Outline of 2023 Tax Reform Proposals

December 2022

In brief

On December 16, 2022, the Liberal Democratic Party and Komeito Party announced the 2023 Tax Reform Proposals (the "Proposals"). As with the 2023 Tax Reform, the Proposals are focused on growing the economy and distributing wealth fairly by promoting investment in markets, industries and human resources.

In response to changes in the international taxation environment as a result of the OECD's introduction of a global minimum tax, as well as the need to reflect changes in the structure of the domestic economy brought on by the declining birth rate and aging population, the Proposals include both changes to existing tax laws, as well as the introduction of new provisions.

This newsletter provides an overview of the major revisions contained in the Proposals. Detailed explanations of specific areas of interest will be published in later newsletters, as the relevant legislation is released.

In detail

Corporate Income Tax

1. Implementing Economic Policy Through Tax Incentives

a) R&D

The Proposals will increase incentives for investing in R&D. Considering the current Cabinet Office *Basic Plan for the Promotion of Science and Technology*, the government will revise the deduction rate curve applicable to R&D expenses, by increasing the benefit for higher expenditure on R&D while at the same time lowering the deduction rate floor. A new mechanism will be introduced to provide more flexibility for companies which have reached the deduction limit.

The scope of open innovation R&D for start-up companies will be greatly expanded, with a new incentive added to encourage companies to hire personnel specialised in performing advanced research. With regard to R&D geared toward the development of new services, the use by companies of already existing big data will also be considered within the scope of such service-related R&D activities.

b) Investment in Open Innovation

Current incentives to promote investment in open innovation (i.e., special tax measures for investment in start-ups) will be increased by expanding the definition of "specified stock" to include the acquisition of stock in an existing company. If certain growth rate and investment level targets are met within five years from acquisition, the incentives may be extended further.

c) Digital Transformation (DX)

Eligibility for tax incentives relating to DX requires taxpayers to obtain a DX certification. It is expected that investment in human resources will be introduced as one of the requirements to obtain such certification going forward. The applicable period for incentives relating to investment in DX will also be extended by two years.

More details of some of the incentives available to Japanese taxpayers can be found here.

2. International Taxation

a) Global Minimum Tax ("Pillar 2")

The Income Inclusion Rule (IIR) is included in the Proposals, based on the progress of the OECD discussions in relation to the global minimum tax and given the increasing implementation in other countries. Effective for tax years beginning on or after April 1, 2024, the IIR will be applicable to Japanese headquartered multinational corporations, and to Japanese subsidiaries of foreign headquartered multinationals, where the worldwide gross revenue of the ultimate parent entity in two or more of the four fiscal years immediately preceding the fiscal year is 750 million Euro or more. Such corporations will be subject to the 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）on the minimum taxable amount and the 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) on the resulting Global Minimum Corporate Tax amount for each applicable fiscal year. A new reporting system for the IIR will also be introduced.

The OECD is expected to discuss implementation details for the Undertaxed Payments Rule (UTPR) and Qualified Domestic Minimum Top-up Tax (QDMTT) during 2023. Based on such discussions, further legislation related to the global minimum tax will be included in the 2024 or later tax reforms.

More details on the Japanese global minimum tax rules can be found here.

b) Controlled Foreign Corporation (CFC) Rules

The introduction of the Pillar 2 legislation requires amendments to the Japanese CFC rules, to ensure alignment between the two. Based on this, the following revisions will be made.

i If the effective tax rate of a specified foreign affiliate in each fiscal year is 27% or more (currently 30% or more), the domestic corporation will be exempt from income inclusion under the CFC rules.

ii The tax return filing requirements for Japanese parent companies will be simplified.

iii Other necessary changes in light of the new Global Minimum Corporate Tax will be made to the CFC rules.

The above amendments will apply to fiscal years of the Japanese parent starting on or after April 1, 2024.

c) Taxation of Non-Residents' Casino Income

A non-resident casino income tax exemption system will be established, such that casino income earned by non-residents between January 1, 2027 and December 31, 2031 will be exempt from tax.

d) Tax Treaty Applications

From July 1, 2024, it will be possible for taxpayers to submit tax treaty applications and documents in support of such applications through the e-Tax system.

3. Small & Medium Sized Enterprises (SMEs)

a) Investment Promotion Incentive

Under the investment promotion incentive, SMEs may take either a tax credit or accelerated depreciation for certain "qualified assets". The scope of "qualified assets" will be revised; the applicable period will also be extended by two years.

b) Special Reduced Tax Rate

The special reduced tax rate for SMEs will be extended by two years.

4. Other Domestic Rules

a) Valuation of Crypto-Assets

The scope of crypto-assets held by corporations that are subject to mark-to-market valuation to recognise gains and losses at the end of the fiscal year will be narrowed.

More details on the treatment of crypto-assets can be found here.

b) Revision to Share Delivery (Kabushiki Koufu) Taxation Rules

Under the "share delivery" rules, a kabushiki kaisha (a Japanese joint stock company) may acquire the shares of another kabushiki kaisha from its shareholders, using the acquiring company's own shares, as a form of tax-deferred reorganisation. Under the Proposals, where the parent company to which shares are transferred is a "family corporation" after the transfer (as defined in the Family Corporation Tax rules), such transfer will not be eligible for the tax-deferred treatment under the share delivery rules. The revision will apply to share transfers that take place on or after October 1, 2023.

c) Tax Treatment of Spin-Offs

From April 1, 2023 through March 31, 2024, where a corporation that has received approval for a business restructuring plan under the Industrial Competitiveness Enhancement Act (ICEA) undertakes a distribution of shares in a wholly-owned subsidiary that meets certain requirements, such distribution in kind will be considered a qualified distribution of shares.

d) Rollover Relief for Specified Assets

The applicable period for exemption from taxation of replacement of specified assets will be extended by three years, while the scope of assets will be narrowed.

Local Taxes

1. Global Minimum Tax

The amount of Global Minimum Corporate Tax on the minimum taxable amount for each target fiscal year will not be included in the amount of corporate tax that is the basis for calculating corporate inhabitants tax.

2. Fixed Assets Tax

In accordance with the provisions of the SME Management Enhancement Act, depreciable assets for which the taxpayer has received certification that the assets will be used to increase productivity will be eligible for a three-year exemption from fixed assets tax.

Consumption Tax

1. New Qualified Invoice System

a) Transitional Measures for Tax-Exempt Businesses

If a taxpayer, who is otherwise eligible to be treated as a tax-exempt becomes a qualified invoice issuer, that taxpayer can elect to apply a special tax credit, through which 80% of its tax liability on taxable sales can be credited. This transitional measure is applicable for three years until the tax period in which September 30, 2026 falls.

b) Reduction of Administrative Burden

For small transactions conducted by certain small businesses in the period until September 30, 2029, transitional measures will be introduced to reduce the administrative burden by allowing such small businesses to support their input tax credits based only on the business' accounting books (i.e., no need to receive and retain qualified invoices for such small purchases/expenses).

The administrative burden will be further reduced by exempting all companies from requirements to issue a qualified return invoice (i.e., credit note) for "return transactions" below JPY 10,000, such as discounts, returns of goods, etc.

More details of the QIS requirements can be found here and here.

2. Other

The Japanese consumption tax treatment of casino business operators will be clarified, including input tax on taxable purchases, taking into consideration that sales of casino business operators are not subject to output consumption tax.

Certain electronic funds transfers will be exempted from consumption tax, in accordance with the revision to the Act on Settlement of Funds.

In anticipation of the introduction of legislation governing private liquidations, the write-off of receivables due to the establishment of an approved Business Restructuring Plan will be within the scope of bad debts subject to consumption tax.

Improvements in Tax Administration

1. Revision to the Electronic Book and Document Storage Act and Related Rules ("e-Storage Act")

The Proposal sets out revisions to e-Storage Act requirements to maintain books and documents digitally, and in relation to the rules covering the maintenance of e-transaction data.

With regard to the mandatory provisions relating to e-storage of e-transaction data, which are set to come into force on January 1, 2024, taxpayers who can provide good reason for not being able to do so may be exempted from compliance with the requirements. Additionally, the "search function" requirements under the e-transaction data rules will also be relaxed.

To encourage the scanning and storing of physical documents, requirements for maintaining digital copies of national tax-related documents under the e-Storage Act will be relaxed further. This will apply to national tax-related documents stored digitally on or after January 1, 2024.

The definition of "quality electronic books" which, if maintained by a corporation, entitles the corporation to receive mitigation of penalties in the event of an audit, will be clarified. Companies that have "quality electronic books" status will be eligible for reduced penalties on national taxes where the statutory deadline for the filing of the return is on or after January 1, 2024.

More details of the e-Storage Act requirements can be found here, here and here.

2. Tax Penalties

Penalty tax for failure to report will be increased on the amount of tax payable exceeding 3 million yen from 20% to 30%. In addition, the current heavy penalty applied in cases of taxpayer fraud will be increased from 40% to 50%. These revisions will apply to national taxes for which the statutory deadline for the filing of the return is on or after January 1, 2024.

Tax Measures to Fund Increased Defence Spending

In order to fund increased defence spending, new measures will be taken regarding corporate income tax, individual income tax, and tobacco tax at an "appropriate time" after 2024.

For corporate income tax, a surcharge of 4% to 4.5% will be imposed on tax payable over 5 million yen for large enterprises. For individual income tax, the special 2.1% surtax previously imposed to fund reconstruction after the Great East Japan Earthquake will be reduced by 1%, but at the same time an additional 1% will be imposed and earmarked to fund increased government defence spending (resulting in the net surtax burden to taxpayers remaining the same). The period for which the special tax surcharge is imposed, however, will be extended.

Let's talk

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

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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