Japan 2023 Tax Reform Proposals: Pillar 2 update

December 2022

In brief

On December 16, 2022, the Liberal Democratic Party and Komeito Party released the 2023 Tax Reform Proposals. The proposals include a legislative outline (the "Outline") to implement a global minimum corporate tax based on the Global Anti-Base Erosion Model Rules ("Pillar Two") published by the Organisation for Economic Cooperation and Development ("GloBE Model Rules").

The Outline introduces an Income Inclusion Rule ("IIR") that is broadly in line with the GloBE Model Rules. The IIR will apply to fiscal years beginning on or after April 1, 2024. Other features of the GloBE Model Rules, such as the Undertaxed Payments Rule ("UTPR") and the Qualified Domestic Minimum Top-up Tax ("QDMTT") are excluded from the Outline, but may be included in the 2024 Tax Reform Proposals or later.

This newsletter provides an overview of the IIR proposed in the Outline and how it may affect taxpayers. Further information will be published in later newsletters after the legislation is published.

In detail

1. Entities in scope

The IIR will apply to Japanese headquartered multinational enterprises ("MNEs") and Japanese subsidiaries of foreign headquartered MNEs where the worldwide gross revenue of the ultimate parent entity in two or more of the four preceding fiscal years is 750 million Euros or higher.

2. Tax base

The IIR incorporates a new Global Minimum Corporate Tax (各対象会計年度の国際最低課税額に対する法人税) calculated based on the Global Minimum Taxable Amount; and a new Global Minimum Local Corporate Tax (特定基準法人税額に対する地方法人税), technically a national tax, calculated based on the Global Minimum Corporate Tax liability (together, the "Top-Up Tax").

The Global Minimum Taxable Amount is equivalent to GloBE income described in Chapter 3 of the GloBE Model Rules. The calculation of the Top-Up Tax is also similar to the calculation of the top-up tax described in Chapter 5 of the GloBE Model Rules. The Top-Up Tax may arise in a jurisdiction even when the Global Minimum Taxable Amount for that jurisdiction is nil or negative as described in Article 4.1.5 of GloBE Model Rules.

3. Tax calculation

The Global Minimum Corporate Tax is calculated by multiplying the Global Minimum Taxable Amount by the tax rate of 90.7/100 for each relevant fiscal year. The Global Minimum Local Corporate Tax is calculated by multiplying the Global Minimum Corporate Tax liability by the tax rate of 93/907.

4. Safe harbour

In addition to the de minimis exclusion rule described in Article 5.5 of the GloBE Model Rules, the Outline states that the calculation of the effective tax rate for each jurisdiction may be simplified by using information in the MNE's Country-by-Country Report ("CbCR"). However, no further details have been provided.

5. Other

The Outline introduced an information reporting system that includes the same reporting items described in Article 8.1 of the GloBE Model Rules. Japanese companies that are subsidiaries of a foreign MNE are obliged to submit an information report in Japan using the National Tax Agency's e-Tax system. However, if there is a mechanism by which the tax authority of the ultimate parent company of the MNE shares the information report with the Japanese tax authorities, the local filing requirement may be exempted.

The takeaway

While it is clear that the IIR in Japan will be closely aligned with the GloBe Model Rules, the Outline does not contain detailed guidance on the calculation of the Global Minimum Corporate Taxable Amount, adjustment items, or the CbCR safe harbour. As the IIR will apply to accounting periods beginning on or after April 1, 2024, there remains some time before the rules are finalised and the legislation is published. However, it is important for taxpayers to prepare early. The potential impact of the IIR should be evaluated and systems should be developed to collect the information to calculate the Top-Up Taxes and prepare information returns.

For calendar year end taxpayers, the first year that the IIR will apply in Japan will be the fiscal year ending December 31, 2025. However, some jurisdictions such as the European Union, the United Kingdom, and South Korea have announced that they will implement legislation based on the GloBE Model Rules for accounting periods beginning on or after January 1, 2024. If Japanese MNEs have subsidiaries in these or other jurisdictions that announce the introduction of rules that will apply earlier than the IIR in Japan, it will be essential to consider how these rules, in particular the UTPR, may affect Japanese MNEs subsidiaries. The introduction of new rules in other countries must be carefully monitored.

Finally, if the IRR legislation is enacted in March 2023, the impact on financial statement tax provisions should also be considered. Discussions within the International Accounting Standards Board ("IASB") and Japan's Accounting Standards Advisory Council are ongoing. While the IASB has published recommendations that International Accounting Standards introduce a temporary exception from accounting for deferred taxes arising from legislation enacted to implement the OECD's Pillar Two model rules, no changes have yet been made.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

PwC Tax Japan
Otemachi One Tower, 1-2-1 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan
Email：jp_tax_pr-mbx@pwc.com
www.pwc.com/jp/e/tax

Haruhisa Shirato
Partner

Kazuhito Asakawa
Partner

Masato Jimbo
Partner

Akemi Kito
Partner

Ryann Thomas
Partner

Shintaro Yamaguchi
Partner

Yumiko Arai
Director

PwC Tax Japan has launched a new e-learning program called Tax Academy in October 2022, to support those wishing to develop their skills in the international tax field. For tax professionals outside Japan, the ‘Introduction to Japanese taxes’ series within Tax Academy provides a basic outline of the Japanese tax system, including corporate tax and consumption tax, and covers key points of international tax practice in English.

Please click here for details and to apply (charges apply):
www.pwc.com/jp/e/tax-academy