

Proposal for **FY2025** Tax Reform

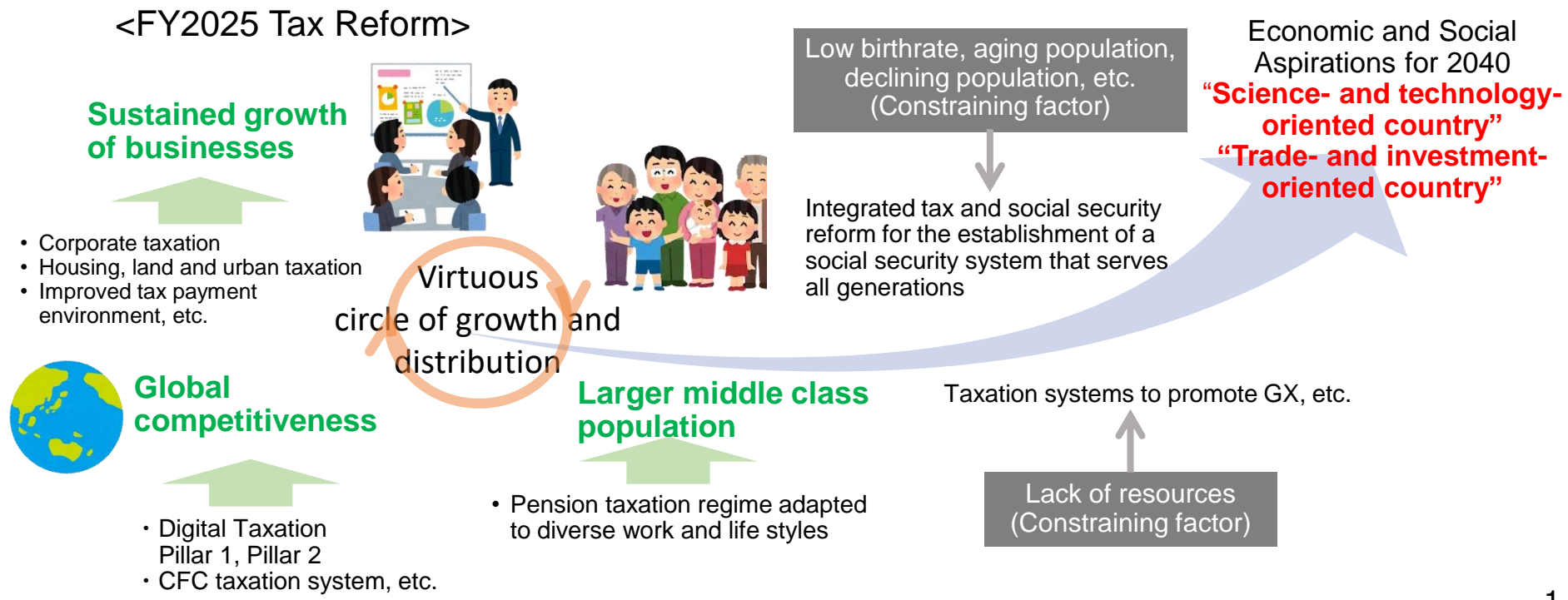
—Driving the Japanese Economy towards a New Stage of Growth—
Summary

October 3, 2024

Keidanren (Japan Business Federation)

I. Introduction

- With capital spending rising to unprecedented levels and wages experiencing their most significant increase in three decades, we are facing a historic turning point. Now, our top priority is to lead the Japanese economy towards a new stage of growth and completely escape deflation.
- To support the sustained growth of businesses, it is critical to take continuous steps to evolve the tax system. As part of the effort to boost the middle class population, a pension taxation regime that is adapted to diversifying work and life styles should be established concurrently with the next pension reform.
- In the field of international taxation, it is vital to ensure the predictability of administrative and other burdens on businesses when designing systems to manage tax issues emerging from the digitalization of the economy. It is also essential to further reduce and streamline the administrative burdens associated with the Controlled Foreign Company (CFC) taxation system.
- From a medium- to long-term view, there is a need to contemplate an integrated tax and social security reform for the establishment of a social security system that serves all generations, and a tax system that promotes GX, to overcome the nation's constraints.



II. Tax Systems to Support Sustained Growth of Businesses

1. Designing Effective Corporate Taxation

(1) Reviewing “Growth-oriented Corporate Tax Reform”

- ✓ Following the implementation of the “Growth-oriented Corporate Tax Reform,” there has been consistent progress in initiatives to expand domestic investment and increase wages since FY2015.
- ✓ While the corporate tax reform was implemented mostly in a tax revenue-neutral manner, it cannot be ruled out that the lower corporate tax rate played a role in boosting business activity. Given the anticipated time for the reforms to take effect, an assessment should be made after analyzing current trends in such areas as domestic investments and wage increases.

(2) Corporate taxation that encourages domestic investment, R&D, and wage increases

- ✓ The ideal form of corporate taxation should be considered from the perspective of encouraging businesses to expand domestic investment, promote R&D, and increase wages.
- ✓ Tax rates should be considered to ensure an equal footing for Japanese taxpayers in the global market. Such considerations should include Japan's high effective corporate tax rate compared to other leading nations, along with the scheduled implementation of tax measures to bolster defense capabilities.
- ✓ Attention must be paid to the fact that the tax base has been expanded through the Growth-oriented Corporate Tax Reform.
- ✓ Special tax measures should continue to be used to provide incentives for investment. While it is necessary to verify the effectiveness of special tax measures to ensure EBPM, the verification should also take into account the actual status of investment by businesses and delays in time, such as the interval between deciding on an investment and carrying it out.

(3) Our view on tax measures to secure financial resources for enhanced defense capability

- ✓ It is essential to ensure public understanding and fully consider the impact of additional taxes on the effective corporate tax rate and the status of domestic investment and wage increases by businesses. Trends in tax revenues and defense budget execution should also be taken into account.

II. Tax Systems to Support Sustained Growth of Businesses

2. Corporate Taxation and Other Issues

(1) Review of business portfolio through reorganization aimed at increasing corporate value

- ✓ Turning of the partial spin-off taxation into a permanent act
- ✓ Measures required for spin-off (how to calculate the ratio of assets to be allocated among companies adopting the group relief system)

(2) Wider application of incentive compensation

- ✓ Wider application of performance-linked payments

(3) Measures to align with the revised lease accounting standard

- ✓ Reforms should be considered for corporate tax, consumption tax, corporate enterprise tax on value-added basis (pro forma standard taxation), etc. to avoid any gap between corporations' tax and accounting practices.

(4) Further promotion of DX and innovation

- ✓ Consideration on how the DX investment promotion taxation and 5G deployment promotion taxation measures should be designed and implemented
- ✓ Consideration on how to enhance the innovation box taxation system

(5) Extending expired special taxation measures

- ✓ Enhancement of the extraordinary contingency reserve system relating to fire insurance
- ✓ Extension and enhancement of the depletion allowance program
- ✓ Extension and enhancement of the Regional Future Investment Promotion Tax System
- ✓ Extension of the Regional Revitalization Support Tax System (corporate version of Hometown Tax Payment Program), etc.
- ✓ Extension and enhancement of the tax systems for small- and medium-sized enterprises
- ✓ Review of taxes on advantageous issuances of shares
- ✓ Development of tax measures for investment corporations
- ✓ Tax measures necessary for the smooth holding of the International Horticultural Expo 2027

II. Tax Systems to Support Sustained Growth of Businesses

3. Accelerating growth of startups

- ✓ Further enhancement of the angel tax system (extension of reinvestment period)

4. Housing, urban, and land tax systems

- ✓ Extension of measures related to the borrowing limits for housing loan tax credit for households with children
- ✓ Extension of the home renovation tax credit for households with children
- ✓ Tax measures for industrial land development

5. Local taxes

- ✓ Review of the tax base for corporate enterprise tax in the electricity and gas supply industries
- ✓ Review of local corporate income taxation
- ✓ Reorganization, consolidation, and simplification of business office taxes

6. Improved tax payment environment and others

(1) National tax-related digitization

- ✓ Improved convenience of e-Tax
- ✓ Digitization of tax audits
- ✓ Efforts to digitalize businesses

(2) Local tax-related digitization

- ✓ Digitization of local tax notices, tax returns/applications, and payment procedures
- ✓ Linking national and local tax data

III. Tax Systems to Achieve a Sustainable Economic Society

1. Tax systems to boost middle class population

(1) Establishment of pension taxation regime adapted to diverse work and life styles

- ✓ Increase in maximum contribution in defined contribution corporate pension plans
- ✓ Elimination of special corporate taxes

(2) Integrated tax and social security reform to establish all-generation social security system

- ✓ An integrated tax and social security reform must be advanced to ensure the sustainability of social security system
- ✓ Social security funding at present relies significantly on social insurance premiums, placing a disproportionate burden on the working-age group
- ✓ To ensure fairness and equity, individuals should bear the burden in proportion to their capability (ability-to-pay principle), regardless of their age. Taking financial and other assets into consideration when assessing the ability to bear burdens, a balanced distribution should be considered utilizing various fiscal resources including taxes. Considering the above, it would be worth exploring the idea of making the linking of bank accounts with Individual Numbers mandatory.
- ✓ The consumption tax plays a crucial role in funding social security as it is shouldered by every individual across all age groups. Looking ahead over the medium to long term, increasing the consumption tax rate appears to be a realistic option. However, from the viewpoint of the ability-to-pay principle, regressive measures (e.g. benefits for low-income groups) should be implemented and attention should be paid to the impact on the economy. When and how much to increase should be examined based on economic conditions.

(3) Finance, securities, and Insurance tax systems

- ✓ Enhancement of the life insurance deduction program for households with children
- ✓ Extension of the gift tax exemption for lump-sum gifts of marriage and child-rearing funds
- ✓ Review of inheritance tax assessment associated with listed stocks and publicly offered investment trusts
- ✓ Further integration of financial income taxes (aggregation of gains and losses from derivatives transactions with those from listed shares)
- ✓ Increased convenience of NISA (abolition or simplification of the steps required to confirm a customer's location after 10 years of opening their cumulative investment account)

III. Tax Systems to Achieve a Sustainable Economic Society

2. Tax systems to promote GX

(1) Comprehensive review of energy-related taxes

- ✓ Current energy taxes should be reviewed in a comprehensive manner, taking into consideration the institutional framework of the “Growth-oriented Carbon Pricing” scheme, including emissions trading and the fossil fuel levy
- ✓ Review of the global warming tax, conversion of tax exemption for raw material use into a permanent act, appropriate adjustment measures between consumption tax and petroleum taxes (elimination of double taxation)

(2) Support for pro-GX enterprises

- ✓ Enhancement of existing tax systems that contribute to GX advancement, including tax incentives for promoting domestic production in strategic sectors and those for encouraging carbon neutral investments
- ✓ Preferential treatment for products with low environmental impact, including reduction or exemption of petroleum and coal tax on imports of neat SAF (raw material for SAF*) and SAF produced in overseas projects with participation by Japanese companies, tax credits for the deployment of fuel-efficient aircraft
- ✓ Reduction or exemption of fixed asset tax on depreciable assets acquired through capital investment that contributes to GX

*Sustainable aviation fuel

3. Automobile-related taxes

(1) Tasks to be accomplished through FY2025 tax reform

- ✓ Review of the classification of light motor vehicle tax concurrently with the revision of the enforcement regulations of the Road Transport Vehicle Act and the Road Traffic Act for motorized bicycles
- ✓ Extension of measures related to automobile tax with an environmental performance-based tax reduction, including special measures for barrier-free vehicles such as non-step buses

(2) Medium-term issues

- ✓ National debate should be held over the next two years to fundamentally review the automobile tax system and transform it to a fair and simple scheme suitable for the new era, based on the premise of simplicity and reduced burden, with the aim of contributing to the “creation of new social values aligned with the evolution from automobiles to mobility,” as well as to the “CO₂ reduction efforts including ownership under the multi-pathway approach.”

IV. Tax Systems to Support Global Corporate Activities

1. International agreement on Pillar One (allocation of new taxing rights to market countries) and Pillar 2 (global minimum taxation), which aim to address the taxation challenges associated with economic digitalization, along with related domestic legislation and smooth implementation

- ✓ Our expectation regarding Pillar One Amount A is that the final draft of the multilateral convention (MLC) will be agreed on in early 2024 and brought into effect promptly after the interdependency between Amount A and Amount B is made clear in line with the unsolved part of Amount B (approach to simplify and streamline transfer pricing).
- ✓ For Amount B, guidance must be provided regarding the use of compensating adjustments.
- ✓ For Pillar Two, we continuously stress the importance of reducing practical burdens on businesses when enacting domestic legislation based on the revised additional implementation guidance
- ✓ When incorporating the QDMTT into domestic legislation, the system must be designed ensuring that there are as few additional items to be stated as possible, taking into consideration such forms as the GloBE Information Return. When considering the need to adopt the QDMTT, it is necessary to carefully consider whether there are any cases where the absence of a QDMTT could result in a problem, bearing in mind the possible effects of UTPR application by other jurisdictions, in addition to the filing of the Information Return

2. Review of Controlled Foreign Corporation (CFC) tax system

- ✓ Review of the time for aggregation in consideration of cases where fiscal years differ between foreign subsidiaries and the Japanese parent
- ✓ Use of information related to the calculation of effective tax rates and tax burden ratios by country
- ✓ Adoption of the approach for forming judgments on each consolidated tax return filing unit, clarification of the treatment of non-taxable income, review of tax audit enforcement approach to paper companies, and review of the special provisions on logistics management companies associated with the non-affiliated party criteria
- ✓ Exemption for cases where the total amount of local income and non-taxable income of a subsidiary is less than zero
- ✓ Review of the special exception for the exclusion of paper companies, review of the calculation for cases where a fiscal year spans more than 12 months
- ✓ Consideration of a fundamental review of the CFC tax system

3. Tax treaty

- ✓ Conclusion of new tax treaties or revision of existing tax treaties, with a view to reducing or exempting withholding tax with nations in the Global South and elsewhere