FY2019 Tax Reform (Main Points)

(Cabinet decision on December 21, 2018)

With a view to leveling demand fluctuations etc. that may occur upon the consumption tax rate increase, tax incentives will be provided in relation to housing. At the same time, automobile tax system will be drastically revised, while securing stable revenue sources for local governments. In addition, in order to ensure the termination of deflation and economic revitalization, the R&D tax system will be reviewed. Furthermore, from the perspective of establishing local taxation systems for sustainable development of cities and rural areas, Special Corporate Enterprise Tax (provisional) and Special Corporate Enterprise Transfer Tax (provisional) and such will be introduced. Other measures the government will implement include creation of Forest Environment Tax (provisional) and Forest Environment Transfer Tax (provisional), revision of the international taxation system to address international tax avoidance in an effective manner, and development of the environment for tax payment that will take diversification of economic transactions into account. The tax reform will be conducted as follows.

Individual income taxation

Enhancement of the tax credit for housing loans

- The tax credit period for housing loans will be extended for another three years with regard to acquisition, etc. of housing subject to the 10% consumption tax (from 10 years at present to 13 years).
- For the last three years of this period, an upper limit will be set for the tax credit amount, focusing on the burden of the 2% consumption tax increase.
- The applicable period will be from October 1, 2019 to December 31, 2020.
- The decrease in individual inhabitant tax revenues due to these measures will be fully compensated for by allocation from the national treasury.

Creation of Forest Environment Tax (provisional) and Forest Environment Transfer Tax (provisional)

- For the purpose of securing local revenues necessary for forest development, etc. on a stable basis, Forest Environment Tax (provisional title: 1,000 yen per year starting from FY2024) and Forest Environment Transfer Tax (provisional title; gifts in FY2019 and after) will be created.

Review of the so-called *furusato nozei* or hometown tax donation system

- The hometown tax donation system will be revised to exclude from the framework of the system (special tax deductions) any local government that offers excess return gifts, thereby missing the intended purpose of the system.

Tax exemption schemes for individual inhabitant tax to deal with child poverty

- In order to address the child poverty issue, a single parent who receives childcare allowance, which is paid after confirming that he/she is not in a de facto marriage, and whose total income in the previous year is 1.35 million yen or less, will be exempt from individual inhabitant tax.

Asset taxation

Creation of a new tax system for business succession by sole proprietors, etc.

- A new tax system for business succession by sole proprietors will be introduced as a 10-year temporary measure (the existing special tax break for small plots of residential land for business use remains selectable instead).
  - Postponement of payment of inheritance tax and gift tax will be granted for an amount equivalent to 100% of the taxable price of the eligible portions of land, building, machinery, or other specified depreciable assets for business use.
  - Requirements for business succession by sole proprietors which are equivalent to those for business succession by corporations will be designed in order to assure the appropriateness of this system.
- Small plots of residential land that have been put to business use within three years before inheritance will be excluded in general from the scope of application of the existing special tax break for small plots of residential land for business use.

Review of the tax exemption schemes for lump-sum gifts of educational funds and marriage/childcare funds

- With respect to the tax exemption schemes for lump-sum gifts of educational funds, while establishing income restrictions on donees and reviewing the use, the applicable period will be extended by two years by giving certain consideration to the continuance of school attendance by persons aged 30 or older.
- With respect to the tax exemption schemes for lump-sum gifts of marriage/childcare funds, income restrictions on donees will be established and the applicable period will be extended by two years.

Corporate taxation

- For the open innovation activity-based R&D tax credit, certain types of research commissioned to large companies and R&D startups will be included in the scope of eligible R&D, and the maximum tax credit amount will be increased to 10% (present: 5%).
  (*) The tax credit rate will be 25% for research conducted jointly with or on commission to a certain scope of R&D startups.
- For the volume-based R&D tax credit, the credit rate will be revised from the perspective of providing more incentives for increasing R&D expenses, and the maximum tax credit rate for a certain scope of R&D startups will be increased to 40% (present: 25%) of the amount of corporate tax.
- High R&D intensity tax credit will be integrated into the volume-based R&D tax credit, while an extra tax credit rate will be granted for companies making a high-level of R&D investment.

Investment-friendly packages for SMEs

- The reduced corporate tax rate and the tax incentive of capital investment promotion for SMEs will be extended.
- The tax incentive for regional future-oriented investment promotion will be revised by increasing the special depreciation rate to 50% (present: 40%) and the tax credit rate to 5% (present: 4%) if the requirement of creating high added value is satisfied.
- With a view to promoting disaster preparedness in light of the impact of disasters on SMEs' business activities, a special depreciation system will be introduced for investment in disaster prevention/mitigation facilities based on Business Continuity Enhancement Plans (tentative name).

Establishment of local taxation systems for sustainable development of cities and rural areas

- In light of the increasing gap in financial capability between different regions, structural changes in economic society, etc. and in order to address the structural problems−where a large proportion of tax revenues is concentrated in large cities compared to the distribution condition of Gross Prefectural Product−and help cities and rural areas to support each other and jointly achieve sustainable development, new measures to correct uneven distribution of local corporation tax will be implemented.

- Specifically, a part of corporate enterprise tax, which will be restored when the consumption tax is raised to 10%, will be separated as Special Corporate Enterprise Tax (provisional title); and the whole amount of Special Corporate Enterprise Tax will be transferred to prefectural governments as Special Corporate Enterprise Transfer Tax (provisional title) on the basis of the population (there are transfer restrictions on local governments not receiving tax grants).

Others

- The system of contingency reserve of insurance companies, etc. will be enhanced by increasing the special reserve rate for fire insurance, etc. to 6% (present: 5%).
- The special depreciation system of medical devices will be reviewed and enhanced from the standpoint of promoting reduction of medical practitioners’ working hours, securing of a regional healthcare delivery system and efficient arrangements of medical devices, such as promotion of joint use of expensive medical devices.

Consumption Taxation

Revision to automobile taxation

- Automobile tax on all types of privately-owned automobiles (registered vehicles), primarily small-sized vehicles, will be reduced, applicable to new automobiles newly registered on or after October 1, 2019.
- Tax rates bracket of environmental performance excise applicable to privately-owned automobiles (registered vehicles) will be reviewed.
- In connection with the introduction of environmental performance excise, special provisions (tax reduction) on clean and energy efficient privately-owned automobiles (registered vehicles and light motor vehicles) will be limited to electric vehicles, etc. Taking the consumption tax hike into consideration, this will be applicable to privately-owned new automobiles (registered vehicles and light motor vehicles) newly registered on or after April 1, 2021.
- Tax credit, etc. for eco-friendly cars (automobile acquisition tax/motor vehicle tonnage tax) will be revised. From the standpoint of the enhanced policy incentive function, the reduction rate of motor vehicle tonnage tax on eco-friendly cars at the first automobile safety inspection will be revised, and the focus of tax exemption for the second automobile safety inspection will be shifted to electric vehicles and very highly fuel-efficient hybrid vehicles.
- Regarding the decreased revenues from local tax due to the permanent automobile tax reduction, which cannot be covered by the increased revenues from the local tax revision, the following measures will be taken to compensate for the shortfall, allocated from the national treasury:
  - Revision of eco-friendly car tax (motor vehicle tonnage tax) credit (as mentioned above)
  - Phased increase of rates of transfer of motor vehicle tonnage tax revenue resources to local governments
  - Transfer of tax resources from gasoline tax to local gasoline tax
- Rates of environmental performance excise allocation grant will be revised, with the aim of adjusting revenues of prefectures and municipalities in connection with the revision of automobile taxation under tax reform for FY2019.

- In order to reduce the tax burden experienced when purchasing automobiles, the environmental performance excise rate will be reduced by 1%, applicable to privately-owned automobiles (registered vehicles and light motor vehicles) acquired between October 1, 2019 and September 30, 2020. The decrease in local tax revenues due to these measures will be fully compensated for by allocation from the national treasury.

Improve convenience of the consumption tax exemption system for foreign tourists

- Permission will be granted to sell products free of tax at temporary shops.

International taxation

Response based on the BEPS (base erosion and profit shifting) project

- With respect to Japan's rules on interest deductibility, stricter restrictions on deduction of interest expenses will be introduced depending on the risk of base erosion through such measures as review of the method of calculating the maximum limit of the deductible amount of interest expenses.
- With respect to transfer pricing rules, the discounted cash flow method will be allowed as a method for calculating arm's length prices. In addition, price adjustment measures will be introduced for transactions of hard-to-value intangibles.

Improvement of compliance environment

Improvement of compliance corresponding to divergence of economic transactions

- In order to ensure the appropriate taxation amidst the spread of digital economy and globalization of economic transactions including virtual currency transactions, provide statutory provisions on obtaining taxpayer's information from third party, which have been made in practice. At the same time, provide NTA with the authority to make inquiries into third parties about identity unknown taxpayer's information, in circumstances where it is particularly necessary to do so in order to identify taxpayers with high degree of non-compliance.

Tariffs

Extension of the application period of temporary tariff rates, etc.

- The temporary tariff rates (for 411 items) whose application period expires at the end of FY2018 will be extended by one year.

Review of tariff rates etc. on individual items