

Japan: Inbound Tax Alert

2017 Japanese Tax Reform Proposal - Approved

December 2016 – News Flash

On 8 December 2016, proposals for the 2017 tax reform were approved by the Liberal Democratic Party (“LDP”) and the Komeito Party and were posted on the LDP’s website. (Japanese / PDF)

One of the most significant proposals for corporate tax is a fundamental revision of the anti-tax haven rules (i.e. Japan CFC rules). In addition, the applicability of tax measures for small and medium-sized enterprises (“SMEs”)¹ is to be limited to fiscal years with an average annual income of less than JPY 1.5 billion (with transitional measures provided). Furthermore, specific revisions have been proposed for tax rules related to R&D expenditures, director compensation, and corporate reorganizations.

Please see below for a list of some key items that may affect foreign 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. Deloitte will provide further details regarding certain proposals in the coming weeks.

Corporate Tax

1) Revision to R&D tax credit

- R&D credit calculation
 - Base amount: 6% to 14% of R&D expenditures, depending on changes in R&D costs* (12% to 17% for SMEs*)
 - *transitional measure applicable for two years
 - Credit limitation: 25% of the corporate tax liability
 - For SMEs: if R&D costs increase by over 5%, an additional 10% credit will be available
 - If R&D costs exceed 10% of average sales, additional credit of 0% to 10% will be available
- Expanded scope of R&D costs eligible for tax credit

2) Amendments to deductibility of director compensation

- Profit linked compensation: addition of indicators used for calculation and eligible companies, etc.
- Retirement and stock option compensation not meeting certain conditions no longer deductible
- Expanded scope of deductible fixed, pre-determined, and pre-notified director compensation
- Revision of pre-notification procedures
- Expanded scope of deductible restricted stock and stock option compensation and revision of the fiscal year of deduction

3) Revisions related to corporate reorganizations

- Expanded definition of qualified spin-off type corporate division
- Mark-to-market valuation of assets in non-qualified share-for-share exchange or at time of entry into a tax consolidated group
 - Assets with book values less than JPY 10 million excluded
- Amortization of goodwill
 - The amortization limit for the fiscal year in which the goodwill was acquired will be made on a monthly basis (applies to both positive and negative goodwill resulting from a non-qualified reorganization)

¹ Generally defined for corporate tax purposes as a company with share capital of JPY 100 million or less and not 100% owned (directly/indirectly) by a company with share capital of JPY 500 million or more.

4) Measures for SMEs

- Revision of scope to which SME tax relief is applicable
 - For fiscal years beginning on or after 1 April 2019, various corporate tax and inhabitant tax measures for SMEs will no longer be applicable to fiscal years with average annual income (i.e. average of income for the previous three fiscal years) of more than JPY 1.5 billion.

5) Fundamental revision of Japan CFC rules

- Revision of criteria to determine foreign companies subject to CFC rules
- Full inclusion of income (for foreign affiliates with effective tax rate < 20%) unless certain conditions met
- Inclusion of pro-rata share of investment income (for foreign affiliates with effective tax rate < 20%), including interest, dividends, royalties, certain capital gains, etc.
 - Certain investment losses may be carried forward for a period of 7 years
 - De minimis amount raised from current JPY 10 million to JPY 20 million
- Full inclusion of income of specified foreign affiliates (with effective tax rate < 30%)
 - Covered entities
 - Foreign affiliates which satisfy neither of the following requirements:
 - Affiliate has a fixed facility (i.e. an office) necessary to conduct its main business; nor
 - Affiliate manages, controls and operates business itself in the country of residence of the head office.
 - Foreign affiliates with proportion of certain investment income to total assets of over 30%
 - Foreign affiliates with a head office in jurisdictions designated to be non-cooperative for the exchange of tax information by the Japanese finance minister

6) Expansion of scope of non-taxable interest on bond repurchase / reverse repurchase transactions of foreign financial institutions

7) Amendment of domestic law in-line with revised Mutual Agreement Procedures under tax treaties

Individual Tax

1) Amendments related to inheritance and gift taxes

- Revision of the deferral of liability for inheritance/gift tax on non-listed shares
- Revision of liability for inheritance/gift tax
- Revision of estate valuation for inheritance tax purposes

2) Revision of scope of taxable income for non-permanent residents

- Gains arising from disposal of certain investments outside of Japan no longer subject to taxation in Japan for non-permanent residents

3) Amendments to spousal deduction

- Increase in income threshold for removal of spousal deduction from current JPY 1.03 million to JPY 1.5 million
- Limitation and removal of spousal deduction for high income earners from 1 January 2018
 - Individuals earning more than JPY 11.2 million will have a reduced deduction available
 - Individuals earning more than JPY 12.2 million will no longer be able to claim a spousal deduction

4) Additions to NISA system

- Introduction of new form of Nippon Individual Savings Account (NISA)
 - From 1 January 2018, individuals will be able to choose to invest up to JPY 1.2 million in the existing type of account, or up to JPY 400,000 annually into a longer-term version
 - Dividends and capital gains on investments held in the new long-term account will be free from income tax for the period of the account (up to 20 years)

Consumption Tax

1) Sale of virtual currency exempt from Japanese Consumption Tax

- Applies to sales/purchase transactions performed by an enterprise in Japan on or after 1 July 2017

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