

Japan Tax Bulletin

Research and development tax credits under Japan tax law

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Japan tax law contains an exemption system for research and development expenses as a tax incentive measure for enterprises conducting research and development (“R&D”). In the 2017 tax reform, development of the “fourth industrial revolution type service”, such as big data, was added to the list of qualifying activities.

1. Overview

1-1. A credit for R&D based on the amount of expenditure

Corporations filing a blue tax return¹ may take a credit for R&D each year based on qualifying R&D expenses multiplied by a certain ratio. The credit is equal to between 6% and 14% of the R&D expenses.

- Where the variation ratio² is higher than 5%, $9\% + ((\text{variation ratio} - 5\%) \times 0.3)$
- Where the variation ratio is 5% or lower, $9\% - ((5\% - \text{variation ratio}) \times 0.1)$
- Where the variation ratio is lower than -25%, 6%

¹ A blue tax return status taxpayer is required to maintain books and records in exchange for certain tax incentives and tax loss carry forward.

² The variation ratio is defined as:

(A) / (B) (negative ratio is possible)

(A) the amount of R&D expenses – the amount of comparable R&D expenses

(B) the amount of comparable R&D expenses

-The amount of comparable R&D expense is the average R&D expense amount over the 3 years beginning before the current year.

- For the business year of establishment or the business year in which comparable R&D expense is zero, 8.5%

The tax credit rate is capped at 10% (14% for fiscal years beginning from April 1, 2017 to March 31, 2019) and the maximum creditable amount is 25% of the corporation tax liability.

1-2. Additional tax credit for -technical infrastructure reinforcement type R&D expense for a small or medium-sized company(SME)

A small or medium-sized company with capital not exceeding JPY100 million which is not a subsidiary of a large company nor a company without capital and fewer than 1,000 full-time employees may take a credit for R&D expenses at 12%-17%.

- Where the increase ratio³ is higher than 5%, $12\% + ((\text{increase ratio} - 5\%) \times 0.3)$ up to a maximum of 17%
- Where the increase ratio is 5% or lower, 12%

The creditable amount is 25% of the corporation tax liability. If the increase ratio is higher than 5% and the additional credit for high level of R&D expense ratio⁴ is not taken, the creditable amount is 35% of the corporation tax liability.

³ The increase ratio is the same as variation ratio but with a minimum value of zero.

⁴ The R&D expense ratio is defined as: R&D expenses for the current year / average sales amount.

-The average sales amount is the average sales in the current year and the 3 years beginning before the current year.

For both 1-1 and 1-2, if the R&D expense ratio is higher than 10% and the additional credit for high level R&D expense ratio is not taken, the creditable amount is increased up to a maximum of 35% of the corporation tax liability, using the following formula:
25% of corporation tax liability + (corporation tax liability x ((R&D expense ratio – 10%) x 2)).

1-3. Additional credit for high level R&D expenditure

In addition to 1-1 and 1-2, corporations filing a blue tax return may take a credit for R&D expenses when the R&D expense ratio exceeds 10%. The credit is calculated as:

$((\text{R\&D expense} - \text{average sales amount} \times 10\%) \times \text{high level R\&D expense ratio})^5$

Once a corporation takes advantage of the maximum tax credit of 35% of its corporation tax liability, the additional credit for high level R&D cannot be taken. The additional tax credit applies for fiscal years beginning before April 1, 2019. The maximum creditable amount is 10% of the corporation tax liability.

1-4. A credit for special R&D expenditure ~Open innovation type~

The special R&D expense applies to the following types of R&D expenses:

- a) R&D performed in collaboration with national

⁵ The high level R&D expense ratio is defined as:
 $((\text{R\&D expense ratio} - 10\%) \times 0.2)$.

research laboratories, universities and others;

- b) R&D outsourced to SMEs;
- c) Research conducted licensing intellectual property rights owned by SMEs; or
- d) R&D expenses related to drugs with a small number of subjects pertaining to their uses.

The special R&D expense is not included in the systems described at 1-1 and 1-2. The tax credit rate is 30% of the special R&D expense for consignment fees paid to the national research laboratories or universities and 20% for other items. The maximum creditable amount is 5% of the corporation tax liability.

2. *Scope of qualifying R&D expenses*

The research and development expenses covered by the R&D tax system are as follows for expenses required for research and development on product manufacture or technology improvement, inventive ideas or invention:

- Raw material costs, personnel expenses (limited to those pertaining exclusively to the work of the relevant research and research with expert knowledge) and other related expenses.
- Costs to pay for those who receive the consignment of R&D

For fiscal years beginning from April 1, 2017, a new category of expenses for developing services qualifies as research and development expenses. Expenses for the following activities qualify:

- Collecting information with wholly or partly automated equipment or technologies designed for the purpose of collecting huge volumes of information
- Analysis by information analysis experts with software designed to identify rules out of the accumulated information collected.

- Designing new services by using the rules identified out of analyses.
- Confirming that rules identified are reasonable and consistent with forecasts and results and services utilizing the rules, with reference to the objective of the services.



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