

# Japan Tax Bulletin

## Digital Transformation (DX) Investment Promotion Taxation

### October 2021

In order to achieve corporate transformation (digital transformation) using digital technology during and after the COVID era, it is essential to implement management and digital strategies in an integrated manner. The 2021 tax reform established a system that allows companies to receive support measures for digital-related investments using cloud technology necessary to realize DX after company-wide approval has been granted by the competent minister.

#### 1. Outline

If an applicable entity acquires or manufactures information technology business adaptation equipment and uses it for the business of the entity in Japan, or makes expenditure for business adaptation, which is capitalized, during the period from June 16, 2021 to March 31, 2023 (the designated period), the entity may apply one of the following measures in the year of use or expenditure (Special Taxation Measures Law 42-12-7①②④⑤).

- a) Special depreciation of 30% of the acquisition cost or the amount of deferred assets
- b) A special tax credit against corporate tax equivalent to 3% (or 5%, depending on the factors listed in section 5) of the acquisition cost or deferred assets

#### 2. Applicable Business Entity

This tax measure is applicable to corporations that file blue tax returns and are certified business adaptation entities<sup>1</sup>.

#### 3. Applicable Assets

- Equipment such as machinery, equipment, furniture, and fixtures that meet the following criteria:
  - (i) Are necessary for the construction or use of the cloud system;
  - (ii) The equipment must not be used for the business of software business, information processing service business, or Internet-related service business; or
  - (iii) The equipment must not have been used for business purposes other than the certified business after its production.
- Hardware should be used in conjunction with software, such as for data integration.
- Capitalized costs are those related to the construction of the cloud system, and are assumed to be the initial cost of customization in the implementation of the cloud system.

#### 4. Applicable Conditions

In order to receive the tax benefits, an application for approval of a business adaptation plan that meets both the digital requirements (D requirements) and the corporate transformation requirements (X requirements) must be prepared and submitted to the minister with jurisdiction over the business field of the business adaptation for review and approval.

D requirements are as follows:

- (i) Linkage of data held by other corporations, etc. or data newly-acquired by businesses using sensors, etc. with existing internal data;
- (ii) Use of cloud technology; and
- (iii) Obtain DX certification, which certifies that the business is ready to implement DX (DX-Ready), based on an examination conducted by the Japan Information-technology Promotion Agency (IPA).

It is a two-step process to obtain DX certification, and then certification of the business adaptation plan.

X requirements are as follows:

- (i) The company must be expected to improve productivity or develop new demand:

- 1.5% improvement in ROA<sup>2</sup> compared to the base period (FY2014-2018); and

- Sales growth rate  $\geq$  sales growth rate in the industry an applicant is in for the past 5 fiscal years + 5%.

- (ii) The planning period shall be within 5 years, and the project shall fall under any of the following;

- a) Production and provision of new products and services  $\Rightarrow$  The ratio of revenue from new products, etc. to the amount of investment shall be 10 times or more.

- b) Introduction of a new production method for products and improvement of equipment efficiency  $\Rightarrow$  Reduction of manufacturing (sales) cost per unit of products by 8.8% or more

- c) Introduction of a new sales method for products and a new provision method for services  $\Rightarrow$  Reduction of sales cost per unit of products, etc. by 8.8% or more

- (iii) The business adaptation to be implemented must be based on the management decision of the entire company, not just one business unit or one business base (the resolution document of the Board of Directors must be attached)

#### 5. Limitations

The minimum investment amount is 0.1% of domestic sales on a consolidated accounting basis, and the maximum investment amount is JPY30 billion per company.

<sup>1</sup> "Certified business adaptation entities" means a business operator that conducts information technology business adaptation (limited to those that have been confirmed by the competent minister

as being particularly conducive to productivity improvement or demand development) in accordance with a certified business adaptation plan as prescribed in the Industrial Competitiveness

Enhancement Act.

<sup>2</sup> ROA = Operating profit / book value of total assets x 100

- Special depreciation limit

The special depreciation limit is on a per asset basis and is calculated as:

a) If the total value of the qualifying assets is JPY30 billion or less

Special depreciation limit = value of qualifying asset x 30%.

b) If the total value of the subject assets exceeds JPY30 billion

Special depreciation limit = JPY30 billion x value of qualifying asset / total value of qualifying assets x 30%.

- Corporate tax credit limit

The tax credit limit is also on a per asset basis and is calculated as:

a) If the total value of qualifying assets is JPY30 billion or less

Tax credit limit = Amount of qualifying assets x 3% (\*)

b) If the total value of the qualifying assets exceeds JPY30 billion

Tax credit limit = JPY30 billion x value of qualifying asset / total value of qualifying assets x 3% (\*)

\*In case of data linkage with other companies outside the group, 5%.

The maximum amount of corporate tax credit is equivalent to 20% of the corporate tax amount before adjustment when combined with the special corporate tax credit under this system and the "Taxation on Investment Promotion for Carbon Neutralization".

6. Notes

- The DX tax measure will only apply to assets that are acquired after the approval of business adaptation and are used for business purposes by March 31, 2023.

- Generally it takes 60-90 days to get the DX certification. However, it is unclear at this time how long it will take to certify the business adaptation plan.

- Due to the tax reform in 2021, the scope of R&D taxation has been expanded to include research and development related to software that provides services through the cloud. Therefore, if there is overlap between the scope of this tax system and that of the R&D tax system, it is necessary to compare the benefits.