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Introduction

On 20 December 2024, Japan's ruling parties announced the 2025 tax reform proposal (the "Proposal"), which was posted on the Liberal Democratic Party 's website (available in Japanese/PDF format).

With signs of getting out of the deflation battled by Japan for years, the aim of the Proposal is to improve productivity to increase wages over price hikes to stably achieve the virtuous cycle between wages and prices. To this end, the proposals place the priority on revisions that allow the shifting to the "growth-oriented economy driven by wage increases and investment" and further develop such economy. Specifically, the proposals include a revision to the basic exemption for personal income tax purposes to reduce the tax burden to help taxpayers cope with price increases and a new deduction for dependent college students to allow them to work part-time jobs without ceasing to be tax dependents. In addition, the so-called Angel Tax Incentives, i.e., the tax incentives for individual investors in venture capital, and the tax incentives for NISA, i.e., Japanese individual savings accounts, will be revised to encourage more investment in startups and to make Japan a "investment-oriented country."

The proposals also include new measures for corporate income and tobacco taxes to secure stable funds for the fundamental strengthening of Japan's defence capabilities.

Within the realm of international tax, revisions to be aligned with the OECD Pillar Two initiative, specifically the undertaxed profits rule ("UTPR") and the qualified domestic minimum top-up tax ("QDMTT"), will be incorporated into domestic law in accordance with the international agreement. While the proposals do not include specific measures for the re-allocation of taxing rights (i.e., the OECD Pillar One initiative), which are related to transfer pricing, the introductory part of the proposals has mentions of Amount A and Amount B that for the former, Japan will continue to consider, among other things, how to incorporate the re-allocated taxing right to Japan as a market country into domestic law and how to eliminate double taxation required under the Multilateral Convention in consideration of Japanese national and local CIT systems while for the latter, Japan will not implement Amount B for a while but will take any necessary measures in accordance with the international agreement, domestic law, and tax treaties if other countries implement simplified or streamlined approach.

In the area of indirect tax, cross-border digital supplies have been increasing rapidly, making it difficult to maintain fair taxation and equal competition due to non-filing of Japanese consumption tax ("JCT") returns by foreign suppliers and the exemption of imports of goods of small value from JCT and customs duties. To address these challenges, the government will consider measures for fair taxation on cross-border digital supplies in consideration of fairness among businesses, implications on customs administration, and relevant systems and their execution in other countries in a future tax reform.

Below, you will find key points regarding some of the proposals that may impact foreign-headquartered companies conducting business in Japan as well as individuals residing in Japan. It should be emphasized that these proposals have not been enacted yet and could change before becoming law. These proposals are expected to be enacted by March 2025.

Corporate Tax

1. Establishment of a Special Defense Corporate Tax

The new Special Defense Corporate Tax [*tentatively named*] (hereinafter "SDCT") was introduced as an additional corporate income tax ("CIT"), which would be effective from fiscal years beginning on or after 1 April 2026. SDCT is applicable to all companies subject to Japanese CIT. The applicable tax rate is 4% of the corporate tax base. In consideration of the increased tax burden for small and medium-sized enterprises (or "SMEs"), a special deduction of JPY 5 million will be introduced to reduce its CIT base before applying the 4% tax rate. An outline of the proposed amendment is provided below.

Items	Proposed amendments
Taxpayers	Companies subject to CIT for each fiscal year
Scope of taxation	For the time being, the SDCT will be levied on the CIT base for each taxable fiscal year of the corporation.
Calculation of tax amount	■ SDCT = Taxable CIT for each taxable fiscal year (tax base) x tax rate of 4% ■ Taxable standard CIT = CIT base – basic deduction ■ CIT base: CIT for each fiscal year calculated without applying the following credits (excluding penalty taxes) ➢ Income tax credit; ➢ Foreign tax credit; ➢ Credit for foreign tax equivalent subject to adjustment at the time of distribution; ➢ Credit for CIT due to reassessment of disguised accounting; ➢ Tax credit for measures to strengthen the competitiveness of specific industries among the domestic production promotion tax systems in strategic areas, and additions of CIT for group corporations due to reassessment of disguised accounting under the same measures; and ➢ Credit for deductible income tax equivalent. ■ Basic deduction: JPY 5 million per year ➢ The basic deduction for a group corporation shall be JPY 5 million per year, which is allocated proportionally with respect to the CIT base of each group corporation. In principle, if the CIT base of a group corporation differs from the CIT base reported in a timely filed tax return, then the allocation indicated in the tax return shall govern the allocation of the CIT base amongst the group corporations. ■ The following tax credits are applicable: ➢ Foreign tax credits; ➢ Credits for foreign tax equivalent subject to adjustment at the time of distribution; ➢ Credits for deductible income tax equivalent; and ➢ Credits for SDCT due to reassessment of disguised accounting.
Tax return and payment etc.	■ Corporations that are required to file an interim CIT return must file an interim SDCT return. ➢ The above mentioned interim SDCT return shall be applied from

	the taxable fiscal year beginning on or after 1 April 2027. ■ The filing due date for the SDCT return and the payment due date for the SDCT shall be the same as the filing due date for the CIT return and the payment due date for the CIT. ■ The special provisions for electronic filing are the same as those for CIT for each fiscal year. ■ If a corporation that has submitted an interim SDCT return submits a final SDCT return for the taxable fiscal year pertaining to the interim SDCT return, and if the interim tax could not be fully deducted from the final tax calculation, the interim tax that could not be deducted shall be refunded. ■ In the event that a corporation submits an application for a refund of CIT due to the carryback of a loss for each fiscal year, and if it is refunded for the taxable fiscal year corresponding to the refundable income, the SDCT for that taxable fiscal year, which is determined at the time of the refund, shall be refunded together. The refund amount shall be calculated as follows: CIT refund x 4% x taxable standard CIT for the taxable fiscal year / CIT base for the taxable fiscal year
Other inspections and penalties etc.	It shall be the same as the CIT for each fiscal year. Other necessary measures will be taken.
Applicability	It will be applied from the fiscal year starting on or after 1 April 2026.

POINT:

Based on the basic direction of the 2023 Tax Reform Outline etc., a SDCT (an additional tax on CIT) was established, and the tax burden on companies is expected to increase. The SDCT will be levied from fiscal years beginning on or after 1 April 2026. Since tax effect accounting is calculated based on the tax rate stipulated in the tax law enacted by the Diet on the closing date, it is necessary to pay close attention to the timing of the enactment of the law and consider the impact on the settlement of accounts.

2. Special Provisions for Reduced Corporate Tax Rates for Small and Medium-sized Enterprises

The special provision for the reduced corporate tax rate for SMEs will be revised as follows, and its application will be extended by two years.

	Current	Proposed amendments
Details of the reduced tax rate	The tax rate is 19% (temporary tax rate of 15%) for taxable income up to JPY 8 million.	For fiscal years in which the amount of taxable income exceeds JPY 1 billion, the applicable tax rate will be raised to 17% (currently: 15%) for taxable income up to JPY 8 million.
Applicable Entities	Entities with share capital (or investments) of less than JPY 100 million or no share capital (or investments) at the end of the relevant fiscal year (excluding	Group corporations are excluded from applicable entities.

	exempt businesses, ordinary corporations wholly controlled by a large corporation, large group corporations, etc.)	
Applicability	Fiscal years starting on or before 31 March 2025	Fiscal years starting on or before 31 March 2027

3. Revisions to the treatment of lease transactions

(1) Treatment of operating lease payments

The deductible amount of operating lease payments by lessees for a fiscal year will remain the amount that is fixed for that fiscal year.

Notes:

(i) The term "operating lease" refers to lease transactions other than finance leases.

(ii) Operating lease payments include expenses incurred as part of lease transactions and those directly necessary for preparing leased assets for business use. However, they do not include costs related to lease revenue, costs for completing construction tied to lease revenue, expenses required to acquire leased fixed assets, or expenses recognized as deferred assets.

(2) Deferral of revenue and expenses related to finance lease assets disallowed

Current rules allow lessors to recognize revenue and expenses related to the transfer of lease assets in one of the two following methods:

- ✓ General approach: Revenue and expenses are recognized in the fiscal year during which the lease asset is transferred.
- ✓ Alternative treatment: Lessors may defer the recognition of such revenue and expenses.

Under the new rules, this deferral approach will no longer be allowed. Transitional measures will be introduced, allowing deferred lease revenue to be recognized evenly over five years if deferral is discontinued during fiscal years beginning from 1 April 2025 to 31 September 2027.

(3) Revisions to rules for amortization of assets under finance leases where ownership is not transferred to lessees

The straight-line lease amortization method will be revised for assets under finance leases where ownership is not transferred to the lessee to disallow the deduction of guaranteed residual value of such assets but allow amortization down to JPY 1 (i.e., memo value).

Note: For assets with guaranteed residual value under finance lease contracts signed before 1 April 2027 where ownership is not transferred to lessees, a transitional measure will allow amortization to proceed using the revised straight-line method for fiscal years beginning on or after 1 April 2025.

(4) Revisions to the calculation of corporate enterprise tax

A portion of operating lease payments for land or buildings, which are deductible by the lessee for corporate tax purposes, will now be included in the calculation of net rent expense (i.e., a component of the tax base for the value-added levy under enterprise tax). Additional measures will be implemented to align enterprise tax and inhabitant tax provisions with new revisions to CIT.

POINT:

The "ASBJ Statement No. 34, Accounting Standard for Leases," issued by the Accounting Standards Board of Japan ("ASBJ"), will be effective from the fiscal year beginning on or after 1 April 2027; however, early application starting from fiscal years beginning on or after 1 April 2025 will be allowed. This new lease accounting standard introduces a significant shift in the reporting of lease transactions by requiring that all leases be included on the balance sheet.

Under this standard, lessees will be required to capitalize and amortize assets under operating leases and recognize interest on lease payments, similar to the treatment of finance leases. For tax purposes, however, the deductibility of lease payments will remain generally unchanged (i.e., lessees can continue to deduct only the fixed amounts of lease payments). Book-to-tax differences resulting from the application of this new lease accounting standard are expected to increase the complexity of lease administration.

In alignment with this revised accounting standard, additional tax measures will be implemented. For lessors, the deferral of lease revenue and related expenses will no longer be allowed, in accordance with the revision that disallows the recognition of lease revenue and associated costs at the time of lease payment receipt.

International tax

1. Global minimum taxation

The UTPR and QDMTT will be legislated in accordance with the international agreements. UTPR and QDMTT will take effect in the fiscal year beginning on or after 1 April 2026. In addition, necessary revisions will be made to clarify the treatment of global minimum taxation based on the guidance issued by the OECD.

(1) Undertaxed Profits Rule

Item	Content
Scope	The following entities are subject to UTPR. **A** A domestic company that is a constituent entity which belongs to a specified multinational enterprise group. **B** A foreign company that is a constituent entity with a permanent establishment which belongs to a specified multinational enterprise group.
UTPR Top-up tax	Domestic group UTPR top-up tax amount is basically calculated in accordance with the following: A × (B + C) A…Group UTPR top-up tax amount The group UTPR top-up tax amount shall be equal to the sum of the top-up tax calculated for each Low-Taxed Constituent Entity, deducted by certain amount such as the top-up tax that is brought into charge under a Qualified IIR. B…Percentage of number of employees (The ratio of number of employees in Japan to the number of employees in all UTPR jurisdictions) x 50% C…Percentage of tangible assets amount (The ratio of tangible assets amount in Japan to the tangible assets amount in all UTPR jurisdictions) x 50% (Note)The same rule shall apply to the UTPR top-up tax amount for a foreign company that is a constituent entity with a permanent establishment which belongs to a specified multinational enterprise group.

<table>
<tr><td></td><td>The UTPR top-up tax amount for a domestic company shall be calculated by multiplying the domestic group UTPR top-up tax amount by the sum of domestic company’s percentage of number of employees and the percentage of tangible assets amount.
The group UTPR top-up tax amount shall be reduced to zero if the tested fiscal year beginning within five years since the first day of the first fiscal year when a group becomes specified multinational enterprise group, and the fiscal year is in the initial phase of international activity.</td></tr>
<tr><td>Filing and payment obligation</td><td>Filing and payment are due within 15 months (extended to 18 months in certain cases) from the day immediately after the last day of each fiscal year. Filing is not required if there is no UTPR top-up tax amount for the fiscal year.</td></tr>
<tr><td>Effective date</td><td>Effective from the fiscal year beginning on or after 1 April 2026.</td></tr>
</table>

(2) Qualified Domestic Minimum Top-up Tax

<table>
<tr><th>Item</th><th>Content</th></tr>
<tr><td>Scope</td><td>The following entities shall be subject to QDMTT.
<table>
<tr><td>A</td><td>A domestic company that is (i) a constituent entity which belongs to a specified multinational enterprise group or (ii) a joint venture which belongs to a specified multinational enterprise group.</td></tr>
<tr><td>B</td><td>A foreign company that is (i) a constituent entity with a permanent establishment which belongs to a specified multinational enterprise group or (ii) a joint venture with permanent establishment which belongs to a specified multinational enterprise group.</td></tr>
</table></td></tr>
<tr><td>QDMTT</td><td>The QDMTT amount for constituent entity is calculated in accordance with the following.
<table>
<tr><th>Category</th><th>Amount</th></tr>
<tr><td>① Domestic ETR is below 15% and domestic net GloBE income is the positive amount.</td><td>A × B + C × D + E
(Note)A...Group QDMTT amount (calculated by multiplying (Domestic net GloBE income - substance based income exclusion) by (15% - domestic ETR))
B...Percentage taking into account the degree of contribution of the domestic company with respect to the group QDMTT amount.
C...Additional current top-up tax for each previous fiscal year
D...Percentage taking into account the degree of contribution of the domestic company with respect to the additional current top-up tax amount for the relevant previous fiscal year
E...Domestic investment entity’s top-up tax amount under the taxable distribution method</td></tr>
<tr><td>② Domestic ETR is 15% or more and domestic net GloBE income is the positive amount.</td><td>C x D + E of ① above</td></tr>
<tr><td>③ Domestic net GloBE income is zero or the negative amount.</td><td>C x D + E of ① above (Where the domestic group’s adjusted covered taxes are less than zero and less than the domestic expected adjusted covered taxes amount: C x D + E + F x G)
(Note) F...Group QDMTT amount attributable to permanent differences
G...Percentage taking into account the degree of contribution of the domestic company with respect</td></tr>
</table></td></tr>
</table>

	to group QDMTT amount attributable to permanent differences Some safe harbors such as the De minimis exclusion and transitional CbCR safe harbor will be established similar to the IIR. In addition, an exclusion rule shall apply during the initial phase of an international activity similar to the UTPR. The QDMTT amount for joint venture is basically calculated in the same manner as the one for constituent entity.
Filing and payment obligation	Filing and payment are due within 15 months (extended to 18 months in certain cases) from the day immediately after the last day of each fiscal year. Filing is not required if there is no QDMTT amount for the fiscal year.
Group QDMTT information return	a) Group QDMTT information return Group QDMTT information return shall be filed to the tax offices via e-Tax within 15 months (extended to 18 months in certain cases) from the day immediately after the last day of each fiscal year. The QDMTT information return shall include the name of an ultimate parent entity, some other information in relation to the QDMTT amount and whether the De minimis exclusion, etc. is applied. b) Exemption from filing obligation Filing obligation is exempted in case that the tax authorities in the jurisdiction where the ultimate parent entity (or a designated filing entity) is located is able to provide group QDMTT information return to Japanese tax authority.
Effective date	Effective from the fiscal year beginning on or after 1 April 2026.

(3) Revisions to global minimum taxation

Necessary revisions will be made to clarify the treatment of global minimum taxation based on the administrative guidance issued by the OECD (e.g., allocation of cross-border deferred taxes with respect to Controlled Foreign Company ("CFC") tax regimes).

POINT:

The UTPR and QDMTT will be legislated in accordance with the international agreements, and both will be effective from the fiscal year beginning on or after 1 April 2026.

2. Revisions to the anti-tax haven rules

The anti-tax haven rules (or CFC rules) will be amended as follows to deal with the additional administrative burden related to Pillar 2.

(1) Revisions to timing of taxation as per CFC rules

Taxable income of CFCs should be included in the taxable income of the Japanese parent company in its fiscal year which includes the date four months (currently two months) following the fiscal year end of the CFCs.

For example, if the fiscal year end of a Japanese parent company (P Co) and CFC (S Co) are 31 March and 31 December, respectively, the amendments are applied as below.

Current	Proposed amendments
Taxable income of S Co for the FYE 31 December X1 is included in taxable income of P Co for the FYE 31 March X2.	Taxable income of S Co for the FYE 31 December X1 is included in taxable income of P Co for the FYE 31 March X3.

(2) Revisions to attachments

The following documents will be excluded from the scope of attachments concerning CFCs which are currently required to be attached to tax returns and maintained.

- Statement of changes in shareholders' equity and appropriation of profits and losses
- Statement of breakdown of accounts concerning balance sheet and profit and loss statement

(3) Effective date

In general, the above reform will be applicable to taxable income of CFCs (*1) in relation to the fiscal years beginning on and after 1 April 2025 of the Japanese parent company.

(*1) Limited to taxable income of CFCs for their fiscal years ending on and after 1 February 2025.

Japanese Consumption Tax ("JCT")

1. Abolition of special provisions related to finance lease transactions, etc.

The special provisions related to finance lease transactions, which allow a lessor to defer the reporting of output JCT on a lease transaction over the lease period (deferred payment method), will be abolished. Enterprises that transfer assets under finance lease before 1 April 2025 will be still allowed to calculate the amount of taxable sales from the finance lease using the deferred payment method, in respect of the calendar years (for individuals) or fiscal years (for corporations) commencing on or before 31 March 2030. Further, related transitional measures will be implemented, such as treating the amount of remaining installment payments, spread evenly over 10 years as the amount of taxable sales from the finance lease, in the event that adopting the deferred payment method is discontinued for calendar years or fiscal years commencing on or after 1 April 2025.

Individual Income Tax

1. Tax Burden and Employment Adjustments in Response to Inflation

(1) Increase of the basic deductions and minimum guaranteed amount for employment income deduction
As the tax burden is ultimately increasing as a result of the basic deductions being a fixed amount in a time where Japan is entering a period of rising prices, the basic deduction amount etc. will be revised as below.

- Basic Deduction

Total Income Amount (JPY)	Deduction Amount (JPY)	
	Current	Proposed amendments
Under 23.5 million	480,000	580,000
23.5 million to under 24 million	480,000	480,000
24 million to under 24.5 million	320,000	320,000
24.5 million to under 25 million	160,000	160,000
25 million and above	0	0

Note: Will apply to National Income Tax for 2025 onwards, and to Withholding Taxes on employment income and public pension, etc. paid from 1 January 2026 onwards

- Total income requirements
  In addition to the increase in basic deductions, the total income amount requirements for both dependents and spouses living in the same household will increase from the current JPY 480,000 to JPY 580,000.

- Minimum guaranteed amount for employment income deductions

	Current (JPY)	Proposed amendments (JPY)
Minimum guaranteed amount	550,000	650,000

Note: Will apply to National Income Tax for 2025 onwards, and to Withholding Taxes on employment income, etc. paid from 1 January 2026 onwards

(2) Implementation of Special Deductions for Specified Relatives

In response to remarks made that the tax regime is restricting employment for college students at their part time jobs, a new income deduction will be implemented. The arrangement of the deduction is as below.

■ Applicable individuals: Individuals who have relatives aged 19 to 23 living in the same household (whose total income amount is less than JPY 1.23 million, excluding spouses), and are not eligible for dependents deduction.

■ The deduction amount will be based on the total income amount of the relative etc. as below.

Total income amount of the relative, etc. (JPY)	Deduction Amount (JPY)
580,000 to under 850,000	630,000
850,000 to under 900,000	610,000
900,000 to under 950,000	510,000
950,000 to under 1 million	410,000
1 million to under 1.05 million	310,000
1.05 million to under 1.1 million	210,000
1.1 million to under 1.15 million	110,000
1.15 million to under 1.2 million	60,000
1.2 million to under 1.23 million	30,000

Note: Will apply to National Income Tax from 1 January 2025, and to Withholding Taxes on employment income, etc. paid from 1 January 2026

Tax Administration

Revisions to the Electronic Records Retention Law

The rules governing the preservation of electronic transaction records will be revised as follows:

Currently, a penalty for fraud is increased by 10% if the taxpayer prepares and files a personal income tax, CIT, or JCT return using concealed or falsified electronic transaction records. Under the new rules, however, the scope of records subject to such a higher penalty rate will be revised to exclude the electronic records that verify rights of representation or are used in electronic power of attorney services ("Specified Electronic Records") if the conditions below (i) to (iv) are met and a notification of Specified Electronic Records is filed with the competent tax office:

(i) Electronic records must be exchanged and preserved using a system capable of tracking any corrections or deletions (including their details) or one that prohibits corrections and deletions entirely.

(ii) If data in electronic transaction records is corrected or deleted, and the modified records are included in national tax books, they must be exchanged and preserved using a system that either tracks changes (including their details) or prohibits such records from inclusion in national tax books.

(iii) Electronic transaction records (e.g., invoices and delivery slips) must be cross-referenced with related electronic records in the national tax books.

(iv) The exchange and preservation of electronic transaction records must be confirmed through the systems mentioned in (i) and (ii).

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