August 24, 2021

PROPOSALS FOR 2022 TAX REFORM

The American Chamber of Commerce in Japan (ACCJ) proposes the following tax measures to the Government of Japan (GOJ) for consideration in the GOJ's 2022 Tax Reform Proposals. A number of these proposals were part of the ACCJ's proposals to the GOJ on Long Term Stimulus, published on 10 December 2020. These are marked with an asterisk for clarity, although many have been amended to reflect developments since that date, including the impact of the 2021 Tax Reform.

In addition, we understand that introduction of domestic laws to implement the OECD's recommendations under BEPS Pillars 1 and 2 in relation to taxation of the digital economy is unlikely to be part of the 2022 Tax Reform Proposals. Similarly, implementation in domestic law of the global minimum tax proposed by the G7 is also unlikely in the coming year. However, the ACCJ supports the GOJ's engagement in and leadership of these discussions at the OECD and G7, and is available to provide support and input into the drafting of such domestic legislation if requested, when the time arises.

Entrepreneurship

- ***Eliminate the NOL carryforward period**
  By eliminating the current 10-year NOL carryforward period to be more in line with Japan's major trading partners, Japan could enable companies to improve their cash flow forecasts and remain incentivized to invest in Japan. Further, many non-SMEs may currently only offset up to 50% of taxable income with NOLs due to usage restrictions. While the 2021 Tax Reform provides a temporary removal of this limit in certain circumstances (i.e., if the taxpayer has obtained an approved Business Adaptation Plan under the Industrial Competitiveness Enhancement Act (ICEA)), the GOJ should remove the limitation completely with no such conditions.

- **Expand deductibility of director compensation for corporate tax purposes**
  The current restrictions on deductibility of director compensation are inconsistent with practices in most other OECD member countries, and go beyond the original intent of the domestic law (to prevent manipulation of taxable income). Changes to the deductibility requirements in the 2021 Tax Reform did little to change this position, and thus are likely to have little positive impact on Tokyo's aim to become a global financial center. However, the intent of the law could be maintained by allowing deductibility except where unreasonable or excessive, as described by the ACCJ here: [Expand Deductibility of Director Compensation for Corporate Tax Purposes to Encourage Growth and Align Japan with International Tax Standards].

- **Expansion of the "angel taxation" or enjyeru zeisei investment taxation rules to increase the allowable deduction for individual investors against ordinary income of 8 million yen to 25 million yen.**
  Increasing the allowable deduction would provide more opportunities for investment at greater levels than currently available, providing much needed capital for new enterprises.

Incentives to invest in technology

- ***Provide support for investments in digital transformation, whether in the form of subsidies, tax credits relating to the investments, or a direct write-off at the time the investments are incurred.**
  Commendably, the GOJ has established tax incentives (along with a series of subsidies and grants) for SMEs to promote telework investment, as well as creating new incentives under the 2021 Tax Reform for all taxpayers who make investments in digital transformation. However, in order to continue to promote paperless operations, and to promote more aggressive digital transformation in critical areas such as healthcare, the tax incentives offered to SMEs need to be made available more widely, and the conditions to benefit from the digital transformation incentive should be relaxed (e.g., by not requiring a Business Adaptation Plan under the ICEA).

- **Provide support for investment in digitization retraining or upskilling undertaken by small and medium sized businesses**

(SMEs), whether in the form of subsidies or tax credits relating to the investments.
Over the past year, many large companies have taken the opportunity to provide retraining or upskilling in digitization. Particularly in Japan where the labor shortage remains significant, the redeployment of an existing workforce can be much more efficient than trying to hire new staff with the required skills. The cost of retraining or upskilling is significant, however, and may be out of reach for many SMEs. The ACCJ proposes that the GOJ provide reimbursement of expenses incurred, or tax incentives for expenditure on, retraining and upskilling in the area of digitization undertaken by SMEs.

Climate change priorities

- ***Investment in new energy infrastructure–e.g. in increasingly cost-competitive energy storage, reliable integration of variable renewable energy resources, as well as demand response technologies – should be encouraged through the availability of tax incentives.**
Decarbonization (carbon neutrality) is consistent with Japan's national commitments to COP21 and is one of several "Ds" that the ACCJ urges Japan to act urgently on — along with further deregulation, digitalization, and decentralization of the energy sector— to drive clean energy innovation. While the 2021 Tax Reform introduced a new carbon neutrality investment incentive, use of the incentive requires adoption of a Business Adaptation Plan under the ICEA. Moreover, the incentive itself provides only for accelerated depreciation or a small tax credit. If the GOJ wants to use tax incentives to align corporate behavior with the GOJ's climate change priorities, more generous tax incentives should be introduced.

Individual taxation reforms

- **Remove any inheritance or gift tax obligations for foreign nationals holding Table 1 visas, and limit the number of foreign nationals holding Table 2 visas subject to such obligations.**
Foreign nationals subject to inheritance or gift tax obligations (whether as legators/donors or heirs/donees) should be limited to those foreign nationals holding Table 2 visas, which would align with the scope of foreign nationals subject to the exit tax. Similarly, in order to be subject to inheritance and gift taxation, foreign nationals holding Table 2 visas should have resided in Japan for at least five out of the last 10 years. This would address concerns of foreign nationals considering to work or establish a business in Japan about the scope of significantly high

taxation on assets, and encourage such foreign nationals to stay and contribute long-term to Japan.

- **Extend the filing due date for e-filed individual tax returns to April 15.**
  This will promote increased digitalization and a paperless process and environment. Furthermore, permanently extending the filing deadline to April 15 will support Japan's initiative to reduce overtime in the accounting and tax advisory professions (and help companies comply with the decreasing legally allowable amount of overtime) and provide better work-life balance and a healthier society. The decrease in overtime could also allow for increased participation in the workforce and the tax industry for working mothers and people with elderly care responsibilities. Finally, as the tax laws become more complex and Japan residents have more assets and income from abroad, additional time for taxpayers and tax practitioners will be required to gather this tax information and duly comply by the deadline.