the integrated resorts industry, ongoing discussions are made to exempt taxes on casino-related income generated by Japan tax non-residents. Japan tax residents will continually be taxed on this income in a similar manner as income earned from pre-existing gambling activities in the country. This will be detailed following tax reforms following 2022.

Deloitte's view

Performance-linked income such as carried interest earned by foreign fund managers will be taxed preferentially at separate, rather than aggregate tax rates. We welcome this change as this consideration is made in an attempt to both attract highly-skilled talent from overseas, and also to create an environment where foreigners can tax-effectively carry out investment activities in Japan.

Moreover, the taxation mechanism of retirement income has been tightened to counteract excessive cost saving measures adopted by certain companies (including foreign) that are not in line with the original intention of preferential treatment for retirement income. Such responses point to the tax reform's attempt to achieving a balance between promotion of foreign investment activities and appropriate taxation.

5. Inheritance Tax

(1) Exemption on overseas assets transferred to foreigners residing in Japan

Just as we recently discussed here, in an attempt to turn Tokyo into an international financial center the Japanese government has implemented tax measures to attract the high-earning employees of foreign financial firms. One of the areas of concern was Japan's high-level of inheritance tax that would be levied on both the domestic and foreign assets tax residents who have resided in Japan for more than 10 years.

Specifically in the tax reform states that long-term foreign residents who have lived in Japan for over 10 years whose estates are currently subject to inheritance tax on both domestic and foreign assets, will be exempted from inheritance tax and gift tax on their foreign assets acquired by or gifted to an heir who themselves are a foreign national residing outside of Japan or a foreign national residing in Japan for a short period of time, regardless of the period of residence.

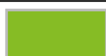
Although the updated inheritance tax and gift tax measures were outlined in the tax reform document under the section title 'Tax Measures for the International Financial City' it is not immediately clear if the inheritance measures are targeted only at those long-term foreign residents who work specifically in the financial services sector or if it covers all long-term foreign tax residents because elsewhere in the tax reform release it states that "from the perspective of promoting the employment, etc. of highly skilled foreign human resources in Japan, inheritance, etc. of foreign nationals residing in Japan for the purpose of employment, etc. shall not be subject to inheritance tax, etc. (page 4)".

Also, at this time a "short period of time" is not defined with regards to the period of exemption.

Based on our current understanding of the 2021 tax reform, we do not see any immediate change to Table 1 below. However, rule ※1 will likely be updated upon ascension of the 2021 tax reform to take account of the fact that heir who has acquired the estate of residents who have resided in Japan for more than 10 years will only be subject to inheritance tax only on the assets acquired domestically during the donor's period of residency.

Table 1. Scope of inheritance tax and gift tax from FY 2018 and FY 2021 tax reforms

Donor \ Recipient		Domestically domiciled		No domestic address		
			Temporary resident (※ 1)	Has Japanese nationality		Other nationality
				Has had an address within 10 years.	No address within 10 years	
Domestic domiciled						
	Temporary resident gift (※ 1)					
No domestic address	You have an address within 10 years.					
	Non-Japanese long-term residents (※ 2) Temporary visitor (※ 3)					
	No address within 10 years					

 Taxation on both domestic and foreign assets Taxation on domestic property only

(※ 1) A person who is staying in Japan under the status of residence listed in Appended Table 1 of the Immigration Control Act and who has lived in Japan for not more than 10 years within 15 years before the grant.
(※ 2) A foreign national who has been domiciled in Japan within the past 15 years before departure for a total period of more than 10 years and for whom 2 years have elapsed since departure (only for gift tax).
(※ 3) An alien who has been domiciled in Japan within 15 years prior to his/her departure for a total of 10 years or less (only for gift tax).

Deloitte's view

It is often reported by the Japanese media that Japan's inheritance tax rules have prevented high-earning and highly skilled foreign workers from staying in Japan over the long-term and so the updated inheritance tax rules for foreign tax residents are certainly a push in the right direction to attract and retain highly skilled foreign workers. This is certainly relevant for the high-earning executives of financial service firms such as investment banks and asset managers.

6. Tax administration

(1) Amendments to the obligation to affix seals in tax-related documents

For national and local tax documents that normally require the seal of the submitter to be affixed, the seal will no longer be required for documents submitted on or after 1 April 2021 except for the following documents.

- Certain documents for collateral and payment in kind, which require the affixing of a registered seal and the attachment of a seal registration certificate
- Certain documents concerning consultation on division of property under the special provisions for inheritance tax and gift tax

Given the purpose of this amendment, national tax documents (which will not require a seal under this provision) will be accepted even before the effective date.

(2) Amendments to the electronic preservation system for books and records

Approximately 20 years have passed since the establishment of the electronic book preservation system, and the information and communications technology environment in the economy and society is undergone major changes. In order to contribute to the improvement of productivity through the computerization of accounting, the promotion of telework, and the improvement of bookkeeping standards through the use of cloud accounting software, etc., bold easing of requirements will be made to the system, such as the abolishment of the prior approval system, and measures will be taken to prevent the falsification of electronic data.

<table>
<tr><th></th><th colspan="2">Type of Documents, etc.</th><th>Current</th><th>Proposed</th></tr>
<tr><td>Books related to national tax</td><td colspan="2">General ledger, cash book, accounts receivable ledger, accounts payable ledger, etc.</td><td>▪ Approval of the commissioner of the disignated tax office is required
▪ Applications and attachments due no later than three months prior to the date the system will be applied</td><td rowspan="2">▪ Abolish approval system
▪ Amend requirements for electronic preservation of books and records
▪ Reduce penalty for understatement of tax liability</td></tr>
<tr><td rowspan="3">Records related to national tax</td><td rowspan="3">Financial statemetns, business documents (Contracts, receipts, invoices, acceptance documents, etc.)</td><td>Self created documents</td><td>▪ Approval of the commissioner of the designated tax office is required</td></tr>
<tr><td>Documents received from other parties</td><td>▪ Applications and attachments due no later than three months prior to the date the system will be applied</td><td>▪ Abolish approval system
▪ Relax timestamp requirements
▪ Eliminate requirements for administrative processing
▪ Relax search requirements</td></tr>
<tr><td>Electronic transaction records</td><td>▪ Approval not required (records must be preserved)</td><td>▪ Relax timestamp requirements
▪ Relax search requirements</td></tr>
</table>

■ Amendment of elecontric preservation system for books and documents related to national tax

Requirements	Current	Proposed
Approval system	Applications due no later than three months prior to the date the system will be applied	Abolished
Preservation requirements for electronic transaction records	Confirmation at the time of application approval	Confirm company meets preservation requirements
Reduction of penalties for understatment of tax liability	N/A	Penalty for understatement of tax liablity reduced by 5% if certain conditions are met

■ Amendment of the scanner storage system for records related to national tax

<table>
<tr><th colspan="2">Requirements</th><th>Current</th><th>Proposed</th></tr>
<tr><td colspan="2">Approval system</td><td>Applications due no later than three months prior to the date the system will be applied</td><td>Abolished</td></tr>
<tr><td rowspan="3">Timestamp requirements</td><td>Grant period</td><td>Within 3 days</td><td>Within approx. 2 months</td></tr>
<tr><td>Signature of the recipient, etc.</td><td>Required</td><td>Not required</td></tr>
<tr><td>Time stamping</td><td>Required</td><td>Not required for certain cases</td></tr>
<tr><td colspan="2">Administrative processing requirements</td><td>• Mutual check
• Regular inspection
• Internal controls to prevent recurrence of issues</td><td>Abolished</td></tr>
</table>

Search requirements	Searchable items	• Transaction date • Account • Transaction amount • Other key items	• Transaction date • Transaction amount • Counter party
	Search function	Must be able to specify range and set conditions	Not required for certain cases

■ Amendment of electronic preservation system related to electronic transaction records

Requirements		Current	Proposed
Timestamp requirements	Grant period	Without delay upon receipt	Within approx. 2 months
Search requirements	Search item	• Transaction date • Account • Transaction amount • Other key items	• Transaction date • Transaction amount • Counter party
	Search function	Must be able to specify range and set conditions	Not required for certain cases

■ Measures to ensure proper preservation of electronic book and records

To ensure the appropriate preservation of electronic books and records, the heavy penalty tax will increase by 10% for taxpayers that conceal or disguise facts in the electronic records.

■ Effective date

The above revisions shall come into effect on 1 January 2022.

(3) Expansion of the tax representative system

To effectively administer tax audits against foreign entities/individuals without a base/domicile in Japan, the current appointment system of tax representatives will be expanded as follows (effective 1 January 2022):

- Requesting taxpayer to appoint a tax representative: If a certain taxpayer is determined to require one, but does not have a tax representative appointed, the commissioner of the designated tax office may request the taxpayer to appoint one within 60 days
- Requesting a facilitator to appoint oneself as a tax representative: If the taxpayer fails to appoint a tax representative per above request, the tax office may request a facilitator in Japan to appoint oneself as a tax representative
- Designating a facilitator to act as a tax representative: If neither the taxpayer nor the facilitator appoints a tax representative, the tax office may designate certain facilitator to act as one. The designated facilitator may be a relative (must be non-minor who has met legal age), affiliated company, or certain other persons depending on whether the taxpayer is an individual or a corporation

Deloitte's view

Allowing taxpayers to process, retain, and access tax documents efficiently has been a key concern of the authorities given the need to limit physical interactions among taxpayers and the tax authorities as a means to combat the current pandemic.

The abolishment of affix a seal on most tax documents should allow taxpayers to reduce processing times and transmit documents more efficiently.

Prior to the amendment related to the electronic preservation system, many taxpayers preferred to retain books and record electronically only, but the application process for approval was often a significant obstacle and without approval, taxpayers were required to retain certain books and records in hardcopy. The elimination of the application process should enable more taxpayers to appropriately retain electronic books and records without the requirement to also retain in hardcopy. However, specific requirements (e.g. ability to search) to be compliant with the system remain.

It is important that taxpayers understand the amendments and the remaining requirements accurately so that they can ensure their systems are either already compliant with the requirements or can modify their systems to become compliant.

Newsletter Archives

To see past newsletters, please visit our website. www.deloitte.com/jp/tax-legal-inbound-newsletter

Subscribe to Japan Tax & Legal Inbound Newsletter and tax@hand

To automatically receive future newsletters, please email japan_taxlegal_inbound@tohmatsu.co.jp and register by providing your name, company, position, and email address.
Click here to download our tax@hand app to view newsletters and other content on your mobile device.

Contacts

Deloitte Tohmatsu Tax & Legal Inbound Client Services Team
Not all facts and circumstances are covered in this newsletter. If you have any questions regarding your specific situation, please contact one of the tax professionals at our Deloitte office in Tokyo or visit our website www.deloitte.com/jp/tax-legal-inbound-services

Jun Sawada, Inbound Client Services Leader	
Business Tax Services	Sunie Oue, Partner
	David Bickle, Partner
Indirect Tax Services	Fumiko Mizoguchi, Partner
Global Employer Services	Russell Bird, Partner
Transfer Pricing	Timothy O'Brien, Partner
	Samuel Gordon, Partner
Tax Management Consulting	Sreeni Menon, Director
International Tax and M&A	Masato Iwajima, Partner
Financial Service Industry	Yang Ho Kim, Partner
	Kai Hielscher, Partner
Tax Controversy	Yutaka Kitamura, Partner
Legal	Kaori Oka, Partner
Immigration	Kumiko Kawai, Partner
Payroll and Social Benefits Processing	John Dorff, Partner
Family Consulting	Michael Tabart, Partner
email to japan_taxlegal_inbound@tohmatsu.co.jp	

Issued by

Deloitte Tohmatsu Tax Co.
Marunouchi-Nijubashi Building, 3-2-3 Marunouchi, Chiyoda-ku, Tokyo 100-8362, Japan
Tel: +81 3 6213 3800 email: tax.cs@tohmatsu.co.jp Corporate Info: www.deloitte.com/jp/en/tax

Deloitte Tohmatsu Group (Deloitte Japan) is a collective term that refers to Deloitte Tohmatsu LLC, which is the Member of Deloitte Asia Pacific Limited and of the Deloitte Network in Japan, and firms affiliated with Deloitte Tohmatsu LLC that include Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and Deloitte Tohmatsu Corporate Solutions LLC. Deloitte Tohmatsu Group is known as one of the largest professional services groups in Japan. Through the firms in the Group, Deloitte Tohmatsu Group provides audit & assurance, risk advisory, consulting, financial advisory, tax, legal and related services in accordance with applicable laws and regulations. With more than 10,000 professionals in over 30 cities throughout Japan, Deloitte Tohmatsu Group serves a number of clients including multinational enterprises and major Japanese businesses. For more information, please visit the Group's website at http://www.deloitte.com/jp/en.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organization"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.
Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which are separate and independent legal entities, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our global network of member firms and related entities in more than 150 countries and territories (collectively, the "Deloitte organization") serves four out of five Fortune Global 500®companies. Learn how Deloitte's approximately 312,000 people make an impact that matters at www.deloitte.com.

All of the contents of these materials are copyrighted by Deloitte Touche Tohmatsu Limited, its member firms, or their related entities including, but not limited to, Deloitte Tohmatsu Tax Co. (collectively, the "Deloitte Network") and may not be reprinted, duplicated, etc., without the prior written permission of the Deloitte Network under relevant copyright laws.
These materials describe only our general and current observations about a sample case in accordance with relevant tax laws and other effective authorities, and none of Deloitte Network is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. The opinions expressed in the materials represent the personal views of individual writers and do not represent the official views of Deloitte Network. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

Member of
Deloitte Touche Tohmatsu Limited

IS 669126 / ISO 27001

© 2020. For information, contact Deloitte Tohmatsu Tax Co.,DT Legal Japan, Deloitte Tohmatsu Immigration Co.