

# Outline of 2024 Tax Reform Proposals

December 2023

## In brief

On December 14, 2023, the Japanese government released the 2024 Tax Reform Proposals (“2024 Proposals”). In line with the “New Capitalism” outlined in the government’s recent economic plans, the 2024 Proposals explicitly state that “wage increases are not a cost but an investment and an engine of growth”. Achieving wage increases is therefore a top priority of the 2024 Proposals. However, they also include measures to improve the investment environment, to strengthen the start-up ecosystem, and to raise productivity and increase potential growth. The 2024 Proposals also outline changes to the Japanese tax system in light of structural changes in both the global and Japanese economies and societies, such as a declining population and continuing economic globalization.

This newsletter outlines the major items contained in the 2024 Proposals.

## In detail

### Corporate Income Tax

#### 1. Tax policies to achieve the New Capitalism

##### (a) Tax credit to promote domestic production in strategic sectors

A tax credit designed to encourage domestic production in sectors considered strategically important by the government will be established. The tax credit amount will be based on either the quantity of goods produced and sold within 10 years after the date of certification of an approved business plan under the Industrial Competitiveness Enhancement Act (“ICEA”) but before March 31, 2027, or the acquisition cost of qualified assets (machinery and equipment acquired pursuant to such a plan) used for such production, whichever is smaller. The maximum tax credit in each year will be 40% of the corporate tax liability, with a carryover period of four years (20% and three years, respectively, for investments related to the semiconductor industry). In addition, in order to increase the effectiveness of the tax credit, a required level of either wage increase or capital investment must be met to be eligible for the benefit.

##### (b) Establishment of an “innovation box” and changes to R&D credit requirements

For patent rights or copyrights related to AI technology that a company has researched and developed itself in Japan, a new “innovation box” will permit 30% of the “qualified income” generated from that technology to be included in deductible expenses for the period from April 1, 2025 to March 31, 2032. “Qualified income” will be the gross revenue generated from the patent rights or copyrights multiplied by a certain percentage (not yet stipulated), or the net operating income, whichever is smaller. To benefit from the innovation box, the revenue generated must arise from assignment of the intellectual property rights to a Japan resident or domestic corporation (excluding a related party) or from the loan of the intellectual property rights to a third party. To avoid “double dipping” of the tax benefit, access to R&D credits for companies applying the innovation box will become more restrictive.

In addition, whether applying the innovation box or not, in order to incentivise the performance of R&D in Japan, the amount of R&D expenses arising from business conducted by domestic corporations through overseas branches will be excluded from the amount of R&D expenses eligible for credit.

**(c) Tax credit to promote wage increases**

Current rules allow a company to take a tax credit if the company meets certain conditions relating to employee salary increases. Under the 2024 Proposals, the application period for this credit will be extended for three more years, the existing minimum tax credit rate will be reduced from 15% to 10%, and the maximum tax credit rate will be increased from 30% to 35%. The eligibility requirements for the maximum rate will be tightened in some cases (e.g., in relation to increased education and training expenses), however, the maximum rate will also be extended to new cases (e.g., for childcare support).

For large enterprises, an even higher wage increase threshold of existing employees will be required to enjoy the maximum rate (i.e., a large enterprise will be required to increase existing employee wages by a minimum of 7% in order to enjoy the maximum tax credit rate). For companies with fewer than 2,000 full-time employees (semi-large companies), the maximum rate will be applicable with wage increases of 4% or more. In order to obtain the benefit of this credit however, semi-large companies are now also required to publish a multi-stakeholder policy.

**(d) Tax credit to promote carbon neutral investment**

The eligibility requirements for the existing carbon neutral investment tax credit (special depreciation or tax credit for the acquisition of equipment contributing to production efficiency) will be tightened to require a carbon productivity improvement rate of 15% or higher (10% or higher for small and medium-sized enterprises, up from 7% at present). Further, taxpayers must be certified by March 31, 2026 and must place the assets into service within three years of certification to qualify for the benefit.

**(e) Requirements for large enterprises to apply specific tax credit provisions**

Currently, large enterprises are required to satisfy certain requirements in order to obtain a number of tax credits, such as for R&D, carbon neutral, or digital transformation incentives. These requirements, the major one of which is the requirement to have a certain salary increase rate, will be made stricter, and will be extended for three more years.

**2. International Taxation**

**(a) Pillar 2**

A Qualified Domestic Minimum Top-up Taxes (“QDMTT”) safe harbour will be established for constituent entities (“CEs”) located in other jurisdictions that have imposed a QDMTT.

In line with guidance published by the OECD in February and July 2023, the following elective treatments will be clarified:

- Gain or loss on the mark-to-market valuation of ownership interests shall be included in the GloBE income calculation.
- Tax credits arising from ownership interests in a conduit company may be added to “adjusted covered taxes”.

The required contents of the GloBE Information Return will be simplified based on the OECD’s July 2023 guidance.

Top-Up Taxes under Income Inclusion Rules and Undertaxed Payments Rules (“UTPR”) of other jurisdictions are excluded from the foreign tax credit system. On the other hand, QDMTT arising in a foreign jurisdiction is eligible for foreign tax credit.

The OECD is expected to continue discussion on the details of implementation of the QDMTT and UTPR during 2024 or later. Based on those discussions, legislation will be considered for enactment in or after the 2025 tax reform.

**(b) Revisions to the controlled foreign corporation (“CFC”) tax system**

Under the current CFC rules, there are certain exceptions available to allow a foreign affiliate without substance to avoid being treated as a “paper company” (which, if it were, would require it to be subject to CFC taxation). Under the 2024 Proposals, if there is no income in the fiscal year of the foreign affiliate, the determination of the percentage-of-income for that fiscal year will no longer be required in order to satisfy the exception.

Taxation under the CFC system may overlap with Pillar 2, so additional revisions may be made in the future, taking into account that the introduction of Pillar 2 will impose additional administrative burden on taxpayers subject to both rules.

**(c) Anti-tax avoidance rules for reduction of book value of investment in subsidiaries**

Under the current rules, the portion of dividends received from a subsidiary that is deemed to have been paid from retained earnings incurred on or after the date that a “special controlled relationship” began can be excluded from taxation in the hands of the Japanese shareholder. Going forward, it will be clarified that the period for the purposes of this calculation will include the fiscal year in which the special controlled relationship began.

**(d) Carry forward of non-deductible interest under earnings stripping rules**

The carry forward period for non-deductible excess interest for fiscal years beginning between April 1, 2022 and March 31, 2025 will be extended from the current seven years to ten years.

**(e) Reporting framework for crypto assets**

Based on the OECD's Crypto Asset Reporting Framework, a system will be established to require domestic crypto asset traders to report transactions in crypto assets of non-residents, so that the Japanese tax authorities can respond to automatic exchange of information requests from treaty partners.

In addition, other automatic information exchange systems, such as that related to banking information of non-residents will be revised.

**(f) Contribution-in-kind where a domestic corporation transfers intangible assets to a foreign corporation**

The contribution-in-kind of intangible assets transferred by a foreign branch of a domestic corporation to a foreign related corporation (and not to a domestic corporation) will be excluded from the definition of “qualified contribution-in-kind” for corporate tax purposes.

**3. Small and Medium Sized Enterprises (“SMEs”)**

**(a) Tax credit to promote wage increases**

Tax credits that could not be utilised in the current year will now be able to be carried forward for five years with the intention to support wage increases for loss-making enterprises.

The maximum tax credit rate for SMEs will also be increased from 40% to 45%. Similar to the changes described above for large and semi-large enterprises, the eligibility requirements for the maximum rate will be tightened in some cases (e.g., in relation to increased education and training expenses), however, will also be extended to some new cases (e.g., to cover childcare support provided to employees).

**(b) SME business restructuring investment loss reserve**

Currently, SMEs are able to defer 70% of their loss allowance reserve for five years. This benefit will be expanded to support SMEs that wish to improve their productivity by undertaking mergers or business transfers. Consequently, where an SME undertakes multiple mergers or acquisitions, the reserve ratio will be increased from the current 70% to a maximum of 100%, and the deferment period will be extended from the current five years to ten years.

**(c) Entertainment expenses**

The amount of food and beverage expenses that may be excluded from the scope of non-deductible entertainment expenses will be increased from 5,000 yen per person per time to 10,000 yen per person per time. In addition, the special exception for deductible entertainment expenses for SMEs of JPY 8 million will be extended for three more years.

**(d) Deductibility of acquisition cost of low value depreciable assets**

Currently, SMEs are able to deduct the full acquisition amount of low value depreciable assets in the year of acquisition. This benefit will be extended for two more years, although the scope of eligible SMEs will be narrowed to exclude those with more than 300 employees.

**4. Other Corporate Income Tax Changes**

**(a) Deduction of acquisition costs for startups (“promotion of open innovation”)**

The applicability period for special taxation rules allowing the deduction of acquisition costs for startups by investors will be extended for two more years.

**(b) Revision of valuation method for crypto assets**

Crypto assets that have been held continuously by third parties other than the issuer will be exempt from existing year-end mark-to-market taxation rules under certain conditions.

**(c) Taxation of spin-offs based on approved business restructuring plans under the ICEA**

The deadline for application of the special taxation rules applicable to spin-offs based on an approved business restructuring plan under the ICEA will be extended by four more years, and the required timing of publication of an approved plan will be reconsidered.

**(d) Entertainment expenses**

The amount of food and beverage expenses that may be excluded from the scope of non-deductible entertainment expenses will be increased from 5,000 yen per person per time to 10,000 yen per person per time. This exemption will be extended for three more years.

**Local Taxes**

**1. Size-based Enterprise tax**

To mitigate the impact of companies deliberately decreasing their capital to reduce their size-based enterprise tax liability, taxpayers subject to size-based enterprise tax in the previous fiscal year will now be subject to size-based enterprise tax in the current year if the total amount of paid-in capital and capital surplus exceeds JPY 1 billion yen, even if their paid-in capital is JPY 100 million or less as at the current fiscal year end. In addition, taxpayers that are wholly-owned subsidiaries of corporations whose total paid-in capital and capital surplus exceeds JPY 5 billion, and where the total paid-in capital of the taxpayer is JPY 100 million or less but the total paid-in capital and capital surplus together exceeds JPY 200 million will also be subject to size-based enterprise tax.

As a transitional measure, a tax credit will be provided to 100% subsidiaries that are newly subject to size-based enterprise tax as a result of the above change, to the extent the amount of tax calculated under the new size-based enterprise tax rules exceeds the amount of tax calculated under the current enterprise tax rules applicable to such taxpayers.

## **2. Property tax**

The current system where property tax on land is reduced by local ordinance will continue until 2026.

## **Consumption Tax**

More details of the 2024 Proposals relating to items 1. and 2; below can be found here:

<https://www.pwc.com/jp/en/taxnews/pdf/jtu-20231215-en.pdf>

### **1. Introduction of platform taxation**

An obligation to report and remit consumption tax on the cross border provision of digital services will be imposed on platform operators of a certain size (“qualified platform operators”) on behalf of foreign operators providing such services to Japanese customers.

### **2. Applicability of consumption tax to foreign corporations**

The rules regarding the base period exemption, and the simplified calculation method for input credits, will both be revised for foreign corporations.

### **3. Qualified invoice system**

Transitional measures allowing taxpayers to obtain input credits in relation to non-qualified invoices will not be applicable for taxable purchases from a single vendor that exceed JPY 1 billion annually.

### **4. Duty free exemption**

Purchases of goods made knowing that they are duty-free imports will be ineligible for input credit. In the 2025 tax reform, the tax exemption system for foreign tourists will be revised such that the exemption will only be provided when the goods are confirmed exported from Japan.

## **Other**

### **1. Taxation of stock options for individual income tax purposes**

Currently, in order for directors to enjoy exemption from taxation on any gain earned upon exercise of stock options issued to them by the company of which they are a director, it is necessary that such options be held by a third party custodian. Going forward, this requirement will be relaxed, so that the stock options can be held in custody by the actual stock option issuer.

In addition, the maximum annual exercise price for stock options issued by startups will be raised to JPY 36 million per year (three times the current maximum).

## **Improvements in Tax Administration**

### **1. Tax Penalties**

Heavy penalty tax will be imposed where a request for downward correction (i.e., a refund request) is submitted based on concealed or falsified information. In addition, directors of companies that have engaged in tax evasion will now be liable for payment of any tax owing by the company. Both of these rules will apply to national and local taxes.

## Tax Measures to Fund Increased Defence Spending

In order to fund increased defence spending, tobacco tax will be increased. In addition, the 2024 Proposals state that proper measures to secure defence spending will continue to be taken in the future, although the timing is not yet clarified. Thus, future legislative changes to achieve this purpose are anticipated.

## Let's talk

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

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Please click here for details and to apply:

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