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Japan tax alert

Ernst & Young Tax Co.

2015 tax reform outline

The 2015 tax reform outline (Outline) was released on 30 December 2014. While the compiling and the release of the Outline came later than in past years due to the House of Representatives election in December, the main reforms revealed in the Outline were largely in line with what had been discussed since early autumn. Below are descriptions of the main reforms.

1. Effective corporate tax rates lowered

- The corporate tax rate will be lowered to 23.9% (current rate: 25.5%) (applied to taxable years beginning on or after 1 April 2015).
- The current standard effective corporate tax rate through the country and municipalities will be lowered from 34.62% (Tokyo base: 35.64%) to 32.11% (Tokyo base: 33.10%). This decrease takes into account the decrease in the corporate enterprise tax per income levy (from 7.2% to 6.0%).
- The aim is to further lower the rate to 31.33% in the 2016 reforms and to below 30% within a few years.

2. Revision of the net operating loss (NOL) carry-forward system

- The current 80% utilization limitation of an annual NOL deduction will be lowered to 65% for taxable years beginning between on or after 1 April 2015 and on or before 31 March 2017 and further lowered to 50% for taxable years beginning on or after 1 April 2017. The carry forward period (currently 9 years) will become 10 years for NOLs incurred during taxable years beginning on or after 1 April 2017.
- As a rule, the above reform does not apply to small and medium-sized enterprises.
- A special rule will apply to newly established corporations and corporations that have commenced rehabilitation procedures, which allows a 100% NOL deduction for a seven-year period.

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3. Revision of the dividends received deduction (DRD) system

- The amount that can be excluded from gross revenue for each stock ownership ratio category will be amended as follows. Stocks with less than 5% ownership will have the exclusion amount greatly reduced, from the current 50% to 20%.

Ownership ratio	Amount excluded from gross revenue
100%	Full amount of dividends received
More than 1/3, less than 100%	Full amount of dividends received (with debt interest exemptions)
More than 5%, up to 1/3	50% of dividends received (no debt interest exemptions)
5% or less	20% of dividends received (no debt interest exemptions)

- In the case of insurance companies, as a special provision, 40% of dividends received from stocks with an ownership ratio of 5% or less may be excluded from gross revenue.
- Dividends of stock investment funds will be fully included in the gross revenue. (80% of ETF dividends will be included in the gross revenue.)

4. Expansion of size-based taxation (corporate enterprise tax)

- The rate of corporate enterprise tax will be revised. The ratio of income-based taxation to size-based taxation (added value-based, capital-based) will be gradually revised (from current 3:1 to 5:3 in 2015, and to 1:1 in 2016.)
- A new system will be created, in which an increase in salary under the tax credits for the salary growth regime can be deducted from the taxable basis of added value-based taxation.
- For corporations below a certain size that experience an increased burden as a result of the expansion of size-based taxation, measures will be implemented to reduce the burden for a two-year period.

5. Revision of tax credit for R&D expenses

- The R&D tax credit limitation with regards to the so-called "gross amount" category will be reduced from the current 30% to 25% of corporate tax liability of a taxable year. Separately, the new R&D tax credit limitation applicable only for special experiment and research expenses (up to 5% of corporate tax liability) will be introduced.
- A carryover of unused creditable amount will be repealed.

6. Consumption tax

- The second phase of the consumption tax rate increase (from 8% to 10%) will be postponed for 18 months to 1 April 2017. At the time of the increase, after gaining the understanding of citizens including relevant businesses, a reduced tax rate on certain items will be introduced.
- Consumption tax will be applied to the provision of services that cross international boundaries such as the provision of digital services (e.g., the distribution of electronic books, music and advertisement) from overseas businesses to Japanese residents or corporations (from 1 October 2015). BtoC transactions (transactions aimed at consumers) will be taxed by self-assessment by the overseas business. BtoB transactions (transactions aimed at businesses) will be taxed in principle by the reverse charge mechanism, in which the domestic business that receives the services will file the tax return.

7. International taxation

- The effective tax rate used as a measure for determining low tax-rate countries under the anti-tax haven rules (also called the trigger tax rate) will be changed from "20% or less" to "less than 20%." This will be applicable for the fiscal year of a specified foreign subsidiary company which begins on or after 1 April 2015.
- Under the foreign dividends exclusion (FDE) system, dividends that are included as deductible expenses according to the laws of the country where the foreign subsidiary resides will be excluded from the FDE system.

8. Income tax

- In order to prevent the evasion of capital gains tax by moving to a country where capital gains on stocks, etc. are not taxed, an "exit tax" in which unrealized capital gains are taxed at the time of departure from Japan will be introduced (applicable to individuals moving their residences out of Japan on or after 1 July 2015).
- In order to encourage the transfer of assets between generations, a system in which gift tax is not applicable to the provision of lump-sum funds for marriage and child-rearing will be introduced. The system of non-taxation of funds for acquiring a house-dwelling, etc. will be expanded and the applicable period will be extended.

9. Other

- In order to revitalize rural areas, reduced taxes for investment in offices and special provisions in the job development tax system will be introduced for companies that strengthen their local presence by moving their offices from Tokyo or expanding their businesses in rural areas, etc.
- The reduced tax rate on eco-cars and the light motor vehicle tax will be reviewed.

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