2015 Tax Reform Act

Issue 110, April 2015

In brief

On 31 March, 2015, the 2015 Tax Reform Act was approved by the Diet and on the same date, the 2015 Tax Reform Act, the Enforcement Orders, and Regulations were promulgated, which are effective for corporate tax years beginning on or after 1 April, 2015.

The 2015 Tax Reform Act provides for tax measures to help realize "economic virtuous cycles" by reducing the effective corporate tax rate from FY2015. In addition, several measures were approved to expand the taxable base to make up for the revenue loss from the tax rate reduction (i.e., limits on the net operating loss deduction, reductions in the dividend income exclusion, changes in the incentive tax system, changes to the size-based enterprise tax system). In addition, certain amendments to the international tax system reflect measures under discussion at the OECD under the so called "BEPS" (Base Erosion and Profit Shifting) discussions.

In detail

On March 31, 2015, the 2015 Tax Reform Act was approved by the Diet and on the same date, the 2015 Tax Reform Act, the Enforcement Orders, and Regulations were promulgated. This newsletter outlines the latest information and major components of the 2015 Tax Reform Act for corporate taxpayers.

1. Corporate tax measures related to the tax rate reduction
2. Corporate tax – other measures
3. Introduction of new incentives for the revitalization of local "hubs"
4. International tax measures
5. Consumption tax measures
6. Other indirect tax measures
7. Impose "exit tax" on individuals from July 2015 in accordance with "BEPS"
8. Changes in tax administration

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1. Corporate tax measures related to the tax rate reduction

(1) Reduce corporate tax rates (national tax and size based enterprise tax)

From tax years beginning on or after 1 April 2015, the National corporate tax rate is reduced from 25.5% to 23.9%. Since the Inhabitants tax rate is based upon the National tax rate, for the Tokyo metropolitan area the Inhabitants tax rate will be reduced from 5.28% to 4.95% (other areas can be lower). Finally, for large corporations, the tax rate related to the income portion of the Enterprise tax will be reduced from 7.2% to 6.0% for years beginning on or after 1 April 2015 but before 31 March 2016. An additional Enterprise tax rate reduction from 6.0% to 4.8% will apply for years beginning on or after 1 April 2016. Because the Enterprise tax is deductible for tax purposes, the effective rate (Note1) for large corporations solely operating in the Tokyo metropolitan area should be reduced from 35.64% to 33.06% and then to 32.26% for years beginning on or after 1 April 2016. The special lower rates for SMEs (Note 2) will be extended to 31 March 2017.

Under the 2015 Tax Reform Act, the tax rate for the value added base and the capital base taxation is doubled while the tax rate for the income base taxation is lowered to two thirds of the current rate. This process will be carried out in two steps. In the calculation of the corporate effective tax rate noted above, only the tax rate for the income base of the size based enterprise tax is reflected. Thus, depending upon the circumstances of each company, the lowered income base tax rate related to the enterprise tax may not really reflect a lower overall tax burden since the size based taxes will be increasing. More details are shown below.

The applicable tax rate will change as illustrated in the following table:

【Changes to the corporate tax rate】

	Before amendments			After amendments		
	Statutory Tax Rate (National tax)			Statutory Tax Rate (National tax)		
	Corporate tax	Local corporate tax	Total	Corporate tax	Local corporate tax	Total
Large Corporation	25.5%	0%	25.5%	23.9%	1.05%	24.95%
SMEs (Note1)	25.5% (Note3)	0%	25.5%	23.9% (Note3)	1.05%	24.95%

(Note 1) $\frac{\text{Corporate Tax Rate} \times (1+\text{Inhabitants Tax Rate}) + \text{Enterprise Tax Rate}}{1 + \text{Enterprise Tax Rate}}$

(Note 2) Small to medium sized enterprises ("SMEs") are ordinary corporations with capital not exceeding JPY 100 million and not wholly owned by a corporation with capital of JPY 500 million or more.

(Note 3) Reduced rate (15%, 19% and 22%) for taxable income of 8 million yen or less is applicable to tax years beginning on or before 31 March 2017.

【Changes to the size based tax rate】

		Before amendments	After amendments	
			Fiscal year 2015	Fiscal year 2016
Value added base		0.48%	0.72%	0.96%
Capital base		0.2%	0.3%	0.4%
Income base (Note)	≦4 million yen	3.8% (2.2%)	3.1% (1.6%)	2.5% (0.9%)
	4 million yen< ≦8 million yen	5.5% (3.2%)	4.6% (2.3%)	3.76% (1.43%)
	8 million yen <	7.2% (4.3%)	6.0% (3.1%)	4.8% (1.91%)
Local corporate special tax (the rate is multiplied by the income base of size based enterprise tax) which is collected as national tax by filing corporate tax returns		67.4% (2.9%)	93.5% (2.9%)	152.6% (2.9%)

Note: The rate shown for the income base is the total income based tax including (a) the portion collected as part of the national tax return and (b) the portion included as part of the Enterprise tax return. The portion in parentheses of the income base column shows the amount collected as an Enterprise local tax (the difference is collected as a national tax). The above rate changes for income base may not affect taxpayers who have elected consolidated taxation since consolidation is not applicable for local tax purposes.

Enterprise tax size based taxation（Standard rate）

	Fiscal year 2014		Fiscal year 2015		Fiscal year 2016	
	Statutory Tax Rate	Effective Tax Rate	Statutory Tax Rate	Effective Tax Rate	Statutory Tax Rate	Effective Tax Rate
Corporate tax+ Local corporate tax	25.50%	23.79%	24.95%	23.54%	24.95%	23.54%
Inhabitants tax	4.41%	4.12%	3.08%	2.91%	3.08%	2.91%
Size based tax (income base)	7.19%	6.71%	6.00%	5.66%	4.80%	5.66%
Total	37.10%	34.61%	34.03%	32.11%	32.83%	31.33%

Enterprise tax size based taxation（Excess rate applicable area：Tokyo metropolitan area）

	Fiscal year 2014		Fiscal year 2015		Fiscal year 2016	
	Statutory Tax Rate	Effective Tax Rate	Statutory Tax Rate	Effective Tax Rate	Statutory Tax Rate	Effective Tax Rate
Corporate tax+ Local corporate tax	25.50%	23.71%	24.95%	23.47%	24.95%	23.75%
Inhabitants tax	5.28%	4.91%	3.90%	3.66%	3.90%	3.71%
Size based tax (income base)	7.55%	7.02%	6.30%	5.93%	5.04%（Note1）	4.80%
Total	38.33%	35.64%	35.15%	33.06%	33.89%	32.26%

（Note1）Since the excess rate for FY 2016 is not yet determined, the rate is calculated with the standard rate multiplied excess rate for 2015.

Enterprise tax non size based taxation（Standard rate）

	Fiscal year 2014		Fiscal year 2015～	
	Statutory Tax Rate	Effective Tax Rate	Statutory Tax Rate	Effective Tax Rate
Corporate tax+ Local corporate tax	25.50%	23.27%	24.95%	22.77%
Inhabitants tax	4.41%	4.03%	3.08%	2.81%
Size based tax (income base)	9.59%	8.75%	9.59%	8.75%
Total	39.50%	36.05%	37.63%	34.33%

Enterprise tax non size based taxation（Excess rate applicable area：Tokyo metropolitan area）

	Fiscal year 2014		Fiscal year 2015～	
	Statutory Tax Rate	Effective Tax Rate	Statutory Tax Rate	Effective Tax Rate
Corporate tax+ Local corporate tax	25.50%	23.17%	24.95%	22.67%
Inhabitants tax	5.28%	4.80%	3.90%	3.54%
Size based tax (income base)	10.07%	9.15%	10.07%	9.15%
Total	40.85%	37.11%	38.92%	35.36%

(2) Limit net operating loss deduction

The changes in the limitation for the net operating loss deduction will be implemented in two steps. For the first two years, the current 80% limitation will be reduced to 65%. Thereafter, the limitation will be reduced to 50% although the limitation carryover period will be extended from the current 9 years to 10 years for losses incurred on or after years beginning on or after 1 April 2017. SMEs are not subject to the loss deduction limitation.

	Before amendments	After amendments	
		Fiscal year 2015～2016	Fiscal year 2017 -
Limitation ratio for large corporations	80%	65% (Note 1)	50% (Note 2)
Carryover period for loss utilization as well as assessment by tax authorities and request for downward adjustment by taxpayer (assuming loss period financial documentation is maintained)	9 Years	9 years	10 years (Note 3)

(Note 1) For fiscal years beginning on or after 1 April 2015 and before 1 April 2017 in which the taxpayer claims a net operating loss deduction.
(Note 2) For fiscal years beginning on or after 1 April 2017 in which the taxpayer claims a net operating loss deduction.
(Note 3) Applicable to tax losses incurred in fiscal years beginning on or after 1 April 2017.

Certain newly established corporations and companies coming out of a rehabilitation process will not be subject to the loss limitation rules for a certain period.

Type of corporation applicable	Years in which full deduction is allowable	Years where regular limitation applies even if full deduction otherwise allowable
Newly established corporations (Note 1) and corporations coming out of the rehabilitation process (Note 2)	Seven years from establishment of the corporation or seven years from the decision of the court to exit the rehabilitation process.	For years ending on or after (i) a company is listed on a stock exchange, or (ii) the company is deemed to be rehabilitated.

(Note 1) SMEs, 100% subsidiary of larger corporations, or 100% parent corporation after share transfer are excluded.
(Note 2) SMEs are excluded

(3) Reduce the dividend income exclusion

In the 2015 Tax Reform Act, the threshold ownership percentage for corporate dividend exclusion will be increased as illustrated in the following table:

The amendments apply to dividends received by a corporation on or after April 1, 2015. Before the amendments, the dividend income exclusion for "Affiliated domestic corporation "was allowed to the extent that the shareholder ownership duration was for 6 months or more until the dividend declaration date. After the amendment, the holding period is changed to the 6 months or more until the fiscal year end for which the dividend will be paid. The dividend income exclusion for "Other domestic corporation" and "Portfolio investment" is allowed by reference to the ownership percentage as of the fiscal year end for which the dividend will be paid.

<table>
<tr><th colspan="3">Before amendments</th><th colspan="3">After amendments</th></tr>
<tr><th>Type of investment</th><th>Ownership %</th><th>Exclusion %</th><th>Type of investment</th><th>Ownership %</th><th>Exclusion %</th></tr>
<tr><td>Wholly owned domestic subsidiary</td><td>100%</td><td>100%</td><td>Wholly owned domestic subsidiary</td><td>100%</td><td>100%</td></tr>
<tr><td rowspan="2">Affiliated domestic corporation</td><td rowspan="2">25% or more</td><td rowspan="2">100% less allocable interest</td><td>Affiliated domestic corporation</td><td>More than 1/3</td><td>100% less allocable interest (Note 1)</td></tr>
<tr><td rowspan="2">Other domestic corporation</td><td rowspan="2">More than 5% but less than 1/3</td><td rowspan="2">50%</td></tr>
<tr><td rowspan="2">Other domestic corporation</td><td rowspan="2">Less than 25%</td><td rowspan="2">50% less allocable interest</td></tr>
<tr><td>Portfolio investment</td><td>Less than 5%</td><td>20% (Note 2)</td></tr>
<tr><td rowspan="2">Investment trusts (Note 3)

(including ETF (Exchange Trust Fund), foreign currency denominated trusts and other investment trusts)</td><td colspan="2" rowspan="2">A maximum of 50% of net income less interest expense of a domestic investment trust can be treated as a dividend from an "other" domestic corporation (i.e., 50% less allocable interest is excludible). The percentage of income from a investment trust which can be treated as a dividend depends upon the type of investment trust.
ETF- 100%
Foreign currency denominated investment trusts – 25%
Other investment trusts – 50%</td><td colspan="2">ETF</td><td>20% (treated as a Portfolio investment)</td></tr>
<tr><td colspan="2">Other investment trusts</td><td>0%</td></tr>
</table>

(Note 1) Under certain simplified calculations to determine allocable interest, the "base period" is the fiscal years beginning between 1 April 2015 and 31 March 2017.
(Note 2) For dividends from portfolio investments received by insurance companies, the exclusion percentage will be 40%.
(Note 3) Not including bond investment trusts, foreign investment trusts and specific type of foreign currency denominated investment trusts

(4) Change tax incentives

(a) R&D tax incentive

With respect to the R&D tax incentive in particular, the R&D tax incentive is the largest incentive in terms of tax benefit in the Japanese corporate tax system. Thus, the Tax Commission Report on one hand wanted to limit the tax revenue cost of the incentive while also maintaining the benefit from a "competitiveness" perspective. Thus, the trend in the legislation is to reward increases in R&D spending rather than support existing spending which has been the case in the 2014 Tax Reform and is continued in the 2015 Tax Reform Act. In addition, there is focus on the "Special R&D" which is the type of R&D which is considered likely to develop innovative basic research. This is illustrated as follows:

The amendments apply for tax years beginning on or after April 1, 2015.

Category		Before amendments	After amendments
Permanent incentive (gross R&D cost base)		A credit against national corporate tax is allowed 【Credit amount】 8-10% of the gross R&D cost (rate depends upon the R&D costs including special R&D costs） 【Limitation of credit】 30% of corporate tax before credit 【Carry over】 Excess R&D cost may be carried over for one year.	【Limitation of credit】 Reduced to 25% of corporate tax before credit 【Carry over】 Carry over is no longer applicable
	Special R&D cost based credit	Joint R&D with or contracted R&D by University or public research institution or contracted 【Credit amount】 12% of the gross Special R&D cost	【Scope of special R&D cost】 Royalty payments to SMEs shall be included to special R&D cost 【Credit amount】 Increased to 30% of the gross Special R&D cost for the joint R&D with University or public research institution (20% for the joint R&D with other non-public corporations) A credit against local inhabitants tax is also allowed for SMEs 【Limitation of credit】 5% of corporate tax before credit (separately from other gross R&D cost credit)
	Gross R&D cost based credit for an SME	A credit against national corporate tax and local inhabitants tax is allowed 【Credit amount】 12% of the gross R&D cost 【limitation of credit】 30% of corporate tax before credit 【Carry over】 Excess R&D cost may be carried over for one year	【Limitation of credit】 Reduced to 25% of corporate tax before credit 【Carry over】 Carry over is no longer applicable
Temporary incentive (incremental R&D cost base)		A credit against national corporate tax is allowed for a tax year commencing from April 1, 2013 to March 31, 2017 【Credit amount】 A credit against national corporate tax is allowed for the higher of (a) and (b) but subject to the limitation of 10% of tax liability before the credit. (a) 5 – 30% of incremental R&D cost or (b) R&D costs in excess of 10% of the average sales, times the "tax credit ratio" (ratio is a mechanical calculation which increases the credit depending upon the relationship between the amount of R&D costs and average annual sales) 【Limitation of credit】 10% of corporate tax before credit.	(Same as left)

(b) Salary income increase incentive
Under the 2015 Tax Reform Act, the salary increase requirement in the FY2016 and 2017 (fiscal years beginning between April 1, 2016 and March 31, 2018) is shown in the following table:

	Fiscal year 2013	Fiscal year 2014	Fiscal year 2015	Fiscal year 2016	Fiscal year 2017
Before amendments	2%	2%	3%	5%	5%
After amendments (SMEs)	2%	2%	3%	3%	3%
After amendments (Large corporations)	2%	2%	3%	4%	5%

(c) Rollover relief granted for replacement of long held real estate or machinery
The type of qualified assets and the rollover ratio is explained in the 2015 Tax Reform Act.

The above amendment applies to the assets transferred on or after January 1, 2015 or the effective date of the "Revised Regional Revitalization Law".

(5) Local tax amendments

Taxable basis for value added tax and capital base tax of the size-based enterprise tax regime, and tax bracket for the per capita tax is reviewed.

The capital base will be changed from the current sum of capital and capital surplus for corporate tax purposes to the larger of (a) capital or (b) the sum of the capital and capital surplus for corporate tax purposes. The effect of this change is to increase the capital base taxation when the sum of the capital and capital surplus is negative (e.g., as a result of share buybacks).

Similarly, the tax bracket for the per capita tax portion of the corporate inhabitants tax will be changed to the larger of (a) capital and (b) the sum of capital and capital surplus for corporate tax purposes. Thus, any reduced capital amount that has been reclassified to income surplus shall be added back as capital for this purpose.

The above amendment applies to the tax years beginning on or after April 1, 2015.

Finally, special relief is provided to allow a taxpayer to deduct any increased salary payments made from the value added taxable base in order not to diminish the effect of the tax incentive for the increased salary payments. Other relief is also provided to allow a taxpayer to deduct the increased tax burden as a result of the rate change from the value added base and the capital base. More specifically, a corporate taxpayer is allowed to deduct the increased salary payment (assuming the requirement for tax incentive for increased salary payment is met) from the value added taxable base in the year beginning on or after 1 April 2015 but before 31 March 2018. Certain measures will be provided not to grant double deductions of salary payment from value added base for a taxpayer whose salary % exceeds 70% of the sum of the salary payment, interest and rent.

For periods beginning on or after 1 April 2015 but before 31 March 2017, a special tax credit is granted to reduce the increased burden of size based tax if the value added amount is less than 4 billion yen.

2. Corporate tax – other measures

(1) Changes in the taxation of hedging transactions

There are differences between the treatment of certain kinds of hedging transactions between JGAAP and Japanese tax law related to the validity of the hedging transaction. Under the 2015 Tax Reform Act, the differences will be eliminated as long as the local tax office is notified by the filing due date of tax return for which the relevant methodology is applied (before the amendment, it was possible to use the JGAAP methodology with advance approval of the local tax office).

The above amendment applies to the tax years beginning on or after April 1, 2015.

(2) Changes in the group tax regime

Under the group taxation rules, taxation is deferred on transfer of assets between Japanese companies under 100% common ownership until the recipient company disposes of the assets to the outside of the 100% group. The 2015 Tax Reform Act provides that even if the recipient company disposes of the asset to the outside of the 100% group pursuant to some sort of expropriation where rollover relief would normally be applicable that this disposal should not be considered a taxable disposal for group taxation purposes. Rather, the "replacement assets" which are normally

required in an expropriation situation will serve as substituted assets for group tax purposes.

The above amendment applies to the triggering event such as expropriation taking place in the year ending on or after April 1, 2015.

(3) Deduction from taxable income of the non-deductible inputs tax per consumption tax return

By introducing the reverse charge system in the consumption tax regime, any non-deductible inputs tax per consumption tax return will be allowed for deduction from taxable income calculation.

The above amendment applies to the tax years ending on or after October 1, 2015.

3. Introduction of new incentives for the revitalization of local "hubs"

A taxpayer will be eligible for certain tax incentives if it relates to or expands certain kinds of operations in local areas (generally other than Tokyo, Osaka or Nagoya). Details as to the kinds of operations eligible will be included in a future "Revised Regional Revitalization Law".

Any qualifying investments will have the following depreciation incentives with respect to investments in buildings:

	Investment pursuant to an approved relocation plan	Investment pursuant to expanding an existing operation
Type of depreciation (if plan is approved prior to 31 March 2018 and asset is acquired within 2 years of approval)	Additional first year depreciation of 25% of the acquisition cost (depreciation is accelerated)	Additional first year depreciation of 15% of the acquisition cost (depreciation is accelerated)

Alternatively, a taxpayer may choose to take a tax credit rather than accelerated depreciation as follows:

	Investment pursuant to an approved relocation plan	Investment pursuant to expanding an existing operation
Tax credits (if plan is approved and asset acquired prior to 31 March 2017)	Acquisition costs x 7%	Acquisition costs x 4%
Tax credits (if plan is approved prior to 31 March 2018 and asset is acquired within 2 years of approval)	Acquisition costs x 4%	Acquisition costs x 2%

Minimum investment is 20 million yen for large corporations and 10 million yen for SMEs.

In addition, an employment related tax credit is allowed for increased employment in a local hub if hired within two years of the plan approval. The credit shall be 500,000 yen times the number of increased employees at a maximum (if certain conditions are not met the credit becomes 200,000 yen per employee).

In total, the amount of the above tax credits can only offset up to 30% of a corporation's tax liability.

4. International tax measures

As part of trends in international taxation, the OECD has organized the BEPS + G20 project in June 2012 (BEPS is short for "Base Erosion and Profit Shifting"). In this project, a number of changes are being proposed by the OECD to make change international tax law to reduce the occurrence of "unfair" shifting of profits between countries by taxpayers.

In the 2015 Tax Reform Act, changes are incorporated to follow a few of the released OECD BEPS guidelines recently issued. In particular, changes made for the Japanese tax system as it relates to the taxation of international transactions as a result of the BEPS process including (a) the taxation of hybrid instruments, (b) the requirement for banks to collect and remit taxpayer information and (c) an "exit tax" for individuals (discussed in the individual section below).

(1) Eliminate dividend income exclusion for "hybrid" financial instruments

The BEPS Action Plan 2 proposed that measures be taken to neutralize the tax effects of so-called "hybrid mismatch" arrangements where, because of differences in the treatment of certain payments between jurisdictions, an item of

income is not taxed in either the payer or the payee country because the payment is deductible in the payer country but not taxable in the recipient country. Thus, the recommendation in BEPS Action Plan is to modify local tax law to in order for the recipient country to tax the receipt.

Before the 2015 amendment, any dividends received by a Japanese corporation from a foreign affiliate was 95% exempt from taxation in Japan regardless of the tax treatment in the payer country. This position was clarified in Q&A guidance issued by the NTA (http://www.nta.go.jp/shiraberu/zeiho-kaishaku/shitsugi/hojin/25/02.htm). Based upon the recommendation of BEPS Action Plan 2, the 2015 Tax Reform Act excludes such type of dividend from the dividend exclusion regime. As a result, any dividends paid to Japanese corporate taxpayers under so called "MRPS" issued by Australian affiliates or by Brazilian affiliates where the dividends are paid in a manner similar to interest and deductible for Brazilian tax purposes will no longer be excluded from taxation in Japan.

To the extent any portion of the dividend is deductible for foreign tax purposes, the general principle is that all of the dividend should be taxable in Japan. However, if a portion of the dividend is not tax deductible in the foreign jurisdiction, dividend exclusion will be allowed only if the taxpayer discloses all of the appropriate information regarding the portion of the dividend which is not deductible in the foreign jurisdiction and backup details for the calculation in a timely filed tax return and maintains the relevant documents for inspection by the tax authorities.

Any foreign tax imposed on the taxable dividend in Japan will be eligible for foreign tax credit relief.

The new rules will in principle apply for any dividends received by a Japanese corporate taxpayer whose fiscal year begins on or after 1 April 2016. However, if the Japanese corporate taxpayer owns the stock of the foreign affiliate as of 1 April 2016, dividends received for years beginning between 1 April 2016 and 31 March 2018 will be subject to the old rules (i.e., still eligible for exclusion).

(2) Require banks to collect and remit information regarding bank accounts owned by non-residents

In July 2014, the OECD guidelines for automatic information exchange by financial institutions were issued and it was recommended by the OECD fiscal committee to begin such measures by G20 countries by the end of 2015. To meet this recommendation the 2015 Tax Reform Act introduces a tax reporting system. Under the Act, it is anticipated that the individuals will be required to report information to the relevant branch of the financial institution which will in turn submit such information to the tax authorities in Japan.

The person who contracts with the financial institution for a deposit to a bank account in Japan on or after 1 January 2017 will be required to report the relevant information to the bank including (a) name, (b) address, (c) date of birth and (d) resident country. If the resident country is outside Japan, the individual will be required to report the taxpayer identification number in the taxpayer's resident country. The financial institution will be required to report the individual information collected as well as details regarding the account (balances, transactions, etc.) as of 31 December by the following 30 April.

(3) Changes to the controlled foreign corporation ("CFC") tax regime

To reduce the tax risks and costs of Japanese corporations operating in foreign countries and to promote more business development and enhance their international competitiveness, it has been requested by the Japanese business community to review the triggering tax rate for CFC status (this relates to the change in the UK tax rate to 20% effective 1 April 2015). In addition, it has been requested that a review should be made regarding the exceptions to the CFC regime in the case that the rate threshold is not met because of low tax rates in the foreign jurisdiction. Thus, changes in the rules are being proposed regarding (a) certain rules regarding the treatment of holding companies, (b) relaxation of tax return filing requirements and (c) changes related to the amounts subject to tax related to tax deductible dividends from foreign corporations discussed above.

Under the 2015 Tax Reform Act, the changes in the triggering rate, the treatment of foreign holding companies, and the relaxation in the filing requirements applies for foreign affiliates whose tax years begin on or after 1 April 2015. Generally, changes related to the definition of taxable income (including deductible dividends) will have an effective date of 1 April 2016. However, with respect to deductible dividends in particular, the effective date will be consistent with the effective dates of changes in the treatment of deductible dividends discussed above.

Category of Amendment		Amendment
Trigger rate		Change from “20% or less” to “less than 20%”
Exceptions to CFC rules even if trigger rate is met	Scope of a foreign controlled companies for purposes of the regional headquarters holding company rules	Under current law, only foreign companies can be considered to be a “controlled company” for purposes of the regional headquarters requirements. Under the 2015 Tax Reform Act, a Japanese company owned at least 50% by a foreign company can also qualify as a “controlled company”.
	Requirements to be a regional headquarters holding company (issue regarding definition of “management services”)	Under current law, management services must be provided to at least two controlled companies. Because of the above change, under the 2015 Tax Reform Act a change is made so that management services must be performed for two or more foreign companies (the Japanese company under the first change noted above does not qualify).
	Requirements to be a regional headquarters holding company	Under current law, one of the conditions to be a “regional holding company” is that the book value of the shares in the controlled companies must be greater than 50% of the total book value of all of the investments by the regional holding company in stock investments. Under the 2015 Tax Reform Act, one of the following additional conditions must be satisfied: (a) The total book value of the shares of the foreign (as opposed to Japanese) controlled companies is greater than 50% of all controlled companies OR (b) The management service fees received from foreign (as opposed to Japanese) controlled companies are greater than 50% of the service fees received from controlled companies. Under current law, transactions between a qualifying regional holding company and its controlled subsidiaries are not considered to be with related parties for purposes of the “related party test”. Under the 2015 Tax Reform Act, for purposes of this test, transactions with a controlled Japanese subsidiary are considered to be with a related party.
	Tax return filing requirements	Under current law, it is possible for a taxpayer to lose certain exceptions to the application of the CFC rules if proper documentation is not attached to the tax return and/or maintained by the taxpayer. The 2015 Tax Reform Act relaxes this rule and allows the appropriate tax authority to allow such exception to apply if he or she determines that the lack of documentation is reasonable.
Definition of taxable income	When CFC receives a tax deductible dividend from other affiliate which is not a CFC	Such dividend should not be excluded from taxable income of the CFC.
	When CFC1 receives a tax deductible dividend from CFC2	If income from CFC2 is subject to tax in Japan, if the dividend is paid out from taxable income of CFC2, the dividend income should be excluded from the income of CFC1 for CFC income calculation purposes.
	Domestic parent receives tax deductible dividend from CFC	Deductible dividends which would otherwise be taxable under the rules discussed above should not be taxable to the domestic parent up to the amount of taxable income already included under the CFC legislation for the last 10 years.

(4) Make changes to the “attribution of income” method for a Permanent Establishments (“PEs”)

In the 2014 Tax Reform, the so called “Authorized OECD Approach” was introduced to be effective for years beginning on or after 1 April 2016. In the 2015 Tax Reform Act, some amendments have been made as follows:

- It is clarified that interest received by a foreign corporation without Japanese branch related to accounts receivable for goods or services outstanding for less than 6 months will not be subject to corporation tax in Japan.
- Any Japan real estate owned by the head office of a foreign company with a PE in Japan shall be considered to have been transferred to the Japanese PE at the book value of the asset in the hands of the head office.
- In calculating the foreign tax credit for a Japanese company, rules clarify the amount of foreign source income attributable to a foreign branch. Further, the amount of foreign taxes attributable to the foreign branches is in a separate “basket” for foreign tax credit calculation purposes.

(5) Change the requirements for certain tax qualified cross border corporate reorganizations

- In the case of a cross border corporation reorganization whereby a Japanese company becomes a subsidiary of a foreign company (i.e., an inversion) and it is not possible to determine the tax rate of the foreign parent company because it is a new company or other issues, the tax rate will be deemed to be the statutory tax rate of the head office of the foreign company.
- For purposes of determining the trigger rate as applies to a corporate "inversion", the trigger tax rate is changed from "20% or less" to "less than 20%".

The new rules apply to corporate reorganizations which occur on or after 1 April 2015.

5. Consumption tax measures

(1) Delay the consumption tax rate hike to 10% until 1 April 2017

On 10 August 2012, the Diet passed a law to implement an increase in the consumption tax in two steps. By an amendment to this law, the 2015 Tax Reform Act delays the second step to increase the tax to 10% from 1 October 2015 until 1 April 2017. With this amendment, other related amendments are also necessary as shown below.

	Before amendments	After amendments
Effective date of 10% rate	1 October 2015	1 April 2017
Designated date to apply for transitional rules of the consumption tax amendment	1 April 2015	1 October 2016
Applicable period of the special measures law to ensure reflect the increased consumption tax on the list price	31 March 2017	30 September 2018

(2) Impose consumption tax on the cross border provision of digital services to Japanese customers from 1 October 2015

In the 2014 Tax Reform, the government indicated that they would examine the application of consumption tax for the provision of cross border digital services in the 2015 Tax Reform. As a result of this process, the following amendments have been proposed and will be applied for the purchase of digital services from foreign service providers on or after 1 October 2015.

- Definition of digital services and criteria for taxation

In the 2015 Tax Reform Act, the definition of where digital services (e.g., e-books, music and advertising) are performed for consumption tax purposes has been change from the place where the service is performed taking into account the location of the office and other criteria of the service provider to the place where the service is received by the customer. The definition of digital services does not include services where the main transaction is the transfer of a physical asset. However, the definition of digital services includes the licensing of products subject to copyright by a foreign person to a Japanese customer (under current rules, such transaction would be deemed to occur at the location of the foreign licensor).

- Reverse charge mechanism

Under the 2015 Tax Reform Act, the change in the tax system introduces a reverse charge system for consumption tax related to digital services. For foreign providers of digital services without a PE in Japan, if it is obvious based upon the terms and conditions or the nature of the service that the recipient of the digital services operates a business in Japan, the business receiving the service will be deemed to be consumption tax taxpayer. If this is not the case, the consumption tax taxpayer is the foreign digital service provider.

By the introduction of the reverse charge mechanism, the provision of the digital services to businesses in Japan is not treated as a taxable transfer by the foreign service provider but is treated as a specific taxable input expense for the business customer which becomes liable for tax payment.

Foreign digital service business providers will be required to specifically notify Japanese business customers prior to the transaction that the Japanese business customer is subject to the consumption tax on a reverse charge basis.

Taking into consideration the burden on businesses and that the input and output credits would be almost the same, if the taxable sales ratio for the Japanese business customer is 95% or more, the Japanese business customer will not be

required to report either the input or output credit from foreign digital service providers (for the time being).

- **Limitation of tax credit for B to C digital services received by business customers**

For the time being, business customers will not, in principle, be allowed to claim an input credit for the purchase from foreign digital service providers of what is normally considered to be B to C digital services (based upon the type of service). While there is a filing requirement for foreign digital service providers, to encourage the foreign digital providers to prepare and file tax returns and to avoid the local businesses to obtain a credit when no filing is made, it was decided not to allow input tax credit. However, if the foreign service provider is properly registered in Japan and the invoices from the foreign service provider specify the registered number, the Japanese business customer should be allowed an input credit assuming the proper invoices are retained.

- **Registration process**

The registered foreign digital service provider is defined as those who do not take the benefit of the small business exemption and (a) has an office or fixed place of business in Japan to carry out the digital services in Japan or (b) has designated a tax agent for consumption tax purposes. Application for registration with the tax authorities can be made on or after 1 July 2015.

	Digital services to business customer	Digital services to consumers
Taxable services	• Digital provision of EBooks, music, and advertising • It is clear under the terms and conditions of the service or the type of service that the recipient is a business customer.	• Digital provision of EBooks, music and advertising provided to customers other than businesses.
Taxation method	• Reverse charge mechanism (liability is shifted to the domestic service recipient) • Foreign digital service provider should notify the domestic business that it is a reverse charge transaction. • If the taxable sales ratio of the domestic business is 95% or more, no reporting is required.	• Foreign digital service operators must declare and pay tax or designate a tax agent. • It is assumed that no input credit is allowed for Japanese customers. • Input credit will be allowed if the foreign digital service provider provides a registration number in the invoice

(3) Reverse charge method applicable to consumption tax on entertainment or sports attractions provided by non-resident suppliers from 1 April 2016

Japanese sponsors will be subject to a reverse change system for sports or music/art attractions in Japan provided by foreign entertainment providers.

This amendment applies to the provision of services on or after 1 April 2016.

6. Other indirect tax measures

- **Registration tax**

Reduced registration tax related to the transfer of ownership of land is extended for two years until 31 March 2017.

Before the amendment, there is a reduced tax rate applicable for the registration of real estate upon transfer through a *bunkatsu* (demerger). This regime will expire for *bunkatsu* transactions on or after 1 April 2015. However, for transfers which occur prior to 1 April 2015, the benefit will be lost unless registration occurs within 3 years of the *bunkatsu* transaction.

- **Real estate acquisition tax**

The reduced tax rate for real estate acquisition tax related to housing for the acquisition of land and building is extended for three years until 31 March 2018.

7. Impose “exit tax” on individuals from July 2015 in accordance with “BEPS”

In accordance with the recommendation as reflected in BEPS Action Plan 6, the 2015 Tax Reform Act introduced a new “exit tax” for individuals leaving Japan.

For this purpose, an “exit” means when an individual no longer has a residence or address in Japan. At the time of the exit, the individual will be subject to tax on gain on securities and derivative transactions as if the individual sold or

settled the transaction at fair market value. The new rule applies to exits and donations and inheritances of property made by a Japanese resident on or after 1 July 2015.

Taxpayer	Resident who meets both of the following conditions: Value of assets subject to taxation at the time of the exit is 100 million yen or more. Within 10 years of exit, the individual has been a Japanese resident for more than five years. For foreign nationals, the five out the last ten years "clock" would not start until July 1, 2015. Time living in Japan under a visa status under "Table 1" of the Immigration Control law is not included (e.g., specialists in the humanities/international services, intra-company transferee, temporary visitor, etc).
Assets subject to exit taxation	Securities as defined in the individual tax law, ownership of *tokumei kumiai* contracts and unsettled derivative transactions, credit transactions and hedging transactions for stock risks trading.
Filing requirements for tax report	By the due date of the final tax return to be filed by a registered agent of the taxpayer (valuation date is the exit date). OR in a "short period" tax return which is due upon exit (if no tax agent is appointed) (valuation date is three months prior to the expected exit date).
Rescission of taxation by return to Japan within five years.	If the taxpayer returns to Japan within five years of exit and retains assets continuously from the date of exit, taxation of such assets will be cancelled upon filing by the taxpayer within four months of the return date.
Transfer by donation or inheritance to a non-resident	Donor is deemed to sell or settle the derivative or transfer the securities on the date of transfer for purposes of the tax return filing.

Please click here for a separate newsletter with more details on the "exit tax."

8. Changes in tax administration

- Tax audit procedures

Once an audit has complete, the basic principle is that a second audit is not allowed. However, if newly acquired information is obtained by the tax authorities which lead them to conclude that the reported taxable income should have been different, then the tax authorities can conduct another audit of the taxpayer. This limitation on the ability of the tax authorities to conduct a second audit only applies if the first audit was conducted on-site. If a "desk audit" is only conducted where the tax authorities do not conduct the audit on-site, no limitation applies.

This rule applies to tax investigations started on or after 1 April 2015.

- Late filing of the tax returns without subject to the penalty tax

Before the amendment, taxpayers who file tax returns within 2 weeks of the filing due date and are deemed to have had an intention to file in due date are not subject to penalty tax for late filing. Under the 2015 Tax Reform Act, this period is extended for up to one month.

This amendment applies for national and local tax returns where the deadline comes on or after 1 April 2015.

Let's talk

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

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