2016 Tax Reform

Issue 122, June 2016

In brief

On 31 March, 2016 the 2016 Tax Reform Act, the Enforcement Orders, and Regulations were promulgated, effective for corporate tax years beginning on or after 1 April, 2016.

In order to revitalize the economy as well as target a return of the government deficit to a surplus by 2020, the 2016 Tax Reform aims to support profitable companies by continuing to lower the corporate tax rate while also continuing to expand the taxable base. To make up for the revenue loss from the tax rate reduction, several measures were included to expand the taxable base, including changes to depreciation methods and the withdrawal of some tax incentives. Similar to the 2015 Tax Reform, the 2016 Tax Reform includes not only changes to the national corporate tax regime but also changes to the local tax regime, in particular, size-based enterprise tax system.

In addition, several measures are included to stimulate local regions and to seek to minimize the growing economic gap between urban and rural areas. Transfer pricing reporting requirements are also updated to reflect measures outlined by the OECD in Action 13 of the BEPS (Base Erosion and Profit Shifting) final report, recently released in October 2015.

With regards to the consumption tax hike, it was decided in the Cabinet on June 2, 2016 to delay the applicable dated from April 1, 2017 to October 1, 2019.

In detail

1. Summary

Continuing on from the 2015 Tax Reform, the main objective of the 2016 Tax Reform is to implement the second stage of *Abenomics*, in particular, to enhance the economic recovery by stimulating the corporate competitiveness of Japanese companies with further reductions in the corporate tax rate, while at the same time seeking to improve the government deficit by a series of base broadening measures.

The effective corporate tax rate of 32.11% is scheduled to fall further in two stages: first to 29.97% in 2016, and then 29.74% in 2018. An increase to the size-based component of enterprise tax, as well as allowing only straight-line depreciation on selected assets, together with the scheduled expiration of tax incentives on investments for productivity growth, are all part of the efforts to increase the taxable base.

The 2015 revisions to net operating loss carryforwards as well as to the sized-based component of enterprise tax are further revised in 2016. The taxation of small and medium sized enterprises (SMEs) and not-for-profit organizations however remain as they were.

The regional revitalization efforts introduced in 2015 to assist in a shift of Japan's economic concentration away from Tokyo have also been expanded.

The consumption tax rate was scheduled to rise to 10% on April 1, 2017. A multiple rates regime was also due to begin on the same date to lessen the burden for lower income tax brackets. However, a Cabinet decision was made on June 2, 2016 to delay the consumption tax increase to October 1, 2019. The 2016 Tax Reform also introduced an invoice method for consumption tax from April 1, 2021 with transitional measures in place to cope with the multiple consumption tax rates.

Finally, based on the recommendations of Action 13 of the final BEPS report issued in October 2015, new reporting obligations for transfer pricing documentation will be implemented.

2. Principal corporate tax changes

(1) Reduction of corporate tax rates

From fiscal years beginning between April 1, 2016 and March 31, 2017, the national corporate tax rate will be reduced from 23.9% to 23.4%, followed by a further rate reduction from April 1, 2018 to 23.2%.

Furthermore, the tax rate relating to the income portion of size- based enterprise tax will be reduced from 4.8% to 3.6% for fiscal years beginning on or after April 1, 2016, while the sized based portion of enterprise tax will increase.

To minimize the growing economic gap between urban and rural areas, the national local corporate tax rate will be increased while the local inhabitants tax rate will fall. Furthermore, the local corporate special tax is scheduled to be abolished from April 1, 2017, and replaced with an increase in the enterprise tax rate.

【Enterprise tax rate】

Fiscal year beginning		April 1, 2016	April 1, 2017
Size based tax regime			
Value added base		1.2%	1.2%
Capital base		0.5%	0.5%
Income base (Note 1)	≦4 million yen	1.9% (0.3%)	1.9%
	4 million yen<, ≦8 million yen	2.7% (0.5%)	2.7%
	8 million yen <	3.6% (0.7%)	3.6%
Local corporate special tax		414.2% (2.9%)	- (Note 2)
Income based tax regime			
Income base	≦4 million yen	5.0% (3.4%)	5.0%
	4 million yen<, ≦8 million yen	7.3% (5.1%)	7.3%
	8 million yen <	9.6% (6.7%)	9.6%
Local corporate special tax		43.2% (2.89%)	- (Note 2)

Note 1: 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 enterprise local tax (where 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.

Note 2: The local corporate special tax will be abolished from April 1, 2017, and replaced with an increase to the enterprise tax rate.

【Local corporate tax rate & Inhabitants tax rates】

	April 1, 2016		April 1, 2017	
	Standard Rate	Maximum Rate	Standard Rate	Maximum Rate
Prefectural Tax Portion	3.2%	4.2%	1.0%	2.0%
Municipal Tax Rate	9.7%	12.1%	6.0%	8.4%
Local Corporate Tax Rate	4.4%		10.3%	

The effective tax rate for large corporations should be reduced from 32.11% (33.06% in the Tokyo Metropolitan area) to 29.97% (30.86% in the Tokyo Metropolitan area) from April 1, 2016 and then to 29.74% (30.62% in the Tokyo Metropolitan area) for fiscal years beginning on or after April 1, 2018.

【Enterprise tax size based taxation (Standard rate)】

	April 1, 2015	April 1, 2016	2 April 1, 2017	April 1, 2018
Corporate Tax (a)	23.9%	23.4%	23.4%	23.2%
Local Corporate Tax	((a) × 4.4%) 1.052%	((a) × 4.4%) 1.030%	((a) × 10.3%) 2.41%	((a) × 10.3%) 2.39%
Total	24.95%	24.43%	25.81%	25.59%
Prefectural Tax	((a) × 3.2%) 0.765%	((a) × 3.2%) 0.749%	((a) × 1%) 0.234%	((a) × 1%) 0.232%
Municipal Tax	((a) × 9.7%) 2.318%	((a) × 9.7%) 2.270%	((a) × 6%) 1.404%	((a) × 6%) 1.392%
Total	3.083%	3.019%	1.638%	1.624%
Enterprise tax (b)*	3.10%	0.70%	3.60%	3.60%
Local corporate special tax	((b)* ×93.5%) 2.90%	((b)* × 414.2%) 2.90%	0	0
Total	6.00%	3.60%	3.60%	3.60%
Statutory tax rate	34.03%	31.05%	31.05%	30.81%
Effective tax rate	32.11%	29.97%	29.97%	29.74%

【Enterprise tax non size based taxation （Standard rate）】

	April 1, 2015	April 1, 2016	2 April 1, 2017	April 1, 2018
Corporate Tax (a)	23.9%	23.4%	23.4%	23.2%
Local Corporate Tax	((a) × 4.4%)1.052%	((a) × 4.4%)1.030%	((a) × 10.3%) 2.41%	(a) × 0.3%) 2.39%
Total	24.95%	24.43%	25.81%	25.59%
Prefectural Tax	((a) × 3.2%)0.765%	((a) × 3.2%)0.749%	(a) × 1%)0.234%	((a) × 1%) 0.232%
Municipal Tax	((a) × 9.7%)2.318%	((a) × 9.7%)2.270%	((a) × 6%)1.404%	((a) × 6%) 1.392%
Total	3.083%	3.019%	1.638%	1.624%
Enterprise tax (b)**	6.70%	6.70%	9.60%	9.60%
Local corporate special tax	((b)** ×43.2%) 2.89%	((b)** ×43.2%)2.89%	0	0
Total	9.59%	9.59%	9.60%	9.60%
Statutory tax rate	37.63%	37.04%	37.05%	36.81%
Effective tax rate	34.33%	33.80%	33.80%	33.59%

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

	April 1, 2015	April 1, 2016	2 April 1, 2017	April 1, 2018
Corporate Tax (a)	23.9%	23.4%	23.4%	23.2%
Local Corporate Tax	((a) × 4.4%)1.052%	((a) × 4.4%)1.030%	((a) × 10.3%) 2.41%	((a) × 10.3%) 2.39%
Total	24.95%	24.43%	25.81%	25.59%
Prefectural Tax	((a) ×4.2%)1.004%	((a) ×4.2%)0.983%	((a) ×2%)0.468%	((a) ×2%)0.464%
Municipal Tax	((a) ×12.1%) 2.892%	((a) ×12.1%)2.831%	((a) ×8.4%) 1.966%	((a) ×8.4%) 1.949%
Total	3.896%	3.814%	2.434%	2.413%
Enterprise tax	3.40%	0.88%	3.78%	3.78%
Local corporate special tax	((b)* ×93.5%) 2.90%	((b)* ×414.2%)2.90%	0	0
Total	6.30%	3.78%	3.78%	3.78%
Statutory tax rate	35.15%	32.02%	32.02%	31.78%
Effective tax rate	33.06%	30.86%	30.86%	30.62%

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

	April 1, 2015	April 1, 2016	2 April 1, 2017	April 1, 2018
Corporate Tax (a)	23.9%	23.4%	23.4%	23.2%
Local Corporate Tax	((a) ×4.4%)1.052%	((a) ×4.4%)1.030%	((a) ×10.3%)2.41%	((a) ×10.3%) 2.39%
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Municipal Tax	((a) ×12.1%) 2.892%	((a) ×12.1%) 2.831%	((a) ×8.4%)1.966%	((a) ×8.4%) 1.949%
Total	3.896%	3.814%	2.434%	2.413%
Enterprise tax	7.18%	7.18%	10.08%	10.08%
Local corporate special tax	((b)** ×43.2%) 2.89%	((b)** ×43.2%) 2.89%	0	0
Total	10.07%	10.07%	10.08%	10.08%
Statutory tax rate	38.92%	38.32%	38.32%	38.08%
Effective tax rate	35.36%	34.81%	34.81%	34.60%

(2) Limitation on net operating loss deductions

The changes in the limitation for the net operating loss deduction will be implemented in three steps, i.e., the rate will decrease by 5% annually, and ultimately reduced to 50% in FY2018. However, the expiry period of losses will be extended from 9 to 10 years for losses incurred on or after fiscal years beginning on or after April 1, 2018.

		FY 2015	FY 2016	FY 2017	FY 2018
Limitation ratio for large corporations	Before amendments	65%		50%	
	After amendments	65%	60%	55%	50%
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)	Before amendments	9 years		10 years	
	After amendments	9 years			10 years (Note 1)

(Note 1) Applicable to tax losses incurred in fiscal years beginning on or after April 1, 2018.

(3) Depreciation methodology

For selected structural improvements acquired on or after April 1, 2016, only the straight line method will be permitted with the declining balance accelerated depreciation method no longer be allowed. Companies in the mining industry as an exception can however elect either the production basis or the straight line depreciation methods.

Asset Type		Asset Acquisition Date			
		From April 1, 1998	From April 1, 2007	From April 1, 2012	From April 1, 2016
Buildings		Straight Line Method	Straight Line Method		
Structures and Attachments to buildings		Straight Line or Declining Balance Methods	Straight Line or 250% DB Methods	Straight Line or 200% DB Methods	Straight Line
Equipment and machinery, vehicles, ships, aircraft					Straight Line or 200% DB Methods
Assets used in Mining	Buildings, Attachments, and Equipment	SL, DB, or Units-of-production Methods	SL, 250% DB, or Units-of-production Methods	SL, 200% DB, or Units-of-production Methods	Straight Line or Units-of-production Methods
	Other assets excluding the above				SL, 200% DB, or Units-of-production Methods
Intangible Assets		Straight Line Method	Straight Line Method		
Foreign Leases		Straight Line	Straight Line over life of lease		

(4) Review of tax incentives

In line with the 2015 Tax Reforms, a number of tax incentives were examined and allowed to lapse with their scheduled expiry dates or were cancelled altogether.

Tax incentives abolished due to the expiration of the applicable period (include as selected example):

Tax incentive	Applicable period
Tax incentives for investments for increased productivity	Assets acquired and placed in service by March 31, 2017

Tax incentives where scope and tax benefit have been changed as a result of prioritization (as selected examples):

Tax incentive	After amendments
SME related special depreciation	Changes were made to narrow the type of corporation qualifying for the incentive and applicable period extended for 2 years
Investment incentive granted to machineries in the national strategic area or international strategic area	Excess credit carry- over regime will be abolished. Applicable period extended for 2 years
Employment promotion credit	Review of the requirements, extension of 2 years
Special depreciation related to clean energy	Review of the requirements, extension of 2 years

Certain high priority incentives were increased (selected examples):

Tax incentive	After amendments
Entertainment expenses related to meals and drinks, and to SMEs	Applicable period extended for 2 years

(5) Tax burden relief in relation to the size-based tax regime

From April 1, 2016 to March 31, 2019, there will be phase-in period for the enterprise tax increase for companies with a value added base of less than JPY 4B: a portion of the tax increase compared to pre-tax reform year (March 31, 2016) will be available as a deduction.

	Amount to be deducted from enterprise tax in the event of an increased burden		
Value added base	Fiscal years from April 1, 2016	Fiscal years from April 1, 2017	Fiscal years from April 1, 2018
Less than JPY 3B	Tax Increase (Note) X 75%	Tax Increase X 50%	Tax Increase X 25%
Over JPY 3B and up to JPY 4B	Fixed portion of tax increase (max 75%)	Fixed portion of tax increase (max 50%)	Fixed portion of tax increase (max 25%)

Note: The tax increase is equal to that year's corporate enterprise tax less the corporate enterprise tax calculated by the pre-tax reform year (March 31, 2016) rates.

3. Small and Medium Enterprises (SME)

① SMEs (Note 1) will be able to continue to apply the deduction on low cost depreciable assets for another two years; however, by the 2016 tax reform, this will no longer apply to corporations with more than 1,000 employees.

② For SMEs undergoing a corporate rehabilitation, discharged debt included in qualified partnership assets (Note 2) where revaluation gain or loss of assets included taxable income or loss, the applicable period is extended for another three years, given a qualified valuation attached to tax return.

③ For SMEs (Note 3) utilizing tax incentives for the investment in productive equipment with qualified machinery or equipment (Note 4) up until March 31, 2019, the taxable base of fixed assets tax for the first three years will be reduced to ½.

④ Entertainment related expenses (internal entertainment expenses excluded) up to JPY 8M or 50% of expenditure for meals and drinks can be deducted for another two years.

Note 1 – SMEs include the following corporations:

① Ordinary corporations with capital not exceeding JPY 100 M. Corporations more than 50% of whose shares are owned by a large corporation, and corporations more than 2/3 of whose shares are owned by large corporations are excluded.

② With our without invested capital corporations, less than 1,000 regular employees.

Note 2 –Debt extended by two or more financial institutions to SMEs in a qualified loan restructuring plan.

Note 3 – SMEs applicable to this tax incentive is defined in the relevant law.

Note 4 – Equipment or machinery whose production started within the past 10 years, which increases production efficiency by at least 1% per annum, and cost savings at minimum of JPY 1.6 M.

4. Other corporate tax related reforms

(1) Corporate reorganizations

For stock exchange or stock transfer transactions (Stock Exchange), the director continuation requirements were stricter compared to the requirements for other tax-qualified organizations, and this will be amended in the 2016 Tax Reform. Also, the acquisition cost of the shares in a subsidiary with 50 shareholders or more by the parent corporation will be revised.

	Before amendments	After amendments
Director continuation requirements for joint ventures	The Stock Exchange will not be tax qualified in the event that any of the specified director departs as a result of the transaction	The Stock Exchange will not be tax qualified only in the event that all specified directors depart as a result of the transaction
Acquisition cost in qualified Stock Exchanges for acquired corporations with 50 shareholders or more	Net book asset value of the acquired company is used for a qualified exchange（Net book asset value is defined as the value of book assets less the value of liabilities immediately before the transaction）	Net book asset value of the acquired corporation immediately before the Stock Exchange adjusted by the investment capital increase or decrease reported before the Stock Exchange.

There will also be clarifying rules released for the share holding period requirements in newly formed mergers, demergers or share transfers.

The above rules will apply to corporate merger, de-merger, share for share swap or share transfer carried out on or after April 1, 2016.

(2) Contributions-in-kind

Before amendments, tax qualified contribution-in-kind rules, the following transfers are excluded:

① Transfers of specified Japan domestic assets or liabilities to a foreign corporation, including real estate or real estate interests, or mining, extraction in Japan, or other assets or liabilities attributed to domestic place of business but excluding equity holding of foreign corporation for 25% or more; and

② Transfers by a foreign corporation to a Japanese corporation of assets or liabilities attributed to foreign place of business, excluding real estate or real estate interests, or mining, extraction in Japan.

By the 2016 Tax Reform, the treatment of the following transfers has been revised and will be applicable to the contribution in kind carried out on or after April 1, 2016 (if a transferee is a foreign corporation, the contribution in kind carried out on or after tax years beginning on or after April 1, 2016).

Transferring Entity	Receiving Entity	Asset	Tax qualification status
Domestic corporation	Foreign corporation	Japan domestic real estate, real estate interests, mining, or extraction right or assets or liabilities attributed to domestic place of business	Tax disqualified before amendments ⇒Transfers of domestic assets fully to the Japanese permanent establishment (PE) of a foreign corporation to be qualified (on condition that it is not expected that certain domestic assets are expected to be transferred to foreign head office)
Foreign corporation	Foreign corporation		
Domestic corporation	Foreign corporation	Assets or liabilities other than the above	Tax qualified before amendments ⇒ Transfer of foreign business assets (which were transferred from Japanese head office within one year before the contribution in kind, excluding cash, inventory, securities) to an office other than the Japanese PE of a foreign corporation to be disqualified
Foreign corporation	Foreign corporation		Tax qualified before and after amendments
Foreign corporation	Domestic corporation	Assets and liabilities attributed to foreign place of business (excluding Japan domestic real estate or real estate interests, mining, or extraction)	Tax disqualified before and after amendments
Foreign corporation	Foreign corporation		Tax qualified before amendments ⇒Transfers of foreign business assets to the Japan PE of a foreign corporation to be disqualified

(3) Director's equity compensation

① Corporations remunerating individuals with restricted shares in return for the provision of future services will be able to deduct the cost on the date of vesting. This treatment will apply to restricted shares granted by corporate resolutions on or after April 1, 2016.

② Remuneration by corporations to directors in the form of restricted shares will not require advance notice to claim a corporate deduction.

③ Clarification to be provided on the deductibility of director bonuses linked to certain performance metrics, such as return on equity. This new rule will apply to the tax years beginning on or after April 1, 2016.

(4) Other

① The disallowance of entertainment expenses (excluding allowance of 50% meals and drinks) from corporate deductions has been extended for 2 years.

② Net operating loss carrybacks not available to corporations other than SMEs are extended for 2 years.

5. Regional revitalization efforts

(1) Local Hub Incentives

With the 2015 Tax Reform, tax incentives as part of the Regional Revitalization Act up until March 31, 2018 and relating to qualified installations as well as promotion of employment were put into effect. The 2016 Tax Reform expanded the tax credit available for an increase in salaries along with the tax credit for promotion of employment. These two credits can now be combined to determine the total credit.

(2) Local government contributions

Also as part of the Regional Revitalization Act, blue-form corporate tax filers who made donations to approved regional donation plans up until March 31, 2020 in additional to taking a deduction from the corporate tax, will also be able to claim a tax credit against corporate tax, enterprise and corporate inhabitant taxes. This is known as the corporate hometown tax, or *furusato nozei* system.

(3) National Strategic Zones

For a blue-form filing corporation with an approved plan for qualified investment in a National Strategic Special Area up until March 31, 2018, a deduction of 20% of income is available for 5 years from the date of establishment.

6. Financial services

(1) Derivative loss carryforwards

Income arising from over-the-counter (OTC) derivative transactions earned by Japanese resident individuals (including foreign exchange and contracts for differences) were subject to separate taxation at the rate of 20%. Losses arising from these transactions could be carried forward for three (3) years. The following derivative transactions will now be excluded from this separate taxation system and losses arising from these transactions cannot be carried forward:

> OTC derivatives conducted with a person other than (i) Commodity Derivatives Business Operators or (ii) Certain Financial Instruments Business Operators which fall under the category of Type I Financial Instruments Business Operators or Registered Financial Institutions.

The new rules will apply to transactions commencing on or after October 1, 2016.

(2) Islamic Finance

The following tax exemptions relating to beneficiary interests issued by special purpose trusts (known as J-Sukuk) are extended for three years:

> ･Exemption for profit distribution derived from book-entry bond type beneficiary interests received by non-resident individuals or foreign corporation; and
> ･Exemption for registration tax when an originator repurchases the trust assets

(3) J-REITs

① In order deduct dividends, J-REITs must pass the Specified Assets Test. The Specified Assets Test requires that more than 50% of total assets be defined “certain assets” in the tax law. The changes provide that *tokumei kumiai* (TK) investments are only included as “certain assets” if they relate to the investment and management of securities or real estate, etc.

② Under the Specified Assets Test, renewable energy facilities which meet certain conditions can be included as “certain assets” for fiscal periods ending on and before 10 years after the date of leasing the facility. This period is extended to 20 years.

③ Certain technical changes impact the calculation of the 90% dividend deductibility test (i.e., the amount of dividend payments made by a J-REIT in a fiscal year must exceed 90% of its distributable profits in that same fiscal year).

(4) Other

Interest on cash collateral received by offshore investors on certain OTC derivatives is exempt from Japanese withholding tax. The scope of OTC derivatives that are eligible for this exemption is widened upon revisions to the applicable securities law, the Cabinet Office Ordinance on Financial Instrument Firms Association, etc.

7. International Tax

(1) Japan – Taiwan agreement on tax matters

On 26 November 2015, the de facto diplomatic organizations representing both Japan and Taiwan completed negotiations on a comprehensive income tax agreement. Along with treating residents and domestic corporations the same in each jurisdiction, the following items were also agreed:

・Residency tie-breaker rules
・Income to Taiwan residents to be nontaxable for income and corporate tax purposes
(1) Business income to be nontaxable for income and corporate tax purposes (assuming no PE)
(2) Dividend taxation to be decreased (dividends taxed at 10%, interest nontaxable)
(3) Capital gains to be nontaxable
(4) Provision of personal services to be nontaxable
・Arbitration measures to be put in place for transfer pricing
・Special measures on the downward requests in case of the confirmation of the tax authorities
・Information exchange measures

Above treatments is expected toapply to the income subject to taxation on or after January 1, 2017 for individual income tax or withholding tax and corporate income subject to taxation in the tax years beginning or after January 1, 2017.

(2) Transfer pricing documentation

In October 2015, the OECD released the final BEPS reporting package with Action 13 relating to transfer pricing and related documentation. Taking into consideration the compliance costs for taxpayers along with increased transparency, the 2016 Japan Tax Reform requires the following documentation in order to adhere with the with the BEPS project:

Document	Required Information	Submission Deadline	Applicability
Country-by-Country Report	Country revenue, pre-tax income, taxes payable, etc.	Must be e-filed within 1-year of the last fiscal day of the ultimate parent	Applicable for fiscal year of the ultimate parent entity beginning on or after April 1, 2016
Master File	Group company structure, business outline, financial conditions, etc.		
Local File	Transfer pricing documentation	By due date of tax return, to retain for 7 years	Applicable for corporate tax in fiscal years beginning on or after April 1, 2017

(3) CFC regime

As Japanese companies endeavor to expand their overseas activities and competitiveness, the 2015 Tax Reform reduced the Anti-Tax Haven trigger tax rate as well as revised the conditions to fall within the specified exceptions. The 2016 Tax Reform specifically addresses controlled foreign corporations (CFCs) of insurance businesses operating in the UK Lloyd’s market and foreign tax credit regime for CFCs.

Revised Items		Content of Revisions
Exception Conditions	100% controlled foreign corporation held by a Japan domestic corporation（limited to insurance companies operating in the UK Lloyd's market）subject to the substance and control tests	If the CFC in its jurisdiction of the head office meets the substance and control test, then it is treated that the substance and control tests for CFC regime is met
	Intra-transaction of 100% CFCs（limited to insurance companies operating in the UK Lloyd's market）and unrelated party transaction tests	Intra-transaction between 100% CFCs is no longer treated as related party transaction.
Foreign Tax Credit Determination	Calculation of foreign corporate taxes paid for the foreign tax credit under CFC rules	Foreign Tax = Foreign Taxes paid by the CFC x Ratio of taxable income 【Revision Point】 For the calculation of the ratio of income (Includable Income / Total income of CFC）, if dividend received by CFC from its subsidiary is not subject to the taxation on CFC level, such dividend income will be excluded from total income of CFC.
	Calculation of foreign taxes paid for the foreign tax credits under the anti-corporate tax inversion rules	

The above revisions will apply to controlled foreign corporations with tax years beginning on or after April 1, 2016.

(4) Attribution of income rules

The 2014 Tax Reform introduced the international tax principle of attribution of income to replace the entire income principle (applicable for fiscal years beginning after April 1, 2016), and the 2016 Tax Reform follows on the 2015 Tax Reform to clarify the following items:

- For the calculation of foreign sourced income in determining the foreign tax credit for a Japan domestic corporation, in the event that foreign sourced income (that is a sum of the foreign sourced income attributable to the foreign business and not attributable to the foreign business) or is negative, foreign sourced income will be deemed to be zero, while the foreign sourced income attributable to the foreign business is negative, such amount is treated as the foreign sourced income.
- In the event a PE of a foreign corporation is acquired by a foreign corporation, which does not have PE but once carried PE and accrued tax loss, in a tax qualified transaction, losses accrued by that former PE will not be permitted to be carried forward (the loss of the acquired PE will be carried over).

The above changes will be applied to both national and local taxes from tax years beginning on or after April 1, 2016..

8. Consumption tax

(1) Multiple rates

In response to the increase in consumption tax rate to 10% from 1 October 1, 2019 lower consumption tax rates on certain goods will be introduced. Also, in response to the multiple tax rates, an invoice system will be introduced from April 1, 2021. In the four year transitional period to the introduction of an invoice system, several measures will be implemented.
The lower consumption tax rate of 8% will still apply to food (excluding when purchased in restaurants) along with newspaper subscriptions where there is at least an issue twice per week.

Until the invoice system is introduced, the credit for consumption taxes paid will follow the current method for tracking, where the lower tax rate on applicable items should be indicated in the invoice. With the increased administration cost of tracking the different rates, the simplified method of determining consumption taxes paid will be allowed.

After the new invoice system is introduced, qualified invoices issued by the registered businesses (Note 1) should be maintained for claiming credits of consumption taxes paid.

(Note 1) Businesses (other than exempt entity) will need to file an application with their tax office to become qualified, for issuing qualified invoices indicating details such as the business registration number, the applicable tax rate, etc.

(2) SME directed measures

For consumption taxpayers other than those applying the exemption or simplified taxation method, high valued transactions as defined will trigger a disallowance from using either the simplified method or being consumption tax exempt for a taxpayer after the following transactions:

Transaction	Period for which exemption or simplified method not applicable
Any inventory or adjusted real property transaction in which the value is JPY 10M or more	3 years starting from the beginning date of taxable period in which the transaction takes place
Building construction expenses totaling JPY 10M or more	3 years starting from the beginning date of taxable period in which the construction completes

The above changes will be applicable to high value assed transactions on or after April 1, 2016 unless the contract for that asset was finalized by December 31, 2015.

(3) B2B digital services

With the 2015 Tax Reform, consumption taxes are now applicable on digital services based on the location of the recipient of those services. From January 1, 2017, the sourcing of B2B digitally provided services will be based on the following:

Transaction	Sourcing
Where a Japan domestic business with a foreign branch office receives a digital service or product, and that transaction is only for the purpose of the foreign business	Foreign (out of scope of consumption tax)
Where a foreign business has a Japan branch, and the digital service or product is provided in Japan only for the purpose of the domestic business	Domestic (consumption tax applicable)

9. Other indirect tax measures

(1) Registration taxes

- A two year extension will be provided for reduced registration tax for corporations undergoing a qualified organizational restructuring plan or qualified foundation business plan.

10. Individual income tax

(1) Exit tax

As part of the 2015 Tax Reform, an exit tax came into effect from July 1, 2015. As part of the 2016 Tax Reform, the following revisions were made to the exit tax:

- From 2016, stock options (where all or part is taxed in Japan) is excluded from the scope of applicable assets.
- The exit tax payment suspension period will be extended from 5 years to 5 years and 4 months from January 1, 2016.
- Where assets subjected to the exit tax were bequeathed to non-residents of Japan and the value of those assets falls due to the certain event occurs, there will be a 4 month period after the event occurs in which to file an amended tax return or a downward request
- Where the exit tax was not applicable at the time of departure from Japan, asset values will not be deemed to be the cost basis at the time of departure.
- For individuals subject to the exit tax who applied for the payment suspension, securities sold after departure from Japan will be indicated in the following order:
  (1) Securities not included in the exit tax suspension
  (2) Securities subjected to the exit tax on a first-in-first-out basis
- For NISA accounts (Japan Individual Savings Accounts) opened before departure, the account will be closed and listed securities will be valued as of the date three months prior to departure. If a tax representative is not appointed by the tax return filing date, these assets are treated as sold and repurchased, and the capital gains will not be taxable.

(2) Other

① Loss carryforwards or offset against gain on listed stocks will be allowed for listed stocks subject to the exit tax.

② The Foreign Equity Reporting which was introduced with the 2012 Tax Reforms will be extended to include the following:

・Resident individuals who were directors or employees of a Japanese subsidiary or branch of a foreign corporation and receive equity related income; and ・Non-resident individuals who are directors or employees of a Japanese subsidiary or branch of a foreign corporation who receive equity related income which is Japan sourced

③ From January 1, 2016, the tax exempt commutation allowance will be increased to JPY 150 K monthly from JPY 100 K.

④ The following have been extended for two years:

・Long term capital gain rates applied to purchase or exchanges on qualified residences; ・Carryforward provisions for capital losses incurred on purchase or exchanges of qualified residences; and ・Carryforward provisions for capital losses incurred on sales of qualified residences

11. Tax Procedural

(1) Increase in penalties

① Penalty taxes (underreporting of income, failure to file, and failure to pay withholding tax) for an amended tax return or payment of withholding tax before expectation of the assessment under audit is either 0% or 5%. With the 2016 Tax Reform, the underreporting of income and failure to file penalties will change as described below after an audit notice has been received:

	Return filed or Payment made before audit notice	Return filed or Payment made after audit notice received but before expectation of assessment		Return filed or Payment after start of audit and assessment expected
		Before amendments	After amendments (Note 1)	
Underreporting Penalty	0%	0%	5%, 10%	10%, 15%
Failure to File Penalty	5%	5%	10%, 15%	15%, 20%
Failure to Pay withholding tax	5%	5%		10%

(Note 1) For the scope excluded by the tax audit such as a transfer pricing audit or tax audit on certain consolidated member company, an amended return relating to tax which is out of scope of the Before amendments audit will not have the increased penalty rates applied. It will not apply to voluntarily amended inheritance or gift tax returns as a result of split of inherited estate.

The above changes will apply to both national and local taxes for which the filing date will fall on or after January 1, 2017.

② In the event of fraud or concealment of facts, the failure to file penalty (15%, 20%) and the heavy penalty tax (35%, 40%) will be increased by 10% for taxpayers who have already been assessed these penalty taxes within the past 5 years.

The above changes will apply to both national and local taxes for which the filing date will fall on or after January 1, 2017.

③ Following the December 12, 2014 Supreme Court decision on inheritance tax with regards to the delinquency tax on amended returns (in the case, downward correction was made by the tax authorities after the tax return filed, then upward correction was followed), the following will apply to both national and local taxes for which the filing due date will fall on or after January 1, 2017:

- The delinquency tax will not be applied (on the portion paid with the original return) from the date of payment to the date of increased tax via assessment or amended tax return; and
- Penalty tax will not be applied (on the portion paid with the original return) on amended tax returns increasing the tax due.

(2) Secondary tax obligations

① When a court ruling is issued to invalidate a corporate merger or demerger, a merged corporation or a transferor corporation will be liable to a national or local tax liability on or after the date of merger or demerger.

This rule will apply to the corporate merger or demerger carried out on or after January 1, 2017.

② For business transfer, the following secondary tax liability responsibilities will be revised:

・The secondary tax liability will be limited to individuals in the same household or entities within the same family corporation group (corporation in which share ownership surpasses 50%).
・The requirement that the business is managed in the same location will be abolished.
・The secondary tax liability will be limited to transferred asset.

This change will apply on national and local taxes delinquency in payment from business transfer on or after January 1, 2017.

Let's talk

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

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