



KPMG Japan Tax Newsletter

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OUTLINE OF THE 2018 TAX REFORM PROPOSALS

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The ruling coalition (the Liberal Democratic Party and New Komeito) agreed on the 'Outline of the 2018 Tax Reform Proposals' ('Proposal') on 14 December 2017. We have set out below brief summaries of the main points of the Proposal.

The Proposal itself is only an indicative outline and is unclear with respect to some of the contemplated changes. The details of the tax reform will be unveiled in the bills revising the tax laws and the succeeding amended tax laws, cabinet orders and ministerial ordinances. Please note that the final tax reform could differ from the Proposal depending on the outcome of discussions in the Diet.

I. Corporate Taxation

1. Tax Credits for Salary Growth

The tax credits for salary growth introduced in 2013 have been applied to blue-return filing companies. Under the 2018 tax reform, the rules for the tax credits will be amended from the viewpoint of promoting domestic capital investment, investment in human resources and sustainable pay-raises. The new rules will be applied for fiscal years beginning between 1 April 2018 and 31 March 2021.

(1) Large-scale companies

[Current tax law]

| | | | | | |
|---|---|--|--|--|----------------|
| Conditions | (a) | Salary payments in the current fiscal year | \geq | Salary payments in the base year | $\times 105\%$ |
| | (b) | Salary payments in the current fiscal year | \geq | Salary payments in the preceding fiscal year | |
| | (c) | Average salary payments in the current fiscal year | \geq | Average salary payments in the preceding fiscal year | $\times 102\%$ |
| Tax credit (capped at 10% of the corporation tax liability) | Where conditions (a)(b) and (c) are satisfied | | $\begin{aligned} & \{[\text{Salary payments in the current fiscal year}] \\ & - [\text{Salary payments in the base year}]\} \times 10\% \\ & + \\ & \{[\text{Salary payments in the current fiscal year}] \\ & - [\text{Salary payments in the preceding fiscal year}]\} \times 2\% \end{aligned}$ | | |

[Definitions of key terms]

- ‘Large-scale companies’ for the purposes of this rule are companies other than ‘small and medium-sized companies’ discussed in (2).
- ‘Salary payments’ refers to salary paid to domestic employees which are deductible in calculating the company’s income for each fiscal year.
- ‘Domestic employees’ refers to employees (excluding employees who have a special relationship with directors or who have the status of directors) working at offices located in Japan, who are listed in a wage ledger prescribed by the Labor Standards Act.
- ‘Base year’ refers to the fiscal year preceding the first fiscal year commencing on or after 1 April 2013.

[Proposal]

| | | | | | |
|--|---|--|---|--|----------------|
| Conditions | (a) | Average salary payments in the current fiscal year | \geq | Average salary payments in the preceding fiscal year | $\times 103\%$ |
| | (b) | Total acquisition cost of depreciable assets located in Japan in the current fiscal year | \geq | Total depreciation costs of depreciable assets recorded in the current fiscal year | $\times 90\%$ |
| | (c) | Education and training costs in the current fiscal year | \geq | Average education and training costs in the preceding 2 fiscal years | $\times 120\%$ |
| Tax credit (capped at 20% of the corporation tax liability) | Where conditions (a) and (b) are satisfied but (c) is not satisfied | | $\{[\text{Salary payments in the current fiscal year}] - [\text{Salary payments in the preceding fiscal year}]\} \times 15\%$ | | |
| | Where conditions (a)(b) and (c) are satisfied | | $\{[\text{Salary payments in the current fiscal year}] - [\text{Salary payments in the preceding fiscal year}]\} \times 20\%$ | | |

(2) Small and medium-sized companies
[Current tax law]

| | | | | | |
|--|--|--|---|--|----------------|
| Conditions | (a) | Salary payments in the current fiscal year | \geq | Salary payments in the base year | $\times 103\%$ |
| | (b) | Salary payments in the current fiscal year | \geq | Salary payments in the preceding fiscal year | |
| | (c) | Average salary payments in the current fiscal year | $>$ | Average salary payments in the preceding fiscal year | |
| | (d) | Average salary payments in the current fiscal year | \geq | Average salary payments in the preceding fiscal year | $\times 102\%$ |
| Tax credit (capped at 20% of the corporation tax liability) | Where conditions (a)(b) and (c) are satisfied but (d) is not satisfied | | $\{[\text{Salary payments in the current fiscal year}] - [\text{Salary payments in the base year}]\} \times 10\%$ | | |
| | Where conditions (a)(b)(c) and (d) are satisfied | | $\{[\text{Salary payments in the current fiscal year}] - [\text{Salary payments in the base year}]\} \times 10\%$ $+$ $\{[\text{Salary payments in the current fiscal year}] - [\text{Salary payments in the preceding fiscal year}]\} \times 12\%$ | | |

[Definitions of key terms]

- ‘Small and medium-sized companies’ for the purposes of this rule are (i) or (ii) below:
 - (i) Companies with stated capital of JPY100 million or less (as at the end of the fiscal year), excluding the following cases:
 - at least 50 percent of the shares are held by one large-scale company (e.g. a company whose stated capital is over JPY100 million); or
 - at least two-thirds of the shares are held by large-scale companies

(ii) Companies with no capital whose number of regular employees is 1,000 or less

(Note that a company whose average income for the preceding 3 years is over JPY1.5 billion will be excluded from the definition of an eligible company for fiscal years beginning on or after 1 April 2019.)

[Proposal]

| | | | | | | |
|---|---|--|---|--|---|--------|
| Conditions | (a) | Average salary payments in the current fiscal year | ≥ | Average salary payments in the preceding fiscal year | x 101.5% | |
| | (b) | Average salary payments in the current fiscal year | ≥ | Average salary payments in the preceding fiscal year | x 102.5% | |
| | Either (i) or (ii) is met: | | | | | |
| | (c) | (i) | Education and training costs in the current fiscal year | ≥ | Education and training costs in the preceding fiscal year | x 110% |
| | | (ii) | The Business Plan for Improvement of Management Capability was approved by the competent Minister under the Act on Enhancement of Management of Small and Medium-sized Enterprises and the fact that the management capability was improved in accordance with the Business Plan was certified. | | | |
| Tax credit (capped at 20% of the corporation tax liability) | Where only condition (a) is satisfied | | {[Salary payments in the current fiscal year] - [Salary payments in the preceding fiscal year]} x 15% | | | |
| | Where conditions (a)(b) and (c) are satisfied | | {[Salary payments in the current fiscal year] - [Salary payments in the preceding fiscal year]} x 25% | | | |

Note that a small and medium-sized company will be able to apply for the proposal discussed in (1) in lieu of the above proposal.

2. Special Measures for Promotion of Investment in Information Collaboration

In order to improve productivity through collaboration and utilization of data within an enterprise or beyond the boundaries of enterprises, the following tax incentives will be introduced based on the premise that the Special Measures Act on Improvement of Productivity is newly enforced.

| | | | |
|--|---|--|--|
| Eligible companies | Blue-return filing company which obtains approval for the Business Plan for Innovative Utilization of Data under the Special Measures Act on Improvement of Productivity | | |
| Conditions | During the period from the effective date of the Act to 31 March 2021, an eligible company acquires software ^(*1) in accordance with the Business Plan and acquires Assets for Data Collaboration ^(*2) and puts them into use for the business. | | |
| Tax incentive for Assets for Data Collaboration (i) or (ii) | (i) Special depreciation | Acquisition cost x 30% | |
| | (ii) Tax credit | Where the pay-raise condition ^(*3) is not satisfied | Acquisition cost x 3% (capped at 15% of the corporation tax liability) |
| | | Where the pay-raise condition is satisfied | Acquisition cost x 5% (capped at 20% of the corporation tax liability) |

^(*1) Total acquisition cost for the software must be JPY50 million or more.

Where machinery or furniture/fixtures are acquired together with the software, the acquisition costs for those should be included in determining if the minimum threshold is met.

^(*2) 'Assets for Data Collaboration' refers to software, machinery and furniture/fixtures discussed in (*1) above, excluding those used for R&D activities. Furthermore, machinery must be used for certain purposes, e.g. collecting eligible data continuously and automatically.

^(*3) The 'pay-raise condition' is as follows:

$$[\text{Average salary payments in the current fiscal year}] \geq [\text{Average salary payments in the preceding fiscal year}] \times 103 \text{ percent}$$

3. Restriction on Eligible Companies for Special Tax Measures

Large-scale companies will be restricted from applying certain types of special tax measures where they do not take positive actions for pay-raises and capital investment in spite of increasing their profits.

Thus, large-scale companies (the same as those discussed in I.1.(1)) will not be allowed to apply tax credits of three special tax measures indicated below for fiscal years beginning between 1 April 2018 and 31 March 2021 where neither condition (i) nor (ii) are met.

- Condition (i) and (ii) are as follows:

| | | | |
|------|---|---|--|
| (i) | Average salary payments in the current fiscal year | > | Average salary payments in the preceding fiscal year |
| (ii) | Total acquisition cost of depreciable assets located in Japan in the current fiscal year | > | Total depreciation costs of depreciable assets recorded in the current fiscal year x 10% |

- ‘Three special tax measures’ are as follows:
 - ✓ Tax credits for R&D costs
 - ✓ Special measures for promotion of future investment in communities
 - ✓ Special measures for promotion of investment in information collaboration

Note that this rule will not be applied for certain fiscal years where the current year’s income is equal to or smaller than the preceding year’s income. (‘Income’ will be defined as ‘income before deducting past years’ tax losses’. Furthermore, certain adjustments will be made to calculate ‘income’ for the purposes of this rule.)

4. Amendments to Revenue Recognition Rules

The ‘Exposure Draft of Accounting Standard for Revenue Recognition (Exposure Draft of Statement No. 61)’ (compulsorily applied to consolidated accounting periods and fiscal years starting on or after 1 April 2021, except when electing for early application) in line with the International Financial Reporting Standards (IFRS 15) was released by the Accounting Standards Board of Japan on 20 July 2017. In response to that, the following amendments to revenue recognition, etc. for corporation tax purposes are proposed.

| | |
|--|---|
| <p>Amount of gross revenue with respect to sales of goods, etc.</p> | <ul style="list-style-type: none"> • The principle rules on the amount to be recognized as gross revenue with respect to sales/transfers of goods/assets or provision of services (‘sales of goods, etc.’) in calculating taxable income will be clarified in the tax laws (i.e. for sales/transfers of goods/assets — the fair market value of the sold/transferred goods/assets as of the date of delivery; for provision of services — the value of consideration to be received normally for the provided services). • The fair market value as of the date of delivery or the value of consideration to be received normally should be calculated ignoring any possibility of bad debts or buy backs. • The amount of gross revenue with respect to sales of goods, etc. can be recorded by dividing into substantial trading units. • With respect to discounts and rebates, the amount estimated objectively can be deducted from the amount of gross revenue. |
| <p>Timing of recognition of gross revenue with respect to sales of goods, etc.</p> | <p>The following will be clarified in the tax laws:</p> <ul style="list-style-type: none"> • The amount of gross revenue with respect to sales of goods, etc. should be, in principle, recognized in calculating taxable income for a fiscal year including the date of delivery of goods/assets or provision of services. • Notwithstanding the above, where the amount of gross revenue with respect to sales of goods, etc. is recorded in the accounts in a fiscal year including the date close to the above mentioned date in accordance with the accounting standards generally accepted as fair and appropriate, the amount of gross revenue will be, in principle, recognized in calculating taxable income in that fiscal year. |

| | |
|--|--|
| <p>Reserves for sales returns</p> | <p>Reserves for sales returns will be abolished for tax purposes.</p> <p>Transitional measures including the following will be established for a company engaging in eligible businesses (e.g. publishing business) for reserves for sales returns as at 1 April 2018.</p> <ul style="list-style-type: none"> • The current rules will be applicable for each fiscal year starting before 1 April 2021. • Recording reserves will be allowed for fiscal years beginning between 1 April 2021 and 31 March 2030, while the allowable amount will be reduced by 10% each year. |
| <p>Long-term installment sales, etc.</p> | <p>The special measures that allow a company to calculate the amount of revenue and expenses for long-term installment sales, etc. on a deferred payment basis will be abolished. (With respect to finance lease transactions, the current treatment will remain.)</p> <p>Transitional measures including the following will be established for a company which has made long-term installment sales, etc. before 1 April 2018.</p> <ul style="list-style-type: none"> • The current tax rules will be applicable for each fiscal year starting before 1 April 2023. • Where a company ceases calculating the amount of revenue and expenses on a deferred payment basis during fiscal years ending on or after 1 April 2018, the remaining deferred profits will be recognized equally over 10 years. |

5. Deferral of Recognition of Capital Gains on Shares under Specified Business Restructuring

From the view point of promoting large-scale and agile business restructuring that could assume an important role to improve productivity, new tax measures will be introduced contingent upon amendments to the Industrial Competitiveness Enhancement Act. Under the new tax measures, the recognition of capital gains on shares surrendered by shareholders (both companies and individuals) who accept exchange tender offers, etc. will be deferred.

These are temporary measures which cover share exchanges conducted by a company which obtains approval for its Business Plan for Special Business Restructuring from the government during the period from the effective date of the amended Industrial Competitiveness Enhancement Act to 31 March 2021.

6. Taxation on Reorganizations

(1) Spin-off transactions

Under the 2017 tax reform, certain types of spin-off transactions (e.g. (i) a horizontal-type corporate division in which a company transfers one of its businesses to a newly established company and (ii) Share-Dividends (Kabushiki-Bunpai) in which a company distributes all of the shares in its wholly owned subsidiary to its shareholders) have been treated as tax-qualified reorganizations provided that certain conditions are met.

Under the 2018 tax reform, where tax-qualified Share-Dividends are expected after a reorganization between companies having a 100 percent control relationship, one of conditions for the first reorganization to be tax-qualified — the 100 percent control relationship is expected to remain — will be treated as being satisfied if such relationship remains until the tax-qualified Share-Dividends are carried out. Consequently, a spin-off transaction in which a preparatory company is established in order to obtain permits or licenses that are necessary for business in advance could be treated as a tax-qualified reorganization.

(2) Other amendments

- Under the current tax law, there are various conditions for tax-qualified reorganizations, including (i) the employees/directors condition (approximately 80 percent or more of employees/directors engaged in the transferred business are expected to be engaged in the business of the transferee company) and (ii) the business condition (the transferee company is expected to continue to operate the transferred business).

It is proposed that the above two conditions will be treated as being satisfied for a reorganization, even where the employees/directors and/or the business are transferred among companies having a 100 percent control relationship after the reorganization.

- Certain limited types of reorganizations without consideration (e.g. a merger in which consideration is not delivered to shareholders of the merged company) could be treated as tax-qualified under the current tax law.

It is proposed that the scope of reorganizations without consideration that could be tax-qualified will be reviewed. Furthermore, detailed rules for the tax treatment of non-qualified reorganizations without consideration will be clarified.

II. International Taxation

1. Permanent Establishment (PE)

(1) Amendments to definition of PE

On the basis of the Multilateral Instrument (MLI)^(*) and the 2017 update for the OECD Model Tax Convention which reflect recommendations in the final reports of the Base Erosion and Profit Shifting (BEPS) project, the following amendments are proposed with respect to the definition of a permanent establishment (PE).

(*) The MLI (the formal title: ‘Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting’) was prepared based on the recommendation of Action 15 of the BEPS project and was signed by 67 signatories on 7 June 2017. The MLI is a mechanism to reflect recommendations under the BEPS project in existing tax treaties in an efficient manner.

A. Introduction of rules for preventing artificial avoidance of PE status

The following amendments will be made to the definition of a PE under the domestic tax laws in order to introduce rules to prevent the artificial avoidance of PE status in line with the MLI and the OECD Model Tax Convention.

- Where a person is acting in Japan on behalf of a foreign company or a non-resident individual (‘non-resident’) and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of certain contracts, and these contracts are for the transfer of ownership of the non-resident’s property and the like, that person will be treated as an agent PE of the non-resident.
- Where a person acts exclusively or almost exclusively on behalf of one or more non-residents to which it is closely related, that person will not be considered to be an independent agent for the non-residents.
- A fixed place of business that is used solely for the purposes of storage, display or delivery of goods, or other certain activities will not be considered to be a PE provided that such activity is of a preparatory or auxiliary character.
- Where a contract for construction is divided into several parts in order for each to cover a period of less than 12 months, if one of the main purposes of the division of the contract is to avoid construction PE status, the 12-month threshold to determine construction PE status will be tested by using total of the terms of the divided contracts.

B. Related amendments

- Where a tax treaty concluded by Japan has provisions on the definition of a PE which are different from those under the domestic tax laws, the definition of a PE under the tax treaty will be applied as the definition of a PE under the domestic tax laws to non-residents to which the tax treaty is applicable.

- Further, it is proposed to amend the wording of the provisions on the definition of a PE under the domestic tax laws in line with the provisions in the OECD Model Tax Convention.

(2) Special provision for foreign partners of investment LPS

The special provision that allows foreign partners of an investment limited partnership ('investment LPS') to be deemed not to have a PE in Japan under certain conditions will be replaced by a new provision, under which foreign partners of an investment LPS will be exempted from Japanese taxation on certain income attributed to their PEs created by businesses of the investment LPS.

The above amendments will be applied from 2019 (for individuals) and for fiscal years commencing on or after 1 January 2019 (for companies).

2. Anti-Tax Haven (CFC) Regime

The Japanese anti-tax haven (CFC) regime was extensively amended in light of the final report of the BEPS project under the 2017 tax reform. Additional amendments to the Japanese CFC regime are expected under the 2018 tax reform.

(Please refer to the KPMG Japan Tax Newsletter '[Japanese CFC Regime \(2017 Tax Reform\)](#)' issued on 19 July 2017 for an outline of the new CFC regime and the definitions of key terms used below.)

(1) Amendment to Economic Activity Tests

A Controlled Foreign Company (CFC) whose primary business is the holding of shares and which would be a Financial CFC (a financial holding company) on the assumption that the CFC satisfies the Economic Activity Tests will be deemed to satisfy the Primary Business Test.

(2) Special measures for capital gains from transfers of shares in post-acquisition restructuring

Where a Japanese company becomes a shareholder of foreign paper companies, etc. through corporate acquisitions, the Japanese company could suffer from a tax burden on income arising in the foreign paper companies, etc. under the CFC regime in the process of post-acquisition restructuring. In order to facilitate smooth post-acquisition restructuring by reducing such tax burden, special measures will be introduced under which capital gains meeting the following conditions will be excluded from income subject to the full-inclusion rules under the CFC regime.

| | |
|-----------------------------|---|
| Transferor ('Eligible CFC') | A Specified CFC or a Full-Inclusion CFC (excluding those held by certain Japanese companies) |
| Transferee | A Japanese company holding the Eligible CFC (transferor) or other CFCs of the Japanese company (excluding those that are other Eligible CFCs) |

| | |
|--------------------------------------|--|
| <p>Eligible period for transfers</p> | <p>[In principle] Fiscal years with days falling within a 2-year period from the Relationship-Created Day (The Relationship-Created Day means the day when a relationship in which more than 50% of shares in the Eligible CFC (transferor) are directly or indirectly held by Japanese shareholders arises.) [Special rule] Where the Eligible CFC transfers shares during fiscal years commencing in the period from 1 April 2018 to 31 March 2020 — fiscal years with days falling within a 5-year period from the Relationship-Created Day</p> |
| <p>Eligible shares</p> | <p>Shares in CFCs (excluding those that are other Eligible CFCs) held by the Eligible CFC (transferor) on the Relationship-Created Day</p> |
| <p>Main conditions</p> | <ul style="list-style-type: none"> • The transfer of the eligible shares is made based on a business plan including the basic policy/methods for post-acquisition restructuring. • The Eligible CFC has the prospect to be dissolved within 2 years from the transfer of the eligible shares. |

(The above measures will not be applied to capital gains caused by a merger or the dissolution of a CFC issuing the eligible shares.)

(3) Effective tax rate in no-tax jurisdictions

The effective tax rate (ETR) for a CFC is the ratio of ‘taxes’ paid by the CFC (imposed in the jurisdiction of its head office and other jurisdictions) to ‘income’ of the CFC (taxable income calculated under tax laws of the jurisdiction of its head office with certain adjustments). There are concerns that it is impossible to calculate the ETR for a CFC whose head office is located in a no-tax jurisdiction as the CFC does not have taxable income calculated under tax laws of the jurisdiction of its head office even when it wishes to calculate the ETR since the CFC pays taxes in other jurisdictions.

In response to such concerns, the calculation method of the ETR for a CFC whose head office is located in a no-tax jurisdiction will be provided as follows:

- The amount of ‘income’ will be income in the financial statements (instead of taxable income) with certain adjustments which are the same as those used in calculating the ETR for a CFC whose head office is located in a jurisdiction having tax laws. Where the CFC receives dividends, such dividends will be deducted in calculating ‘income’.
- In cases where the CFC has no income or is in a loss position, the ETR will be zero.

(4) Amendments related to Partial-Inclusion Income

- Interest on loans to related parties is excluded from the Partial-Inclusion Income. An individual will be excluded from the scope of related parties for the purposes of this rule.
- When a Financial CFC becomes a Partial-Inclusion CFC that is not a Financial CFC due to starting its dissolution, certain financial income will not be subject to the partial-inclusion rule for fiscal years with days falling within a 3-year period from that day.

(5) Other amendments

- Various amendments to the rules related to a Financial CFC including conditions for a Financial CFC and a Foreign Financial Holding Company are proposed.
- There is a system to eliminate double taxation for cases where a CFC suffers from Japanese taxes. The scope of Japanese taxes covered by this rule will be expanded.

The above amendments will be applied from fiscal years of a CFC commencing on or after 1 April 2018.

3. Other Amendments

(1) Shares in real estate holding company

Capital gains derived by a foreign company or a non-resident individual from sales of shares in a company with 50 percent or more of its total assets consisting of real estate located in Japan on a fair market value basis ('real estate holding company') are deemed as Japanese source income and subject to Japanese tax.

Under the current tax law, the judgment of whether shares are shares in a real estate holding company is to be made on the transfer date of the shares.

By virtue of the 2018 tax reform, the timing of the judgment will be amended to 'at any time during the 365 days preceding the sale of the shares'.

This amendment will be applied from 2019 (for individuals) and for fiscal years commencing on or after 1 April 2018 (for companies).

(2) Exemption for interest on margins for over-the-counter derivatives

Under the current tax law, if a foreign financial institution receives interest on certain margins deposited at a Japanese financial institution under over-the-counter derivatives with the Japanese financial institution conducted up to 31 March 2018, the interest is exempted from income tax provided that the foreign financial institution submits appropriate tax exemption applications.

This exemption rule is scheduled to be extended by 3 years up to 31 March 2021.

III. Individual Taxation

1. Amendments to Employment Income Deduction/Public Pension Income Deduction/Basic Deduction

In consideration of the diversification of working styles and in order to support people working in a variety of forms, the current deduction systems for employment income, public pension income and the basic deduction will be reviewed.

(1) Employment income deduction

The following amendments to the employment income deduction have been proposed.

- The employment income deduction will be reduced by JPY100,000.
- The amount of gross salary to which the upper limit of the employment income deduction applies will be lowered from JPY10,000,000 to JPY8,500,000.
- The upper limit of the employment income deduction will be reduced from JPY2,200,000 to JPY1,950,000.

By virtue of the above amendments, the tax burden for taxpayers with gross salary income exceeding JPY8,500,000 will be increased. However, the tax burden for people having children or family members in need of nursing care, etc. will not increase by the introduction of a new deduction (deduction for income adjustment, discussed in (4) below).

The employment income deduction after amendments will be as follows:

(unit: JPY thousand)

| Gross salary (A) | | Employment income deduction | | |
|------------------|--------|-----------------------------|------------------------------|---|
| | | Current tax law | Proposal | |
| In excess of | Up to | | (1) Person other than (2) | (2) Person having children or family members in need of nursing care, etc. ^{(*)1} |
| - | 1,625 | (A) × 40% (minimum: 650) | 550 | 550 |
| 1,625 | 1,800 | | (A) × 40% - 100 | (A) × 40% - 100 |
| 1,800 | 3,600 | (A) × 30% + 180 | (A) × 30% + 80 | (A) × 30% + 80 |
| 3,600 | 6,600 | (A) × 20% + 540 | (A) × 20% + 440 | (A) × 20% + 440 |
| 6,600 | 8,500 | (A) × 10% + 1,200 | (A) × 10% + 1,100 | (A) × 10% + 1,100 ^{(*)2} |
| 8,500 | 10,000 | | 1,950 (maximum) | |
| 10,000 | - | 2,200 (maximum) | | 2,100 (maximum) ^{(*)2} |

(*)1 'Eligible person' discussed in (4).

(*)2 Including the amount of the deduction for income adjustment.

(2) Public pension income deduction

The following amendments with respect to the public pension income deduction have been proposed.

- The public pension income deduction will be reduced by JPY100,000. (Further reduction are expected for people who are large income earners.)
- A cap on the public pension income deduction (JPY1,955,000) will be established for taxpayers who receive public pensions in excess of JPY10,000,000.

The public pension income deduction after the above amendments will be as follows:

(unit: JPY thousand)

| Total earnings from public pension (A) | Public pension income deduction | | | |
|--|---------------------------------|--|--------------------------------|--------------------------|
| | Current tax law | Proposal | | |
| | | Total income other than public pension | | |
| | | 10,000 or less | over 10,000 and 20,000 or less | over 20,000 |
| Age of pensioner is less than 65 years old | | | | |
| less than 1,300 | 700 | 600 | 500 | 400 |
| less than 4,100 | $(A) \times 25\% + 375$ | $(A) \times 25\% + 275$ | $(A) \times 25\% + 175$ | $(A) \times 25\% + 75$ |
| less than 7,700 | $(A) \times 15\% + 785$ | $(A) \times 15\% + 685$ | $(A) \times 15\% + 585$ | $(A) \times 15\% + 485$ |
| 10,000 or less | $(A) \times 5\% + 1,555$ | $(A) \times 5\% + 1,455$ | $(A) \times 5\% + 1,355$ | $(A) \times 5\% + 1,255$ |
| over 10,000 | | 1,955 (maximum) | 1,855 (maximum) | 1,755 (maximum) |
| Age of pensioner is 65 years and more | | | | |
| less than 3,300 | 1,200 | 1,100 | 1,000 | 900 |
| less than 4,100 | $(A) \times 25\% + 375$ | $(A) \times 25\% + 275$ | $(A) \times 25\% + 175$ | $(A) \times 25\% + 75$ |
| less than 7,700 | $(A) \times 15\% + 785$ | $(A) \times 15\% + 685$ | $(A) \times 15\% + 585$ | $(A) \times 15\% + 485$ |
| 10,000 or less | $(A) \times 5\% + 1,555$ | $(A) \times 5\% + 1,455$ | $(A) \times 5\% + 1,355$ | $(A) \times 5\% + 1,255$ |
| over 10,000 | | 1,955 (maximum) | 1,855 (maximum) | 1,755 (maximum) |

(3) Basic deduction

The basic deduction (JPY380,000 under current tax law) will be increased to JPY480,000. Further, if the total income exceeds JPY24,000,000, the basic deduction will be reduced gradually as follows:

(unit: JPY thousand)

| Total income | | Basic deduction | |
|--------------|--------|-----------------|----------|
| In excess of | Up to | Current tax law | Proposal |
| - | 24,000 | 380 | 480 |
| 24,000 | 24,500 | | 320 |
| 24,500 | 25,000 | | 160 |
| 25,000 | - | | 0 |

(Note that the basic deduction for individual inhabitant tax purposes will also be amended in the same way.)

(4) Deduction for income adjustment

As discussed in (1), in order to avoid the increase of the tax burden for people having children or family members in need of nursing care, etc., a new deduction (deduction for income adjustment) will be introduced as follows:

| | |
|---------------------------------|---|
| Eligible person | <p>A person whose employment income exceeds JPY8,500,000 and who falls under any of the following:</p> <ul style="list-style-type: none"> • A special handicapped person • A person having dependents aged less than 23 in the same household • A person having special handicapped dependents or special handicapped spouse in the same household |
| Deduction for Income adjustment | <p>$(\text{Gross salary} - \text{JPY}8,500,000) \times 10\%$ (maximum: JPY150,000)</p> |

Note that rules will also be introduced in order to eliminate double reduction in the employment income deduction and the public pension deduction for people who have both employment income and public pension income.

(5) Related amendments

As a result of the amendments to the employment income deduction and the basic deduction, the following amendments have been proposed.

■ Dependent deduction/spouse deduction/special spouse deduction

- The threshold of income for the deductions for dependents/spouse will be increased to JPY480,000 (current tax law: JPY380,000).
- The threshold of income for the special spouse deduction will be increased to the range from JPY480,000 to JPY1,330,000 (current tax law: the range from JPY380,000 to JPY1,230,000).

(Note that similar amendments have been proposed for inhabitant tax purposes as well.)

■ Blue-return filing special deduction

Taxpayers who have elected to file blue tax returns ('blue-return filing taxpayers') are allowed to take the blue-return filing special deduction for their business income and/or real estate income under certain conditions.

The amount of the blue-return filing special deduction will be amended as follows:

- For a blue-return filing taxpayer who maintains the accounting books in accordance with the principle of orderly book-keeping: JPY550,000^(*) (current tax law: JPY650,000)
- For a blue-return filing taxpayer who records the accounting books using a simplified method: JPY100,000 (no amendment)

^(*) JPY650,000 will be applicable provided that the taxpayer uses the electronic tax filing system for their filing or stores their accounting books electronically.

The above amendments will apply from 2020 for national income tax purposes and from 2021 for individual inhabitant tax purposes.

2. Specific Expense Deduction

Under the current tax law, where an earner of employment income pays specific expenses (e.g. certain moving expenses, training expenses to learn skills or knowledge directly necessary for performing job functions), and the amount of such specific expenses paid in a year exceeds 50 percent of the employment income deduction, the excess amount is also deductible in the calculation of employment income.

The following amendments with respect to the scope of specific expenses have been proposed.

- Travel expenses directly necessary in performing job functions will be included in the scope of specific expenses.
- Concerning travel expenses for returning home for an employee assigned away from their family, the limitation on the number of times per month will be abolished. (Under the current tax law, it is limited to four times per month.)
- Fuel costs and toll road fees necessary for returning home for an employee assigned away from their family will be included in the scope of specific expenses.

The above amendments will apply from 2020 for national income tax purposes and from 2021 for individual inhabitant tax purposes.

3. Forest Environment Tax

Forest environment tax will be introduced in order to secure the financial resources for forest management and conservation. Forest environment tax will be imposed together with individual inhabitant tax on a person who has a domicile in Japan in the amount of JPY1,000 per year from 2024.

IV. Inheritance Tax/Gift Tax

Amendments to Scope of Tax Payment Obligations of Foreign People after Leaving Japan

Under the 2017 tax reform, the scope of the tax payment obligations of inheritance tax/gift tax was amended in that inheritance tax/gift tax will not be imposed on properties located outside Japan with respect to inheritance/gifts involving foreign people living or having lived temporarily in Japan under certain conditions.

However, by virtue of the tax reform, where a foreign national who had lived in Japan for more than 10 years passes away within 5 years of leaving Japan, inheritance tax/gift tax will be imposed on properties located outside Japan even if the heir has neither domicile in Japan nor Japanese nationality. Thus, there are concerns that the amendment could be a disincentive for foreign people to live and work in Japan.

(Please refer to the KPMG Japan Tax Newsletter [‘2017 Tax Reform - Inheritance Tax/Gift Tax - Amendments to Scope of Tax Payment Obligations on Properties Located outside Japan’](#) issued on 19 June 2017 for more details about the amendments.)

In consideration of the above concerns, under the 2018 tax reform, it is proposed that properties located outside Japan will be treated as non-taxable properties for inheritance tax/gift tax purposes if the following conditions are met:

| | |
|----------------|--|
| Heir Donee | They have domicile outside Japan and do not have Japanese nationality when an event causing inheritance/gift occurs. |
| Decedent Donor | <ul style="list-style-type: none"> • They do not have domicile in Japan when an event causing inheritance/gift occurs. • Their total period of having domicile in Japan is over 10 years within the past 15 years before they left Japan. • They do not have Japanese nationality for the period of having domicile in Japan. |

Note that however, where a donor gives properties located outside Japan to a donee within 2 years after the donor left Japan, if the donor returns to live in Japan again during the above 2 years, gift tax will be imposed on the properties.

The above amendment will be applied to inheritance tax/gift tax levied on properties acquired on or after 1 April 2018 by inheritance/gift.

V. Consumption Tax

1. Abolishment of Deferred Payment Method

The 'Exposure Draft of Accounting Standard for Revenue Recognition (Exposure Draft of Statement No. 61)' (compulsorily applied to consolidated accounting periods and fiscal years starting on or after 1 April 2021, except when electing for early application) in line with the International Financial Reporting Standards (IFRS 15) was released by the Accounting Standards Board of Japan on 20 July 2017. In response to that, the special measures that allow taxable persons to calculate taxable sales for long-term installment sales, etc. on a deferred payment basis will be abolished. (With respect to finance lease transactions, the current treatment will remain.)

Transitional measures including the following will be established for taxable persons who have made long-term installment sales, etc. before 1 April 2018.

- The current tax rules will be applicable for each calendar year or each fiscal year starting before 1 April 2023.
- Where a taxable person ceases calculating taxable sales on a deferred payment basis during taxable periods ending on or after 1 April 2018, the remaining taxable sales will be recognized equally over 10 years.

2. Place of Taxation for Sales of Paperless Securities

The place of taxation for sales of paperless securities will be provided as follows:

| Securities | Place of taxation |
|---|--|
| Paperless securities handled by a book-entry institution ^(*) | The place where the book-entry institution is located |
| Paperless securities other than the above | The place where the head office of the company issuing the securities is located |

^(*) Paper securities handled by book-entry institutions are treated in the same way.

3. Digitalization of Tax-Qualified Simplified Invoices

Items to be described in tax-qualified invoices can be provided electronically instead of issuing paper-based tax-qualified invoices, where advance acknowledgement is obtained from the counterparties. However, tax-qualified simplified invoices are not allowed to be issued electronically since they could be issued to many and unspecified persons.

Under the 2018 tax reform, it is proposed that items to be described in tax-qualified simplified invoices will also be allowed to be provided electronically instead of issuing paper-based tax-qualified simplified invoices.

This amendment will be applied to transactions carried out on or after 1 October 2023 when an invoicing system will be introduced for consumption tax.

VI. Requirements for Electronic Tax Filing

Considering the increased usage of technology in business and society and in order to improve taxpayers' convenience and tax administrative efficiency, certain companies will be obliged to file their tax returns through online systems ('electronic tax filing system' ^(*)).

^(*) 'Electronic tax filing system' means a system to file tax returns electronically — the e-Tax system for national tax returns and the eLTAX system for local tax returns.

The scope of companies and tax returns subject to electronic tax filing obligations is as follows:

| | | |
|--|---|--|
| Companies subject to electronic tax filing obligations | <ul style="list-style-type: none"> • A Japanese company whose stated capital is over JPY100 million at the beginning of the fiscal year • A Japanese company which is a mutual company, a Tousei Houjin (J-REIT) or a Tokutei Mokuteki Kaisha (TMK) | |
| Tax returns subject to electronic tax filing obligations | (1) | Corporation tax and local corporation tax: final tax return, interim tax return and amended tax return |
| | (2) | Consumption tax: final tax return, interim tax return, amended tax return and return form for tax refunds |
| | (3) | Inhabitant tax and business tax: final tax return, interim tax return and amended tax return |

Submission methods for documents to be attached to tax returns

- Documents to be attached to tax returns are also required to be submitted using the electronic tax filing system. Submission via an optical disk, etc. will be acceptable for documents to be attached to tax returns described in (1).^(*)

In cases where a company fails to file using the electronic tax filing system

- Where a tax return is filed not using the electronic tax filing system, it will be treated as not being filed, in principle.
- Where a company has difficulty filing its tax returns described in (1) or (2) using the electronic tax filing system due to trouble with telecommunication lines, etc., but is able to file them on paper, the company will be allowed to file the tax returns and attachments on paper upon approval from the relevant tax office.^(*)

^(*) These measures may be introduced for local tax purposes in the future.

The above amendment will be applied for fiscal years or taxable periods beginning on or after 1 April 2020.

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