17 December 2019

Global Tax Alert

Japan releases 2020 tax reform outline

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

Executive summary

On 12 December 2019, Japan's coalition leading parties released the 2020 tax reform outline (the Outline). A tax reform bill (the Bill) will be prepared based on the Outline. The Bill will be submitted to the Diet[1] and is expected to be enacted by the end of March 2020.

This Alert summarizes the key provisions relevant to multinational corporate taxpayers.

Detailed discussion

Group income and loss sharing rules

As a result of the replacement of the tax consolidation system, new group income and loss sharing rules will be introduced. Under the new rules, the loss of a company is passed to and shared with another company within the same company group. Consistent with the current tax consolidation system, the group loss relief rules are voluntary.

While many of the rules under the tax consolidation system will continue to apply under the new group income and loss sharing rules, there will be some differences. One difference is that loss sharing is fixed at the time of the original tax return filing, and if taxable income or loss increases or decreases pursuant to a subsequent tax assessment or an amended tax return, the loss sharing is not impacted by such an assessment or amended tax return.

The new group income and loss sharing rules will automatically apply to a company group currently filing a consolidated tax return. These company groups can opt out of the new rules by submitting the prescribed document prior to the start of the first fiscal year beginning on or after 1 April 2022.

This revision will apply to taxable years beginning on or after 1 April 2022.

Open innovation tax incentives

The open innovation tax incentive provides a deduction to companies making an eligible investment in a venture company.[2] The deduction is equal to 25% of the amount invested.

Requirements for the deduction include:

- The age of the venture company does not exceed 10 years.
- At least JPY100 million[3] is invested in a Japanese venture company (JPY500 million investment is required for a foreign venture company).
- The company making the capital contribution is engaged in a highly productive business or the development of new business, and the management resources of the venture company are utilized for the highly productive business or development of new business.[4]
- Government approval is obtained.

The deduction will be subject to recapture if a change occurs to the venture company investment[5] within five years of the capital contribution.

The tax incentive will be available for qualifying investments made during the period 1 April 2020 to 31 March 2022.

Tax incentives for 5G technology

The Outline provides a tax incentive for investments in 5G technology.[6] A company can receive either a 15%[7] tax credit or 30% bonus depreciation for qualifying 5G investments. The tax incentive cannot exceed 20% of the corporate tax liability in any year.

The tax incentive will be available for expenditure incurred from the date of enactment of the *Advanced Information Communication Promotion Law* until 31 March 2022.

Anti-avoidance measures for dividends and capital losses

The Outline includes an anti-avoidance measure for dividends and capital losses. Under the new measure, a parent company's tax basis in the shares of a subsidiary[8] will be reduced if the parent company receives a dividend from the subsidiary exceeding 10% of the tax basis of the subsidiary, and the dividend income is subject to the domestic or foreign dividend received deduction (DRD). It is thought that this anti-avoidance measure was proposed to address tax losses created by a parent company, by way of the payment of a dividend from a subsidiary to a parent prior to the transfer of the subsidiary (where the dividend is subject to the DRD).

An exception from the application of this anti-avoidance measure will be available if any of the following apply:[9]

- 90% or more of the subsidiary was owned only by Japanese companies and/or Japanese resident individuals from the subsidiary's incorporation until the acquisition by the parent.
- The dividend is paid out of retained earnings earned after the parent acquired the subsidiary.
- The dividend is paid at least 10 years after the parent acquired the subsidiary.

The measure does not apply if the dividend does not exceed JPY20 million.

The Outline does not specify when the revision will start to apply, but it is expected that this revision will apply to taxable years beginning on or after 1 April 2020.

Increased thresholds for tax incentives

The Outline raises the thresholds for tax incentives. Currently, large companies cannot receive certain tax incentives, including the research and development tax credit, if all of the following conditions are met:

- Current taxable income exceeds the prior year's taxable income.
- The total salary paid by the company to the employees is less than the total salary paid during the previous fiscal year.
- Domestic investment in depreciable assets is less than 10% of depreciation expense.

The 10% depreciation threshold will be increased to 30%.

In addition, under the current tax credit system for wage increases, a company can receive a tax credit if both of the following conditions are met:

- The average salary paid by the company to the employees increases by at least 3% from the previous fiscal year
- Domestic investment in depreciable assets is equal to or more than 90% of depreciation expense.

The 90% depreciation threshold will be increased to 95%.

The Outline does not specify when the revision will start to apply, but it is expected that the revisions will apply to taxable years beginning on or after 1 April 2020.

Entertainment expenditure

Corporations with share capital exceeding JPY10 billion will no longer be able to claim deductions for meal entertainment expenditure.

The Outline does not specify when the revision will start to apply, but it is expected that this revision will apply to taxable years beginning on or after 1 April 2020.

Endnotes

1. Japanese bicameral legislature.
2. The investment should be by way of a capital contribution and receipt of shares.
3. The minimum capital contribution for small or medium sized companies is JPY10 million.
4. Definitions of key terms are yet to be released.
5. For example, the investor sells the venture company shares or there is a liquidation of the venture company.
6. The *Advanced Information Communication Promotion Law* is expected to be enacted for this measure.
7. The tax incentive also applies to local inhabitant tax for small or medium sized companies.
8. A company will be a subsidiary of a parent if more than 50% of the company is owned directly or indirectly by the parent.
9. Other exceptions may be available.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Tax Co., Tokyo

- Hiroshi Namba hiroshi.namba@jp.ey.com

Ernst & Young LLP (United States), Japanese Tax Desk, New York

- Hiroaki Ito hiroaki.ito1@ey.com

Ernst & Young LLP (United States), Asia Pacific Business Group, New York

- Chris Finnerty chris.finnerty1@ey.com
- Kaz Parsch kazuyo.parsch@ey.com
- Bee-Khun Yap bee-khun.yap@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 005822-19Gbl

1508-1600216 NY
ED None

ey.com