2020 Japan Tax Reform Proposals News Flash

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In brief

On 12 December 2019, the ruling parties in Japan published their 2020 Tax Reform Proposals ("2020 Tax Proposals"). It is expected that most of the items contained in the 2020 Tax Proposals will be passed into law in March 2020.

A summary of the major items contained in the 2020 Tax Proposals is set out below. A more detailed analysis of the 2020 Tax Proposals will be provided in a subsequent Japan Tax Update.

In detail

<u>**Corporate Tax**</u>

1. **Abolishment of consolidated tax system and introduction of group tax relief ("group tax relief") system**
   a) Group tax relief will be introduced to allow domestic corporations to allocate profits and losses between companies within a 100% Japan-parented group. The new law will be effective for fiscal years beginning on or after 1 April 2022. Measures to transition from the current consolidated tax system will also be introduced.
   b) The basic rules for the application of group tax relief will be essentially the same as under the current consolidated tax system. The difference between the two systems will be that, under group tax relief, the parent corporation and each subsidiary will file their own (blue form) corporate tax return. These tax returns will also need to filed through the e-tax system.
   c) Under group tax relief, new measures will be provided to calculate, among other items, the allocation of current profit and loss and carried forward losses to the group member corporations, and adjustments to book value of subsidiary corporations; as well as the valuation of assets owned and (dis)allowance of carried forward losses, upon entry or exit from the group or beginning or termination of group tax relief.
   d) In contrast to the current consolidated tax system, under group tax relief, certain income or tax credits will be calculated on a stand alone entity basis to lessen the administrative burden on group corporations. On the other hand, certain tax measures will be determined on a group basis (e.g., the amount of R&D credits).

e) To align with the above amendments, the current rules of the "group taxation regime" will be reviewed, such as the dividend income exclusion, donation expenses, bad debt allowances, and capital gain deductions arising from the transfer of assets intragroup.

2. Investment in open innovation corporations and other policy measures

a) Establishment of a tax system to promote investment in open innovation corporations
Where a corporation engaging in specified business activities[1] acquires the shares of a venture company[2] by contributing equity over a period of time, and accounts for that investment as a tax special account, an income deduction will be permitted for the investor corporation (i.e., the corporate shareholder).
[1] Specified business activities are those that aim to develop new businesses, are expected to be highly productive, or that make use of management resources other than those of the company itself (i.e., by investment into other corporations).
[2] As certified by the Ministry of Economy, Trade and Industry.

b) Establishment of a tax system to promote the introduction of 5G technology
Accredited corporations will be entitled to elect either a 30% special depreciation rate or a 15% tax credit where they invest in infrastructure to promote the introduction of 5G technology, and where they put that infrastructure into use, within a certain period of time.

c) The threshold investment amount for the application of certain tax incentives designed to promote investment, such as R&D tax incentives and tax credits related to improvements in productivity will be increased for large corporations.

d) The application of special rules permitting deduction of entertainment expenses will be extended by two years. However, corporations with capital greater than JPY10 billion will no longer qualify for the 50% deduction for entertainment expenses.

3. Tax proposals related to SMEs, regional revitalisation, etc.

a) The application of special rules permitting deductions for entertainment expenses to SMEs will be extended for two years.

b) The current rules relating to deductions for small depreciable assets for SMEs will be extended for two years, although the scope of corporations to which the rules apply will be narrowed.

c) The two year extension will be subject to review of the requirements to apply the special rules and subject to the strength of the regional tax system.

4. International taxation

a) Measures to prevent tax avoidance through the payment of dividends and subsequent transfer of shares in subsidiaries.
If the dividend received from an affiliated subsidiary (i.e., a subsidiary with a specified control relationship on the date of the dividend resolution) exceeds 10% of the book value of the shares of that affiliated subsidiary, the book value of the affiliated subsidiary will be reduced. That is, any capital gain on the transfer of the shares cannot be reduced through payment of the dividend.

b) Calculation of income of a controlled foreign corporation (“CFC”) with partial income aggregation
Interest received from suppliers to whom financing was provided will be excluded from a CFC’s aggregated taxable income.
c) The scope of creditable foreign tax payments under the foreign tax credit regime will be reviewed.
d) Non-deductible interest under the earnings stripping rules will exclude certain interest paid by a Japanese corporation to the Japanese permanent establishment of a foreign corporation.
e) The reporting system for automatic exchange of country-by-country reports of non-residents will be reviewed.

5. Improvements to tax administration

a) A one month extension to the deadline for filing of final consumption tax returns will be introduced.
b) Given current market interest rates, the rates of delinquent interest and interest applied to refunds will be reduced.
c) The maintenance requirements for electronic bookkeeping systems will be reviewed.
d) The requirements for reporting of overseas property will be reviewed.
e) The statutory limitation for tax assessments relating to overseas transactions will be extended.
f) Taxation of share-based remuneration paid to directors will be aligned with recent amendments to the Corporate Law.
   - Taxation of shares granted as consideration for the provision of services where there is no payment required and where there are restrictions on transfer of the shares will be reviewed.
   - In order to determine whether shares or share options granted to directors are excessive or not, formal limits will be established.
   - The requirements that the grant of shares be linked to performance will be reviewed.
g) Provisions for determining fair market value will be revised in accordance with the introduction of IFRS 13, Fair Value Measurement.

<u>Individual Income Tax</u>

a) Special rules for the calculation of profit and loss on real estate income of second-hand buildings located overseas will be introduced. The income generated from such buildings will be calculated as if there were no depreciation cost.
b) The scope of listed stocks registered with the specified brokerage accounts and subject to the special taxation will be expanded. Necessary documentary evidence will be permitted to be filed electronically.
c) The corporations covered by the “angel investor” taxation system will be expanded (special taxation treatment for shares acquired in specified SMEs and for carry forward losses related to shares in specified SMEs).

Let's talk

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

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