2022 Japan Tax Reform Proposals News Flash

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In brief

On December 10, 2021, the ruling parties in Japan published their 2022 Tax Reform Proposals ('2022 Tax Reform Proposals'). The 2022 Tax Reform Proposals were drafted as the first tax reform proposals under the Kishida administration, which has prioritized a new approach to capitalism.

The 2022 Tax Reform Proposals include: (1) review of existing special measures to realize a virtuous cycle of growth and wealth distribution (e.g., increased salary tax incentive, open innovation promotion tax incentive, 5G introduction promotion tax incentive), (2) review of the tax system based on structural changes in the economy and society (e.g., personal income taxation, inheritance tax, gift tax), (3) review of the international tax system including responses to tax avoidance and tax evasion, (4) improvement of smooth and appropriate tax administration (e.g., qualified invoice storage method, bookkeeping obligations, scanned document storage systems, storage of electronic transaction information).

A summary of the major items contained in the 2022 Tax Reform Proposals is set out below.

In detail

Corporate Tax

1. Measures to achieve a virtuous circle of growth and wealth distribution

a) Increased salary tax incentive

The increased salary tax incentive (tax system for raising wages and improving productivity) was revised in 2021, as a result of which incentives for wage increases for existing employees and incentives for investments by large companies in facilities and equipment were replaced with incentives for salary increases as a result of hiring new employees, as well as increases in education and training costs.

In the 2022 Tax Reform Proposals, the increased salary tax incentive will be amended to allow a credit of up to 30% of the increase in salary payments for companies that increase salary payments for existing employees by 3% or more, with an even more preferential incentive for companies that increase education and training expenses by 20% or more. (For large companies [capital of 1 billion yen or more and regular employees of 1,000 or more], this incentive applies only if the company notifies Minister of Economy, Trade and Industry of a publicly announced policy to increase salaries.)

b) Restrictions on application of tax incentives
For years beginning before March 31, 2024, many tax credits and incentives are available if the taxpayer satisfies either the increased salary requirement or the new investment requirement, and the company's taxable income of the current year simply exceeds that of the previous year. Under the 2022 Tax Reform Proposals however, large companies (capital of 1 billion yen or more and regular employees of 1,000 or more) whose prior year income exceeds zero will now be required to demonstrate an increase in the amount of salaries paid to existing employees by 1% or more (0.5% in 2022) to be eligible for all such tax credit incentives.

c) Investment in open innovation corporations
Under the 2020 Tax Reform, where an investor corporation engaging in certain defined business activities acquires the shares of a qualified venture company by contributing equity, and if the investor corporation accounts for that investment in a reserve account, the investor corporation (i.e., the corporate shareholder) will be permitted an income deduction. Under the 2022 Tax Reform Proposals, the category of investor corporation able to utilise this income deduction will be expanded (i.e., the defined business activities will be increased), and the minimum required holding period of shares by such investor corporation will be shortened from the current five years to three years (by extending the application period by two years).

d) Regional revitalization
To realize the 'Digital Garden City National Concept', which aims to revitalize local areas and connect them with the world, the following tax measures will be amended.

(1) After reviewing the qualifying assets, employees and plan certification requirements, the application period will be extended by two years.

(2) After reviewing the qualified equipment and tax credit rate for the 5G introduction promotion tax incentive (special depreciation or tax credit for investment in certain information and communication technology equipment), the application period will be extended by three years.

e) Carbon neutrality and environmentally friendly investment incentive
An investment incentive will be introduced for certain equipment that reduces the amount of environmentally harmful production materials used by a company, and for equipment that manufactures replacements for chemical pesticides or fertilizers.

2. Group tax relief

a) The following revisions will be made to the group tax relief system that will be applicable from fiscal years beginning on or after April 1, 2022.

(1) Upon withdrawal of a subsidiary from group tax relief, the parent company should currently recognise any built in gain and goodwill related to the subsidiary shares in the business year in which the withdrawal occurs. With appropriate supporting documentation and analysis, the amount to be recognised going forward will exclude goodwill.

(2) Upon withdrawal of a subsidiary from group tax relief, the scope of assets subject to market valuation will be revised to include assets with book value goodwill of less than 10 million yen.

(3) Deductible interest tax accrued on accounts payable or receivable among group entities shall be excluded when calculating tax effected amounts.

(4) The five-year continuation or controlling period requirement for tax losses carried forward under the group tax relief system will be relaxed.

b) Regarding the application of the foreign tax credit to group tax relief, the current adjustment system for foreign tax credits among group companies will be reviewed.

3. Tax proposals related to SMEs

a) After reviewing the requirements for preferential tax credit rates, the application period for increased salary tax incentives will be extended by one year.

b) The application deadline for the special deduction for entertainment expenses will be extended by two years.

c) The current deduction for the acquisition of small depreciable assets (acquisition price of less than 300,000 yen) will be reviewed to exclude assets used for leasing purposes (excluding those used as part of a company’s main business) and the application period will be extended by two years.

4. Other measures

a) The application period for deduction of overseas investment allowances will be extended by two years.

b) The application deadline for non-deductible entertainment expenses and the special deduction for food and drink entertainment expenses will be extended by two years.

c) The current deduction for the acquisition of small depreciable assets (acquisition price of less than 100,000 yen) will be reviewed to exclude assets used for leasing purposes (excluding those used as part of a company’s main business).

d) The lump-sum depreciation of depreciable assets (acquisition price of less than 200,000 yen) will be reviewed to exclude assets used for leasing purposes (excluding those used as a part of a company’s main business).

5. International taxation

a) Expansion of the application of earning stripping rules to foreign corporations without a PE in Japan
When a foreign corporation that has no PE in Japan earns certain domestic source income (such as through leasing of aircraft or investing in real estate in Japan), that foreign corporation is generally required to file corporate tax returns and pay taxes in Japan. Until now however, this income has not been subject to any limitation on deductions of interest under the earning stripping rules. To be consistent with the treatment for domestic corporations and for foreign corporations that earn domestic source income through PEs in Japan, the earnings stripping rules will be extended in their scope to cover foreign corporations that have no PE in Japan.

b) Modifications of the CFC rules for insurance companies
An insurance company that conducts insurance business in a foreign country (foreign insurance company) without maintaining any office in that country, or that outsources its management functions to an affiliated operating company, may fall within the Japanese controlled foreign corporation (CFC) rules if it is ultimately held by a Japanese corporation. Nevertheless, if such a foreign insurance company is directly held by a Japanese insurance company, a special exception (insurance consignor exception) may apply when determining whether it can qualify as a special foreign related company; if so, such insurance consignors are not subject to the CFC

rules. However, as the insurance consignor exception only covers insurance companies under the Japanese Insurance Business Act or foreign insurance companies directly held by Japanese insurance holding companies, foreign insurance companies indirectly held through domestic intermediate holding companies do not qualify for this exception.

The 2022 Tax Reform Proposals expand the scope of the insurance consignor exception to include foreign insurance companies indirectly held by a Japanese insurance company. This amendment is effective for fiscal years of the foreign related company beginning on or after April 1, 2022.

c) Anti-tax avoidance rules for revision to the book value of subsidiaries
The anti-tax avoidance measures dealing with reductions in the book value of subsidiaries will be reviewed and relaxed (specifically, the requirements in relation to retained earnings)

6. Finance transactions

a) No withholding taxation on dividends paid by related companies
Dividends paid by the following domestic corporations will no longer be subject to withholding tax on or after October 1, 2023 (applicable for dividends receivable on or after October 1, 2023).

(1) Dividends paid by a 100% subsidiary.
(2) Dividends paid by a domestic corporation directly owned by another domestic corporation by more than one third of the total number of issued shares at the dividend record date.

b) Revisions to the calculation method for deemed dividends
Following the Supreme Court's judgment on March 11, 2021 regarding the methodology in calculating the ‘portion corresponding to shares or capital contributions’ for deemed dividends, deemed dividends funded by both retained earnings and capital surplus will be required to follow these revised calculations for both corporate and income tax purposes going forward:

(1) The capital reduction that is the basis for calculating deemed dividends related to capital repayments and the capital reduction that is the basis for calculating capital for tax purposes will be limited to the capital surplus reduced by the dividend payment.

(2) The reduced capital that is used to calculate the capital equivalent to repayments, and the capital, as the basis for calculation of the deemed dividend in the case of a corporation issuing different classes of shares for the redemption of capital is to be calculated on the basis of each class of shares related to the refund of such capital.

7. Improvements to tax administration

a) Scanned document storage systems
A national certification system for time stamps was introduced in 2021. By the 2022 Tax Reform Proposals, taxpayers will be required to use only those time stamps approved by the national authenticated system on or after April 1, 2022.

b) Two year transitional measures for implementation of new mandatory rules for e-storage of data for transactions conducted electronically
Transitional measures relating to the implementation of new rules for e-storage of data for transactions conducted electronically will be provided (currently, the new rules are applicable from January 1, 2022). The measures will be applicable to electronic transactions conducted between January 1, 2022 and December 31, 2023.

Local Tax

1. Tax filing and payment through the eLTAX system

The procedures for filing tax returns through eLTAX will be expanded, and the scope of tax items that can be paid electronically, and the means of electronic payment will also be expanded.

2. Corporate enterprise tax

(1) The taxation method for corporate enterprise tax levied on the gas supply industry will be reviewed.

(2) The tax rate for the income-based component of the size based taxation regime will be reviewed.

(3) Corporate taxpayers who apply for foreign tax credits will not be able to claim a deduction of foreign corporate tax payments from the taxable amount of their enterprise tax, in addition to no being qualified for foreign tax credits, unless they maintain documents certifying that foreign corporation tax has been levied.

Consumption Tax

a) Registration of qualified invoice issuer

(1) If a tax exempted business or person is registered as a qualified invoice issuer during the taxable period from October 1, 2023 to September 30, 2029, the tax exempted business or person can become a qualified invoice issuer from the registration date, although their taxable status must be maintained for at least two years after the registration date.

(2) A non-resident business entity or person (other than certain specified foreign businesses or persons) who wishes to register as a qualified invoice issuer and who is obliged to designate a tax administrator for Japan tax purposes shall not be permitted to register or will have any existing registration revoked, if the tax administrator is not already designated at the time of applying for that registration.

b) Storage method for qualified invoices

New measures will be introduced regarding the use of consumption tax credits in relation to storage of qualified invoices, as follows.

(1) Input tax credits must be based on detailed purchase statements or other relevant documents.

(2) Transitional measures for input tax credits related to taxable purchases from persons other than qualified invoice issuers will be applicable when the classified invoice (the invoice specifying the purchase amount by the different consumption tax rates) is received electronically.

(3) Consumption tax adjustment measures for inventories to which the transitional measures for input tax credits are applied shall be applicable to taxable purchases from persons other than qualified invoice issuers.

Individual Tax and Property Tax

1. Individual Income Tax

a) Income tax credit for housing loans

Regarding the income tax credit for housing loans, the application deadline will be extended to December 31, 2025, and the borrowing limit and deduction rate (reduced to 0.7% after revision) will be reviewed.

b) Threshold for large shareholder in dividend taxation
For large shareholders (3% or more equity holding) whose dividend income from listed companies is subject to aggregate individual income taxation rather than separate taxation, the threshold will be determined including the ratio held by any family corporation (applicable to dividends receivable on or after October 1, 2023).

c) Submission of information about assets and liabilities
The range of persons obliged to submit information on their assets and liabilities will be expanded, and the deadline for submitting such information will be extended to June 30 of the following year (applicable from 2023).

2. Inheritance, gift and other property taxes

a) The application deadline for gift tax exemption measures when receiving a gift of funds, such as the acquisition of property will be extended by two years until December 31, 2023.

b) The property tax burden adjustment measures for land will be reviewed only for 2022.

c) The application period for the preferential stamp duty rate related to contracts for the transfer of movables will be extended by two years.

d) The deadline for submitting special succession plans under the business succession tax regime (currently March 31, 2023) will be extended by one year.

Let's talk

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

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