2 October 2013

Japan tax alert

Ernst & Young Tax Co.

Japan's tax reform outline announced

Executive summary

On 1 October 2013, the Japanese government formally decided to increase the rate of consumption tax from the current 5% to 8% from 1 April 2014. It also provided a five-trillion yen (US$51B) economic stimulus policy that aims to alleviate burdens resulting from the consumption tax increase and avoid a negative impact on the economy. This policy includes the ruling parties' outline of various tax cut measures for businesses, that was also released on the same day. This Alert summarizes main corporate tax cuts and incentives.

Detailed discussions

1. Earlier repeal of special reconstruction tax

The 10% special reconstruction surtax on corporate tax was introduced in April 2012 and was intended for three years. The government has proposed to repeal the tax a year early and will make a final decision in December of this year. Under this proposal, the effective corporate tax rate (Tokyo area, including local taxes) will be reduced from 38.01% to 35.64% for taxable years beginning on or after 1 April 2014. The government is also contemplating further measures to reduce the effective corporate tax rate.

2. Tax incentives to promote capital expenditure on productivity-enhancing equipment

According to the proposed provisions of an Industrial Competitiveness Enhancement Act if productivity-enhancing equipment is acquired and placed in service between an effective date of this act and 31 March 2017, a special bonus depreciation of 50% or 25% of the acquisition cost or a 4% or 2% of the acquisition cost as a tax credit may apply. The maximum tax credit available is capped at a 20% of the corporate tax liability for that fiscal year. Equipment acquired before 31 March 2016 may either be deducted immediately or a 5% or 3% of the acquisition cost as a tax credit may be allowed. Productivity-enhancing equipment is defined as:

i. Cutting-edge equipment
   The equipment must be the latest model and must improve productivity by at least 1% increase in an average annual productivity.

ii. Equipment that improves production lines or operations

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3. Tax incentives to promote venture investment

For a period from an effective date of the Industrial Competitiveness Enhancement Act through 31 March 2017, a corporate investor is allowed to accelerate an investment loss if it enters into an agreement with an investment limited partnership (venture fund) approved pursuant to this act, and the venture fund acquires shares or other interest in a venture business. The claimable loss is limited to 80% of the book value of the investment. In each of the succeeding year, such loss is recaptured but would be offset by claiming another investment loss. Accordingly, if the loss reserve amount remains constant throughout the qualified period, the initial year will benefit from the loss claim but will have no effect in the succeeding years.

4. Tax incentives to promote corporate reorganization

A corporation which obtained an approval for its reorganization plan based on the Industrial Competitiveness Enhancement Act between a period from an effective date of the act through 31 March 2017 may deduct a maximum of 70% of acquisition cost of shares or interest, or of book value of a loan to a specified company that is set up in accordance with the reorganization plan. The loss will be recaptured in a 5-year period beginning after the earlier of completion of a 3-consecutive profitable year or 10 years from the date of the approval.

5. Tax incentives to promote capital expenditure for small and medium enterprises (SMEs) extended and enhanced

Under the current incentives, when an SME acquires certain specified machinery or equipment, an accelerated depreciation of 30% of the acquisition price or a 7% tax credit (only for corporations with capital of JPY30M (US$300K) or less) is available. The applicable period for this incentive will be extended for another three years to 31 March 2017. In addition, SMEs (including SMEs with capital of more than JPY30M (US$300K) may apply for an immediate full deduction or 10% or 7% tax credit when acquiring certain equipment for business use, if such equipment falls under the productivity-enhancing equipment category as stated in 2 above.

6. R&D tax credits extended and enhanced

The expiring sunset provision for additional R&D tax credits will be extended for three years to fiscal years beginning on or before 31 March 2017. In addition, the current credit that is equal to 5% of the increased R&D cost may be revised by applying a rate of increase (maximum 30%, minimum 5%) to a cost increase, allowing a proportionate increase in a tax credit, capped at a 10% of the corporate income tax liability.

7. Tax incentives for increasing wages extended and enhanced

The current sunset provision for the increase in wage incentive will be extended by two years to 31 March 2018 and some requirements will be relaxed.

Comments or general inquiries regarding this tax newsletter may be directed to our Corporate Communications team at tax.marketing@jp.ey.com.

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