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Japan tax alert

Ernst & Young Tax Co.

2016 Japan tax reform outline

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The coalition government released their 2016 tax reform outline on 16 December 2015. This alert summarizes the major changes proposed; however, please note that there may be further amendments, deletions or additions as the bill passes through the Diet.

Effective corporate tax rate reduction

The corporate tax rate is to be reduced to 23.4% (currently 23.9% for regular corporations) from fiscal years beginning on or after 1 April 2016. This will be further reduced to 23.2% for fiscal years beginning on or after 1 April 2018.

The combined national and local effective corporate tax rate will be reduced from the current 32.11% to 29.97% on 1 April 2016, and to 29.74% on 1 April 2018, thus realizing the government's goal of lowering the effective corporate tax rate below the 30% mark. A decrease in the tax rate of enterprise tax income levy (from 6.0% to 3.6%) also contributed to this reduction.

Expansion of the tax base

To recoup the tax revenue lost due to the reduction of the effective tax rate, the tax base will be expanded.

Building a better working world

1) Expansion of business size tax (in enterprise tax)

The proportion of business size tax (added value levy and capital levy) in enterprise tax (a local tax) will increase from the current 3/8 to 5/8. The tax rate of added value levy is to increase to 1.2% (from the current 0.72%) and the capital levy to 0.5% (from the current 0.3%). This reform will represent an increase in tax for loss-reporting companies. As a relief measure, the increase in tax due to this reform will be partly exempted for three years for companies under a certain size.

2) Loss carryforward rules

For large companies, the maximum deduction of losses carried forward will be reduced to 60% of its annual income from 1 April 2016 (currently 65%) and will be further reduced to 55% in 2017 and 50% in 2018.

3) Depreciation rules

Fixtures and structures which form part of a building will be depreciated using the straight line method.

Consumption tax

1) Introduction of reduced tax rate

When the consumption tax rate is raised to 10% in April 2017, the current 8% rate will be retained for sales of all food (fresh and processed) and drink, excluding alcoholic beverages and dining out. Certain newspapers will also be eligible for the 8% rate.

A new invoice system will be introduced in April 2021 to provide a method for calculating input tax using multiple tax rates. Until such time, the current system will be maintained and a measure that allows for categorized accounting will be put in place. For the four years starting in April 2017 (when varied tax rates are introduced) businesses will also need to indicate whether the item is subject to the lower rate and indicate the total sales amount for each tax rate in preparing their books and their bills. For small and medium businesses (with taxable sales of JPY50 million or less), it is acceptable to use a simplified method to calculate the tax amount based on an estimate of sales eligible for the lower rate.

Businesses will begin issuing invoices in April 2021 and these invoices must be kept in order to take input tax credits. Tax-exempt enterprises (with taxable sales of JPY10 million or less), however, cannot issue invoices.

Generally, an input tax credit cannot be taken for purchases from tax-exempt enterprises; however, a transitional measure will be available for six years in which a certain proportion of such input tax may be credited.

2) Changes to the input tax credit system for acquisition of high-value assets

For two fiscal years after purchase of an asset costing at least JPY10 million (before tax) by a taxable enterprise, the consumption tax exemption for small businesses and the simplified taxation method cannot be applied.

International taxation

1) Transfer pricing documentation requirements

Documentation requirements in the transfer pricing regulations will be revised in accordance with Action 13 of the Base Erosion and Profit Shifting (BEPS) project.

- Country-by-country reporting (CbCR)
  A Japanese company which is the ultimate parent of a multinational group must submit a report stating the income amount, pre-tax profits, tax paid and other necessary items by each country in which the group does business within one year of the end of the accounting period. CbCR will be required for accounting periods of the ultimate parent that begin on 1 April 2016 or later.
- Master file
  A Japanese company which is a constituent entity of a multinational group and a certain foreign company must submit a report showing the organizational structure, business overview, financial status and other necessary items within one year of the end of the accounting period of the ultimate parent. This business overview report is required for accounting periods of the ultimate parent that begin on 1 April 2016 or later.
- Local file
  Documents necessary for calculating the arm's length price of transactions with foreign related parties must be prepared by the tax return filing due date and, in principle, should be kept for seven years. This applies to corporate tax for fiscal years beginning of 1 April 2017 or later.

2) Other

In line with the shift to the income attribution principle for international taxation in 2016, the scope of cross-border tax-qualified contributions in kind will be revised. The requirements to apply the special measures for taxation of investment companies with TK (*tokumei kumiai*) investments will also be revised.

Individual taxation

1) Exit tax (when leaving the country)

Stock options will be excluded from the scope of securities subject to exit tax. Other revisions and clarifications will be made such as a change to the due date upon expiration of the deferral period for tax payment.

2) Comprehensive individual income tax reforms

A comprehensive revision of individual income tax, including changes to all types of itimized deduction, has been designated for discussion in the 2017 tax reforms or later.

Other

1) Director compensation deduction rules

ROE, etc. will be officially included in the scope of calculation indicators of deductible performance-linked compensation.

2) Taxation on vehicles

Automobile acquisition tax will be abolished on 31 March 2017, and both automobile tax and light vehicle tax will have a new levy on environmental impact, in which the tax rate will be set according to fuel efficiency.

3) New hometown tax for businesses

A new version of the hometown tax will be introduced for businesses, in which blue-return filing companies can take tax credits for enterprise tax, inhabitants tax and corporate tax in return for making donations to local governments for the promotion of rural regions.

4) Reduction of fixed assets tax

The tax base for fixed assets tax on machinery and equipment will be reduced to 1/2 of the price of the machinery for the first three years when a small or medium enterprise acquires certain machinery and equipment that enhances productivity.

5) Tax payment procedures

- Penalties will be imposed for amended tax returns filed after having received advance notification.
- If, after filing, the tax due amount is corrected downwards and then later corrected upwards, interest will not be imposed on the period from the original due date to the correction upwards.
- Credit card payment of national taxes will be introduced.