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Japan: Inbound Tax Alert

2016 Tax Reform Proposal

December 2015, No.15

On 16 December 2015, the Liberal Democratic Party and the New Komeito Party released the 2016 Tax Reform Proposals ("Proposals"). According to the Proposals, the Japanese government intends to further promote growth-oriented corporate tax reform by reducing the effective corporate tax rate to below 30%, specifically to 29.97% in 2016 and 29.74% in 2018. Also, there will be further expansion of factor-based enterprise tax and broadening of the tax base through the revision of depreciation system and other measures are proposed. Other notable proposals include provisions regarding transfer pricing documentation requirements based on OECD recommendations regarding the Action Plan on Base Erosion and Profit Shifting ("BEPS"). With regard to consumption tax, the tax rate will be raised to 10% and a multiple rate system under which a lower rate of 8% on foods and beverages will be implemented on 1 April 2017. Also, a qualified invoice system will be implemented on 1 April 2021.

This alert highlights several key proposals that may affect foreign companies doing business in Japan. It should be emphasized that these proposals have not been enacted yet and could change prior to becoming law.

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1. Corporate Tax

(1) Reduction of the national corporate tax rate

The corporate tax rate was reduced from 25.5% to 23.9% in the 2015 tax reform. The rate will be further reduced in stages in order to decrease the effective corporate tax rate to below 30% as part of efforts to promote the growth-oriented corporate tax reform:

Tax year	Corporate tax rate	Income levy of corporate enterprise tax*	Effective tax rate (standard)
	23.9%	6.0%	32.11%
Proposed: Tax years beginning on or after 1 April 2016	23.4%	3.6%	29.97%
Proposed: Tax years beginning on or after 1 April 2018	23.2%	3.6%	29.74%

(2) Revision of the NOL carryforward system

1) Revision of the limitation on the utilization of NOLs

The limitation on the utilization of net operating losses, disaster losses and consolidated NOLs (collectively "NOLs") was reduced from 80% to 65% in the 2015 tax reform, but will be further limited in the 2016 tax reform as follows:

<table>
<tr><th colspan="2">After 2015 tax reform</th><th colspan="2">Proposed revisions</th></tr>
<tr><th>Tax years beginning</th><th>Utilization limit</th><th>Tax years beginning</th><th>Utilization limit</th></tr>
<tr><td>Before 1 April 2015</td><td>80%</td><td>Before 1 April 2015</td><td>80%</td></tr>
<tr><td rowspan="2">From 1 April 2015 to 31 March 2017</td><td rowspan="2">65%</td><td>From 1 April 2015 to 31 March 2016</td><td>65%</td></tr>
<tr><td>From 1 April 2016 to 31 March 2017</td><td>60%</td></tr>
<tr><td rowspan="2">On or after 1 April 2017</td><td rowspan="2">50%</td><td>From 1 April 2017 to 31 March 2018</td><td>55%</td></tr>
<tr><td>On or after 1 April 2018</td><td>50%</td></tr>
</table>

2) Delay to the planned extension of the NOL carryforward period

The extension of the NOL carryforward period from nine years to ten years, which was determined in the 2015 tax reform, will be delayed for one year as follows:

<table>
<tr><th colspan="2">After 2015 tax reform</th><th colspan="2">Proposed revisions</th></tr>
<tr><th>Tax years beginning</th><th>Carryforward period</th><th>Tax years beginning</th><th>Carryforward period</th></tr>
<tr><td>Before 31 March 2016</td><td>9 years</td><td>Before 31 March 2017</td><td>9 years</td></tr>
<tr><td>On or after 1 April 2017</td><td>10 years</td><td>On or after 1 April 2018</td><td>10 years</td></tr>
</table>

The extension of the NOL-related book retention period and the statute of limitations for correction of NOLs will also be delayed to tax years beginning on or after 1 April 2018.

(3) Revision of the factor-based enterprise tax rate

1) Revision of the corporate enterprise tax rate (i.e., increase in factor-based tax)

Factor-based corporate enterprise tax is imposed on ordinary companies with share capital of over JPY100 million. The rates of factor based levies (i.e., value added levy and capital levy) were raised in the 2015 tax reform, but will be further increased as follows. (These changes will be applicable for tax years beginning on or after 1 April 2016.)

		Reference Pre-2015 tax reform	**Current FY 2015**	**Proposed revisions in 2015 tax reform FY 2016 -**	**Proposed revisions in 2016 tax reform FY 2016 -**
Value added levy		0.48%	0.72%	0.96%	**1.2%**
Capital levy		0.2%	0.3%	0.4%	**0.5%**
Income levy	Annual income of JPY4 million or less	3.8% (2.2%)	3.1% (1.6%)	2.5% (0.9%)	**1.9% (0.3%)**
	Annual income of over JPY4 million and JPY8 million or less	5.5% (3.2%)	4.6% (2.3%)	3.7% (1.4%)	**2.7% (0.5%)**
	Annual income of over JPY8 million	7.2% (4.3%)	6.0% (3.1%)	4.8% (1.9%)	**3.6% (0.7%)**

The actual rates for the income levy component are shown in parentheses and are after the application of the provisional measures law regarding special local corporate tax, etc. The maximum rates that may be imposed by prefectures will be raised from the current 1.2 times, to two times, the standard rates.

2) Revision of the special local corporate tax rate

The income levy component of the corporate enterprise tax is used as the tax basis for the calculation of the special local corporate tax liability. Due to the decrease in the rates of the income levy component described in (1), the rate of special local corporate tax will be raised from the current 93.5% to 414.2% so that there will be no net effect on the amount of special local corporate tax due. (This change will be applicable for tax years beginning on or after 1 April 2016.)

It should be noted that special local corporate tax will be repealed and reinstated as corporate enterprise tax for tax years beginning on or after 1 April 2017.

* Under a previous tax reform, corporate enterprise tax was divided into two parts, i.e., corporate enterprise tax and then newly implemented special local corporate tax. Special local corporate tax is national tax collected via local governments, which the central government then distributes to local governments based on certain criteria in the form of special local corporate tax grants.

The sample calculation of special local corporate tax for income in excess of JPY8 million is shown in the table below.

Current FY 2015		Proposed FY 2016		Proposed FY 2017
Income levy of corporate enterprise tax (income in excess of JPY8 million)	Special local corporate tax	Income levy of corporate enterprise tax (income in excess of JPY8 million)	Special local corporate tax	Special local corporate tax
3.1%	3.1% x 93.5% = Approx. 2.9%	0.7%	0.7% x 414.2% = Approx. 2.9%	Repealed

3) Reduction in corporate inhabitant tax rate and increase in the local corporate tax rate

The rate of corporate inhabitant tax will be reduced while the local corporate tax rate (which is a national tax despite the name) will be raised. In aggregate, the reduction and increase will offset, such that there should be no net increase in taxation. These measures will, in principle, be applicable for tax years beginning on or after 1 April 2017.

	Current		Proposed		Delta
	Standard	Maximum	Standard	Maximum	
Corporate tax levy of prefectural tax	3.2%	4.2%	**1.0%**	**2.0%**	▲2.2%
Corporate tax levy of municipal tax	9.7%	12.1%	**6.0%**	**8.4%**	▲3.7%
Total of corporate tax levy of corporate inhabitant tax	12.9%	16.3%	**7.0%**	**10.4%**	▲5.9%
Local corporate tax (national tax)		4.4%		**10.3%**	+5.9%
Total	17.3%	20.7%	**17.3%**	**20.7%**	—

(4) Revision of the depreciation system

The declining balance method will no longer be available for equipment attached to buildings, structures or buildings for mining purposes acquired on or after 1 April 2016. As a result, only the straight-line method will be available for these assets.

(5) Amendments to special economic zones

The following measures will be eliminated or scaled down:

Proposed items	Detail
Special depreciation or tax credit for machinery acquired in National Strategic Special Zones	· Ability to immediately write-off and the carryforward of certain unused tax credit will be abolished. · Extension by two years
Special depreciation or tax credit for machinery acquired in International Strategic Comprehensive Special Zones	· Reduction of the rate of special depreciation/tax credit · Abolition of the carryforward of unused tax credit · Extension by two years

(6) Tax Measures for Corporate Reorganization

1) Revision of the qualification requirements for share-for-share exchanges and share transfers (collectively "share-for-share exchanges, etc.")

The management retention condition (i.e., one of the conditions in order for share-for-share exchanges, etc., to be tax qualified) will be relaxed. As a result, the resignation of specified directors of the wholly-owned subsidiary prior to the share-for-share exchange, etc., will no longer be considered as resulting in that condition being failed, unless all of them resign.

2) Clarification of qualification requirements

The criteria for determining whether or not the shareholding continuity requirement is satisfied with regard to incorporation-type mergers, incorporation-type company splits or share transfers for the purpose of joint business will be clarified.

3) Revision of the qualification requirements of contributions-in-kind

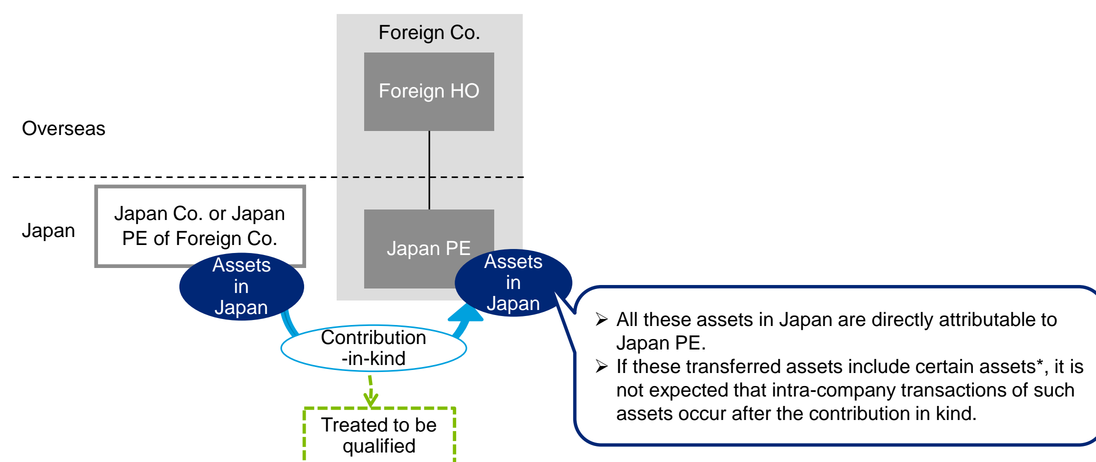
In principle, the following contributions-in-kind are currently not qualified for tax purposes:

- Contributions-in-kind of assets/liabilities in Japan (excluding shares in foreign companies with shareholding of 25% or more) to foreign companies
- Contributions-in-kind of foreign assets/liabilities (excluding real property, etc., in Japan) by foreign companies to Japanese companies

In accordance with these principles, the following addition to, and exclusion from, the scope of qualified contributions-in-kind will be made:

1. Addition of certain contributions-in-kind to the scope of qualified contributions-in-kind

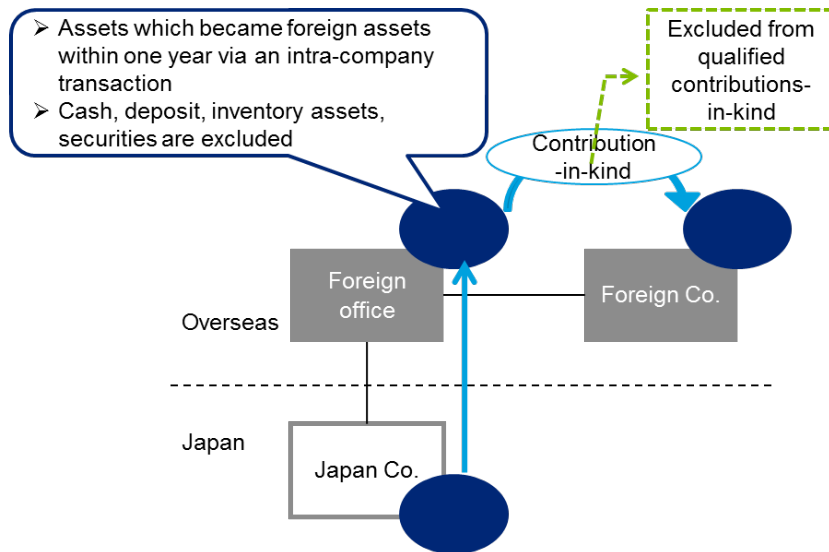
Contributions-in-kind of assets in Japan to foreign companies will be qualified for tax purposes if all these transferred assets become directly attributable to their Japan permanent establishment ("PE") and other qualification conditions are satisfied.



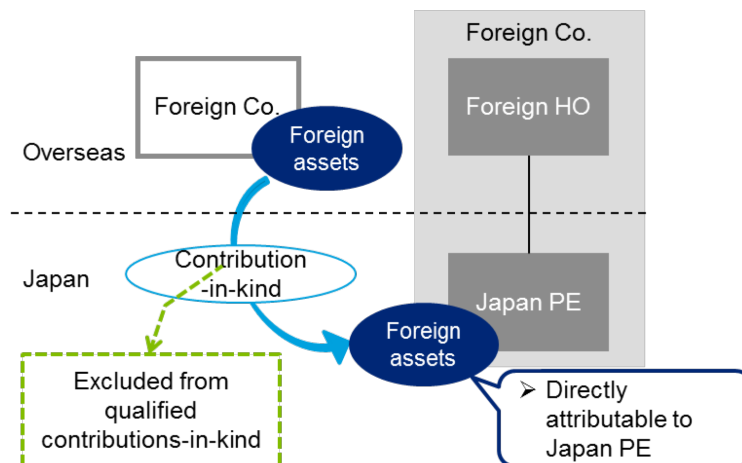
2. Exclusion of certain contributions-in-kind from the scope of qualified contributions-in-kind

The following contributions-in-kind will be excluded from the definition of qualified contributions-in-kind:

- Contributions-in-kind of foreign assets (excluding cash, deposits, inventory assets and securities) by Japanese companies to foreign companies if these assets became foreign assets via an intra-company transfer by the Japanese company to its foreign office within one year of the date of the contribution-in-kind and become directly attributable to the foreign company's office via the contribution-in-kind.



- Contributions-in-kind of foreign assets by a foreign company to another foreign company where the transferred foreign assets become directly attributable to the other foreign company's Japan PE.



(7) Revision to implement provisions in the Japan-Taiwan Tax Agreement

On 26 November 2015, the Interchange Association (Japan side) and the Association of East Asian Relations (Taiwan side) signed an agreement with respect to taxes on income.

No tax treaty has been entered into between Japan and Taiwan. Therefore, double taxation between the two territories currently occurs with respect to individuals who are considered to be resident in both territories ("dual residents") and intragroup transactions between the two territories covered by transfer pricing taxation. However, these issues will be resolved by these revisions. The revisions will be made

on the condition that Japanese individuals and companies are granted in Taiwan the same rights as those granted to Taiwanese individuals and companies in Japan (i.e., principle of reciprocity). Based on that agreement, the revisions described below will be made.

1) Implementation of tie breaker rules (individual income tax)

Dual residents who are determined as Taiwanese residents based on tie breaker rules (including the permanent home test) will be treated as non-Japanese residents.

2) Reduction or exemption of income or corporate tax on Taiwanese residents

1. Exemption of business income from income or corporate tax

Business income of Taiwanese residents which is not attributable to offices, etc., in Japan will be exempt from Japanese income or corporate tax.

2. Reduction or exemption of income or corporate tax on dividends, interest and royalties

Type of income	Dividend	Interest	Royalty
Reduced rate	10%	10%	10%

3. Exemption of capital gains on the sale of assets from income or corporate tax
4. Exemption of personal service fees from income tax

3) Correlative adjustments in relation to transfer pricing taxation in Taiwan

4) Special measures for the filing of requests for correction by taxpayers

5) Provision of information to the Taiwanese tax authorities

6) Effective date

These revisions will be implemented when procedures necessary to ensure the principle of reciprocity are completed.

(8) Other

1) Timing to deduct service costs related to stock compensation

If a company provides certain restricted stock compensation for services performed by individuals in the future, costs for such services will in principle be deductible for the tax year in which the restrictions are removed.

2) Directors' compensation

Prior-notification procedures to deduct directors' compensation with regard to certain restricted stock compensation will no longer be required.

3) Entertainment expenses

Extension of 50% deduction of meal expenses and special treatment for SMEs by two years.

4) Job increase credit

Tax credit under the tax measures for job increases and tax credit under the tax measures for wage increases cannot be currently claimed both at the same time. In certain cases, the job increase tax credit related to plans for the establishment of specified facilities for local revitalization and wage increase tax credit will become available simultaneously.

Deloitte's view

The Proposals continue the recent trend of reducing the statutory combined corporate income tax rate, which should generally be beneficial for taxpayers. However, the benefit will depend on a company's specific fact pattern, including the impact of the changes to the non-income based taxes and also the reduction in certain tax deductions.

Companies with carried forward NOLs will find it even more difficult to utilize these losses in future.

As can be also seen by the above, the various corporate income taxes and the different bases for calculating taxable income means that Japan's tax system remains relatively complex.

In light of these Proposals, companies may want to consider the following:

- ➢ The impact of non-income based taxes and NOL utilization on their cash tax liability, and whether this can be improved by changes to their capital structure, etc.
- ➢ Re-calculate deferred tax assets ("DTA") using amended tax rates, and consider the impact of NOL restrictions on DTA recognition.

2. Transfer Pricing

The Proposals include the following transfer pricing documentation reforms in response to the OECD/ G20 BEPS Project Action 13 (Transfer Pricing Documentation) Final Report.

(1) Country-by-Country Report

Japanese companies which are the ultimate parent company of a Japanese multinational group (MNE Group) must provide revenue, profit before tax, income tax paid, and other information (per Annex III to Chapter V of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations or the OECD Transfer Pricing Guidelines) for each tax jurisdiction in which the MNE Group operates. This information must be filed with the District Director of the Tax Office via the electronic data processing system, e-Tax. Japanese tax authorities will primarily rely on the Japan tax treaty and information exchange network to receive the Country-by-Country Reports of non-Japanese MNE Groups. These reforms apply for fiscal years beginning on or after 1 April 2016 and an English language Country-by-Country Report must be provided no later than one year after fiscal year end of the ultimate parent company of the MNE Group. Penalties will apply if the Country-by-Country Report is not filed by the due date. MNE Groups with consolidated revenues of less than JPY 100 billion in the year prior to a given reporting year are exempt from filing a Country-by-Country Report for the relevant reporting year. An MNE Group is defined as a corporate group whose consolidated financial statements, prepared under applicable financial standards, include two or more enterprises, including permanent establishments, that are in different tax jurisdictions. An exception applies where the parent company's consolidated financial statements become a consolidated subsidiary in another group's consolidated financial statements.

(2) Masterfile

Companies which are the Constituent Entity must provide information about the MNE Group's organizational structure, descriptions of businesses, financial position, and other information (per Annex I to Chapter V of the OECD Transfer Pricing Guidelines). This information is to be provided in a Japanese or English language Masterfile and must be filed with the District Director of the Tax Office via the e-Tax System no later than one year after fiscal year end of the ultimate parent company of the MNE Group. These reforms note that the Masterfile Reporting Entity responsibility can be a designated to a Japanese permanent establishment of a foreign company of a non-Japanese MNE Group. These

reforms apply for fiscal years beginning on or after 1 April 2016. Penalties are expected to apply if the Masterfile is not filed by the due date. MNE Groups with consolidated revenues of less than JPY 100 billion in the year prior to a reporting year are exempt from filing a Masterfile for the relevant reporting year. A constituent entity is either (i.) an entity that is consolidated in the MNE Group under applicable accounting standards, or (ii.) an entity which would otherwise be consolidated in the MNE Group under applicable accounting standards, however is excluded from the consolidation due to size or materiality grounds.

(3) Local file

Japanese entities with foreign related party transactions must prepare, maintain, and provide upon request Local files to tax authorities. Local files must include documents necessary to determine arm's length pricing of foreign related party transactions. The items to be contained in the Local file are specified in the Act on Special Measures Concerning Taxation Enforcement Order Article 22-10 and Annex II of the OECD Transfer Pricing Guidelines. These reforms apply for tax filings for fiscal years beginning on or after 1 April 2017 and must be prepared by a Japanese entity's tax return filing date. The local file must be kept for seven years. Non-exempt companies who fail to submit the Local file within 45 days of a request of tax authorities or who fail to submit additional material supporting the arm's length price (e.g. the information on which the local file is based) within 60 days of a request from the tax authorities may be subject presumptive taxation. Japanese entities are exempt from Local file requirements for specific related party transactions, under the following conditions: (i) the value of transactions with the foreign related party in the previous fiscal year (or the current fiscal year if there is no previous fiscal year) is less than JPY 5 billion; and (ii) the value of intangible property transactions with the foreign related party in the previous fiscal year (or the current fiscal year if there is no previous fiscal year) is less than JPY 300 million. For entities that are exempted from preparing a local file, the tax authorities may request material for supporting the arm's length nature of pricing. This must be provided within 60 days of a request from the tax authorities or they may be subject to presumptive taxation.

Deloitte's view

The following observations can be drawn from the proposed reforms:

1. Consistency with OECD guidance – The proposed reforms are largely consistent with the BEPS Project Action 13 (Transfer Pricing Documentation) Final Report. One area for clarification is Local file content inclusive of Act on Special Measures Concerning Taxation Enforcement Order Article 22-10 content and with content listed in the Annex II of the OECD Transfer Pricing Guidelines. The content listed in these two sources overlaps substantially with the exception of Advance Pricing Arrangements and tax ruling information which is included in Annex II (which would represent an addition to the items required under the Act on Special Measures Concerning Taxation Enforcement Order Article 22-10).
2. Prescriptive nature of changes – The proposed reforms make documentation compulsory, include specific deadlines for production of documentation and when documentation must be provided to tax authorities, and introduce new penalties (to be further clarified). These represent prescriptive changes the implications of which will only become clearer with clarification of the proposed reforms as they are written into the existing law and the actions of the regional taxation bureaus over future audit cycles.
3. Timing considerations – Most Japanese MNE Group's first Country by Country Report and Masterfile requirements will be for the year ending 31 March 2017 due on 31 March 2018. For MNE Groups with January to December fiscal years their first Country-by-Country Report and Masterfile reporting year in Japan will be the year ending 31 December 2017 due on 31 December 2018; these MNE Groups will need to address a 'first mover' country requirements for a year prior (year end 31 December 2016) to what is required for Japan.

3. Consumption Tax

(1) Multi-rates

1) Introduction of multiple Japanese Consumption Tax rate structure

A reduced rate of Japanese Consumption Tax ("JCT") will be introduced when the JCT rate is raised to 10% on 1 April 2017.

The supplies shown below will be eligible for the lower rate of 8%, which consists of the national tax portion of 6.24% and the local tax portion of 1.76%.

Supplies eligible for lower rate	Details
Supply of food products	・ "Food products" are defined as foods and beverages defined under Food Labelling Law (excluding alcoholic drinks defined under Liquor Tax Law) ・ Dining out is excluded ・ Products consisting of a food element and a non-food element are, in principle, out of the scope of food products. However, such products will be within the scope, if the price of the products is a certain amount or less; and the food element is the primary portion of the product.
Supply of newspapers	・ Sale of newspapers issued at least twice a week under subscription contracts

2) Transitional measures

To calculate input JCT and output JCT under a multiple JCT rate structure until the qualified invoice method (see below) comes into effect on 1 April 2021, the following transitional measures will be implemented.

	Proposed rules	Notes
Addition of item to be included in accounting books	The following item will be added to the items that need to be recorded in accounting books ・ Statement that the taxable purchase is subject to reduced JCT rate	
Addition of items to be included on invoices	The following items are added to the items to be shown on invoices: ・ Statement that the supply is subject to the reduced JCT rate ・ Total amount of consideration according to each rate	Enterprises receiving the invoice are allowed to add these items themselves based on the facts
Simplified methods for calculating taxable sales/purchases	Simplified methods for calculation of output JCT/input JCT will be implemented for enterprises having difficulty identifying sales /purchases according to JCT rate	See the matrix below

The table below shows an overview of the proposed simplified methods for calculation of output JCT and input JCT:

<table>
<tr><th colspan="2"></th><th>SME
(Enterprise with JCT taxable sales of JPY 50 million or less during the base period*)</th><th>Non-SME</th></tr>
<tr><td rowspan="3">Calculation of output JCT</td><td>Applicable period</td><td>1 April 2017 – 31 March 2021</td><td>1 April 2017 – End of the taxable period including 31 March 2018</td></tr>
<tr><td>Eligible enterprises</td><td colspan="2">Enterprises having difficulty identifying taxable sales according to JCT rate</td></tr>
<tr><td>Applicable simplified methods</td><td colspan="2">One of the following percentages may be used to calculate the amount of output JCT, depending on the type of enterprises:
・ Percentage of taxable sales subject to reduced rate for 10 successive ordinary business days against total taxable sales for the 10 day period
・ Percentage of taxable purchases attributable to taxable sales for wholesale/retail business against total taxable purchases for wholesale/retail business
・ 50/100</td></tr>
<tr><td rowspan="3">Calculation of input JCT</td><td>Applicable period</td><td colspan="2">1 April 2017 - End of the taxable period including 31 March 2018</td></tr>
<tr><td>Eligible enterprises</td><td colspan="2">Enterprises having difficulty identifying taxable purchases according to JCT rate</td></tr>
<tr><td>Applicable simplified methods</td><td>The amount of input JCT may be calculated using one of the following methods:
1. Enterprises engaged in retail/wholesale business will be allowed to calculate the amount of input JCT using the percentage below
Percentage of taxable sales for retail/wholesale business subject to reduced rate against taxable sales for retail/wholesale business
2. If a notification of election of the simplified input JCT credit calculation method** is filed with the jurisdictional tax office:
The simplified input JCT credit calculation method is applicable from the taxable period of filing</td><td>The amount of input JCT may be calculated using one of the following methods:
1. Same as left
2. If a notification of election of a method similar to the simplified input JCT credit calculation method is filed with the jurisdictional tax office:
A method similar to the simplified input JCT credit calculation method is applicable.</td></tr>
</table>

* Base period is the fiscal year two years prior to the current fiscal year.

** Under the simplified input JCT credit calculation method, the amount of creditable input JCT is calculated as a certain percentage of the amount of output JCT, regardless of the amount of input JCT actually incurred.

3) Qualified invoice system

1. Amendment to requirements for claiming input JCT credits

From 1 April 2021, a tax invoice system similar to the EU-style invoicing system ("qualified invoice system") will be introduced to allow enterprises to account for JCT under the multiple JCT rate structure.

Under the qualified invoice system, the requirements for claiming input JCT credits will be amended as follows:

	Current	Proposed (1 April 2021 -)
Retention of accounting books	Retention of accounting books including the following information: **(i)** Name of supplier; **(ii)** Date of transaction; **(iii)** Description of goods or services supplied; **(iv)** Amount of consideration (including JCT)	Retention of accounting books including the following information: **(i)** Name of supplier; **(ii)** Date of transaction; **(iii)** Description of goods or services supplied; **(iv)** Amount of consideration (including JCT) **(v)** Statement that the supply is subject to the reduced rate
Retention of invoices	Retention of invoices including the following information: **(i)** Name of issuer; **(ii)** Date of transaction; **(iii)** Description of goods or services supplied; **(iv)** Total amount of consideration (including JCT) ; **(v)** Name of recipient	Retention of qualified invoices including the following information: **(i)** Name and registration number of supplier **(ii)** Date of transaction **(iii)** Description of goods or services supplied (including the statement that the supply is subject to reduced JCT rate, if applicable); **(iv)** Total amount of consideration (including or excluding JCT) according to each JCT rate, and applicable JCT rates **(v)** Amount of JCT

2. Registration system for enterprises issuing qualified invoices

A JCT taxpayer will be allowed to issue qualified invoices, if it submits a relevant application form to the jurisdictional tax office and is registered as an eligible supplier.

An overview of the registration system is as shown below:

	Proposed rules
Registration application	Registration applications will be accepted from 1 April 2019
Obligation of registered suppliers	Registered suppliers are obliged to issue qualified invoices.

Exemption from the obligation to issue qualified invoices	The obligation to issue qualified invoices is exempted for certain transactions, such as public transportation services.
Transitional measure	In principle, taxable purchases form a JCT-exempt enterprise will not be creditable. However, as a transition measure, a certain percentage of the amount equivalent to input JCT on such purchases may be credited for six years from the introduction of the qualified invoice system.
Other considerations	· The name and registration number of registered suppliers are published on the NTA website. · Foreign digital service suppliers registered under the digital service JCT rules as of 31 March 2021 will automatically be registered as suppliers eligible to issue qualified invoices on 1 April 2021.

3. Effective date

The above changes will apply to taxable supplies and taxable purchases made by enterprises in Japan as well as taxable goods removed from bonded areas on or after 1 April 2021.

(2) Expansion of JCT-free shopping system for foreign tourists

From 1 May 2016, the minimum purchase thresholds to be eligible for JCT-free shopping will be lowered as follows:

a) Non-consumable goods: JPY 10,001 → JPY 5,000

b) Consumable goods: JPY 5,001 → JPY 5,000

(3) Amendment for business-to-business digital services

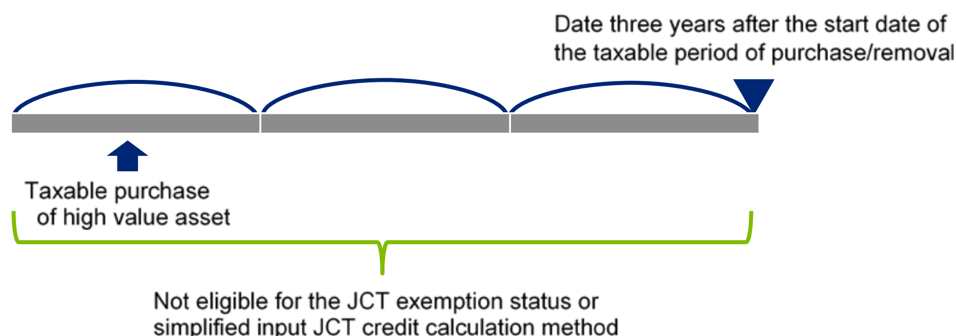
In the 2015 tax reform, the place of supply of digital services has changed from where the service supplier is located to where the head office or domicile of the recipient is located. This rule will be amended in respect of business-to-business ("B2B") digital services provided to branches, etc. The outline of affected services and their JCT implications are as shown in the matrix below:

Services	Current	Proposed
B2B digital services purchased by a foreign branch, etc., of a Japanese enterprise which are attributable to supplies made outside Japan	Domestic transaction (services are deemed to be received by the Japanese enterprise)	Out-of-scope transaction
B2B digital services purchased by a Japanese branch, etc., of a foreign enterprise which are attributable to supplies made in Japan	Out-of-scope transaction (services are deemed to be received by the foreign enterprise)	Domestic transaction

(4) Restriction on application of special tax relief for SMEs

If a JCT taxpayer purchases a high-value asset or removes such an asset from the bonded area in the taxable period in which the simplified input JCT credit method does not apply, the JCT taxpayer will not

be eligible for the JCT exemption status or the simplified input JCT credit calculation method for a maximum of three years from the start date of the taxable period of purchase/removal.



High-value assets are defined as inventories or fixed assets subject to adjustment* whose JCT-exclusive purchase price per unit is JPY 10 million or more.

* Fixed assets subject to adjustment are defined as assets other than inventories (e.g., buildings, structures, machinery and equipment, aircraft, vessels, vehicles, fixtures and tools, mining right, etc.), the purchase price of which is JPY 1 million or more per unit.

The above change will apply to purchases of high-value assets made on or after 1 April 2016, except where the purchase is based on a contract entered into on or before 31 December 2015.

Deloitte's view

Japan's consumption tax system, with its single rate and no invoicing system, is relatively simple compared to many other jurisdictions around the world. However, these Proposals, if enacted, will introduce complexity from both a technical and administrative perspective and will be a fundamental change to Japan's consumption tax system.

Looking at the experiences of other countries with a multi-rate system, there can be difficulty in categorizing certain items that arguably could fall within and outside the scope of what is intended to be subject to a lower rate. Assuming the multi-rate proposals are enacted in early 2016, there would be little over a year for taxpayers to get prepared so taxpayers may want to start taking steps to identify which products (if any) clearly fall within the scope of the reduced rate. For any products that are difficult to clearly categorize as in scope, taxpayer should consult with their tax advisors after the law is enacted to determine how best to proceed.

Further, while there will be increased administration for taxpayers, there is a several year grace period to allow taxpayers time to update their systems and adjust to the new invoicing requirements. However, during this period taxpayers will still need to appropriately account for their input and output JCT and maintain additional records identifying purchases subject to a reduced rate. Due to the increase record keeping and documentation requirements, taxpayers may need to identify additional resources to allocate to their indirect tax teams in order to ensure compliance with these new rules.

Also, given that input JCT on taxable purchases from a JCT-exempt enterprise will become an additional cost (due to not being creditable) upon introduction of the invoicing system, taxpayers may need to take more care when selecting a supplier. On the other hand, suppliers who will be JCT-exempt enterprises may want to consider electing to become a JCT-taxable enterprise and register under the new system so that their supplies do not become more costly to customers.

4. Individual Tax

(1) Clarification of the definition of securities as covered assets for exit tax

The definition of securities that would be subjected to exit tax which came into effect from 1 July 2015 has been further clarified. Currently, covered individuals who meet the following conditions will be subjected to the exit tax:

1. Have covered assets of JPY 100 million or more at the point of breaking residency.
2. Have stayed in Japan for more than 5 years in the 10 years up to the point of breaking residency.

As part of the scope of exit tax, financial assets, which are held at the time of exit from Japan shall be deemed transferred at the time of exit and unrealized capital gains on these securities and investments shall be taxed in Japan. The proposed amendment will bring about the exclusion of both qualified and non-qualified stock options from the scope of financial assets with effect from 1 January 2016. However, stock options acquired for value are still considered covered assets for exit tax.

(2) Expansion in the scope of persons for employer equity reporting

To recap the current employer equity reporting requirement, Japanese subsidiaries that are owned (directly or indirectly) 50% or more by a foreign entity and Japanese branches of foreign entities will be required to submit an annual statement to the national tax office detailing any income realized from equity income (including cash awards where the underlying value of the award is based on share value) for their tax-resident employees and directors. This statement is due by 31 March of the year following the year of realization.

In order to increase compliance in tax reporting for leavers, the reporting requirement will be expanded to include the following persons:

- Non tax-resident individuals who are/ were employees and directors of Japanese subsidiaries that are owned (directly or indirectly) 50% or more by a foreign entity and Japanese branches of foreign entities.
- Tax-resident individuals who were employees and directors of Japanese subsidiaries that are owned (directly or indirectly) 50% or more by a foreign entity and Japanese branches of foreign entities.

The exact timing of the change has not yet been announced.

(3) Commuting allowance

Currently, public transportation expenses paid by employers to employees and directors to cover reasonable return routes from home to work may be excluded from tax up to a maximum of JPY 100,000 per month. Recognizing the increasing costs of commutation and with more individuals living farther from their workplaces, with effect from year 2016, the National Tax Agency has allowed the tax free exemption to be increased to JPY 150,000 per month.

(4) Addition to the scope of medical expenses eligible for deduction

Currently, taxpayers are allowed to take medical expense deduction on expenses relating to medical treatment, but not for expenses relating to preventive medicine. To encourage self-medication, a special deduction for expenses associated with switching prescription drugs to OTC will be introduced. The table below shows a summary of the change:

Eligible period	1 January 2017 to 31 December 2021
Eligible taxpayer	An individual who undergoes regular medical checkup etc. in order to maintain or improve their health condition.
Special deduction	Where an eligible taxpayer incur expenses to switching prescription drugs to OTC for self and/ or family members residing with the taxpayer and the total amount exceeds JPY 12,000 per year, the excess will be deductible.

Deloitte's view

Since the exit tax was introduced in the 2015 tax reform, there have been several revisions made to the rules including the exclusion of foreign nationals on working visas from the scope of persons subject to exit tax, the introduction of a transitional period for another category of foreign nationals and other special measures. The reduction in scope of financial assets subjected to exit tax is further good news as this mitigates the impact for tax residents who have significant financial assets, especially those holding substantial employee equity awards.

With the expansion in the scope of persons subjected to employer equity reporting, authorities would be able to greater track underreporting of (and failure to report) equity income of employees and directors who leave Japan and/ or their companies. Since 2013, the National Tax Agency was able to go back 5 years to recover any unpaid tax (to which interest and penalties would apply) and the amendment would better enable them to cross-reference data received and potentially go after a greater pool of non-compliant individuals as tax evaders. Employers should start paying more attention to identify leavers who hold equity-based plans with a taxable event during the year and file the report for them and where there is a personal obligation for the individual to report any foreign equity income, take steps to remind their employees of this tax reporting requirement even after they leave Japan or ceased to be employed.

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