16 December 2013

Japan tax alert

Ernst & Young Tax Co.

2014 tax reform outline

Executive summary

On 12 December 2013, the coalition leading parties have officially released the 2014 Tax Reform Outline (December Outline). This is a second tax reform outline following the October Outline released on 1 October 2013. This alert summarizes new items included in the December Outline. For proposals included in the October Outline, please refer to our *Japan tax newsletter, Outline of tax reforms to stimulate investment*, dated 31 October 2013.

Detailed discussions

1. Corporate tax

- An early repeal of special reconstruction surtax by one year was finalized. As a result, the effective corporate tax rate (Tokyo area, with capital of more than JPY100 million (US$1 million), including local taxes) will be reduced from 38.01% to 35.64% for taxable years beginning on or after 1 April 2014. A further reduction of the effective corporate tax rate will continue to be considered.
- Fifty percent of entertainment expenses related to meals (excluding internal entertainment) will be deductible (currently 100% non-deductible). SMEs[1] can choose either the 50% deduction or the current fixed deduction of JPY8 million (US$80 thousand).
- The sunset provision for a special tax treatment on undisclosed expenditures will be eliminated and become permanent.
- Suspended net operating loss carry back rules applicable to large corporations will be extended for additional two years.
- A suspended application of a capital gains surtax derived from a land transfer will be extended to 31 March 2017.
- New tax incentives (i.e., special bonus depreciation, tax credit) for acquisitions of machinery in a zone that will be designated as a National Strategic Special Zone will be introduced.

1 SMEs are generally defined as an entity with capital of JPY100 million (US$1 million) or less. An entity that is wholly owned by a shareholder whose capital amount is JPY500 million (US$5 million) or more is excluded from SMEs.

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2. Consumption tax

- A reduced tax rate for certain consumable items will be implemented on or after the standard rate reaches at 10%, provided that necessary revenues are secured and such reduction is acceptable to general public and enterprises. The coalition leading parties' tax system council will continue to discuss details on implementation of the reduced tax rate and will reach a conclusion by December 2014, which will be included in leading parties' tax reform outlines.
- A 'deemed purchase rate' that is used to calculate a creditable input consumption tax under the simplified method will be reduced from the current rates of 60% for financial/insurance business and 50% for real estate business to 50% and 40%, respectively.
- Concrete measures of consumption tax on cross border services will be discussed towards the 2015 tax reform.

3. Individual income tax

- A standard employment income deduction for high income taxpayers will be reduced. For a taxpayer with a gross salary of more than JPY12 million (US$120 thousand), the deduction will be capped at JPY2.3 million (US$23 thousand) for 2016, and 2017 and thereafter, JPY2.2 million (US$22 thousand) for a taxpayer with a gross salary of more than JPY10 million (US$100 thousand).
- A gain derived from a transfer of a non-qualified stock option by an employee to an issuing company will be taxed to the employee as a salary income vs. the current lower capital gains tax rate.
- A capital loss arising from a transfer of a golf club membership, resort membership etc. will not be eligible to offset with other income.
- A special rule that allows an individual to add the inheritance tax amount to the acquisition cost of the inheritance will be reconsidered.

4. Individual income tax on financial/security transactions

- Interest receivable on or after 1 January 2016 on private placement bonds issued to a small number of persons will become taxable as ordinary income.
- Improvement on a use of an NISA (Japanese Individual Savings Account, or tax exemption system on small investment income) will be considered.

5. International taxation

- The basic principle of taxation on nonresidents/foreign corporations will be changed from the current 'entire income principle' to an 'attributable income principle' that is in line with the Authorized OECD Approach by amending the current tax law to reflect this change. This tax reform will be applied to corporations for taxable years beginning on or after 1 April 2016.
- A service transaction through an unrelated party will be included in the scope of the transfer pricing regime.

6. Tax on automotive

- The automotive acquisition tax rates (local tax) will be reduced from April 2014 from 3% for a light vehicle and 5% for private ordinary vehicle to 2% and 3%, respectively. The automotive acquisition tax will be repealed in October 2015 when the planned consumption tax rate hike reaches the 10% rate.
- The light vehicle tax (local tax) will be increased and applies to new vehicles purchased on or after 1 April 2015. For example, the annual tax amount for a private passenger vehicle will be increased to JPY10,800 (US$108), a 150% increase of the current JPY7,200 (US$72).

7. Local taxes

- A part of corporate inhabitant tax (local tax) will be moved to the national tax regime that is tentatively termed as 'local corporate tax'. A part of special local corporate tax (national tax) will be reverted back to a component of an enterprise tax (local tax).

8. Other

- A taxpayer who disagrees with a tax assessment made by tax authorities will be allowed to appeal directly to the National Tax Tribunal. Further, an appeals period will be extended to 3 months from the current two-month period, determined from a day after the date when the assessment is made known to the taxpayer.

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Japan Tax SCORE CC20131216-4

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