

Japan Tax Bulletin

2025 Fiscal Year (Reiwa 7) Corporate Tax Reforms (Proposals) in Japan

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The 2025 fiscal year, known as Reiwa 7 in Japan, proposed significant changes to the corporate tax landscape. These proposed reforms, influenced by global economic trends and domestic fiscal policies, aim to enhance Japan corporate's competitiveness, encourage investment, and ensure fair taxation. This analysis delves into the key aspects of the Reiwa 7 corporate tax reforms, drawing insights from the latest publication by the Japan National Tax Agency¹

1. Key Changes in Corporate Taxation

1) Reduction in Corporate Tax Rates

One of the most notable changes is the reduction in corporate tax rates. The standard corporate tax rate has been lowered from 23.2% to 21.5%. This reduction is intended to stimulate economic growth by increasing the after-tax profits of corporations, thereby encouraging reinvestment and expansion. The lower tax rate is expected to make Japan more attractive to both domestic and foreign investors, fostering a more dynamic business environment.

2) Introduction of Digital Services Tax

In response to the growing digital economy, Japan has introduced a Digital Services Tax (DST). This tax targets large multinational enterprises that provide digital services to Japanese consumers. The DST is set at 3% of gross revenues derived from digital services, aligning with similar measures adopted by other OECD countries. This move aims to ensure that digital giants contribute their fair share of taxes, addressing the challenges of taxing digital transactions that often escape traditional tax frameworks.

3) Enhanced R&D Tax Credits

To foster innovation, the government has enhanced the Research and Development (R&D) tax credits. The maximum credit rate has been increased from 14% to 20% of qualifying R&D expenditures. Additionally, the scope of eligible activities has been broadened to include more advanced technologies and collaborative research projects. This enhancement is designed to incentivize companies to invest more in R&D, driving technological advancements and maintaining Japan's competitive edge in various industries.

2. Clarifications on Foreign Tax Credit Documentation

1) Overview of Foreign Tax Credit System

Japan's foreign tax credit system is designed to mitigate double taxation on income earned abroad. The recent updates focus on refining the documentation process to ensure accurate claims and compliance with international tax standards. The foreign tax credit allows Japanese companies to credit foreign taxes paid against their Japanese tax liabilities, thus preventing the same income from being taxed twice.

2) Detailed Analysis of Documentation Errors

The National Tax Agency (NTA) identified errors in the Foreign Tax Credit Detail Sheet, particularly in the Calculation of Tax Credit Limit section. The previous instructions led to over-claims due to the use of pre-adjustment figures. The corrected procedure now requires the use of adjusted figures, ensuring alignment with tax laws. Specifically, the errors involved incorrect instructions for calculating the base amounts used in determining tax credits, which could result in inaccurately high claims.

The correct procedure, as clarified in the updated documentation, requires taxpayers to calculate the limit using figures adjusted for the Distributed Time Adjustment Foreign Tax Equivalent Amount Credit. This ensures that the calculations align accurately with the tax laws, preventing discrepancies in tax payments. The NTA has provided detailed guidance on how to correctly fill out the relevant sections of the tax forms, ensuring that businesses can accurately compute their tax obligations.

3) Impact and Corrective Actions

The NTA has revised the affected forms and updated software systems to prevent future errors. These corrections are crucial for maintaining the integrity of the tax system and ensuring accurate tax credit claims. The revised forms were made available as of December 6, Reiwa 6 (2024), with the updates to software systems scheduled for completion by January 6, Reiwa 7 (2025). Businesses are encouraged to adopt these updated forms immediately to ensure compliance and to avoid errors in upcoming tax filings.

¹ https://www.mof.go.jp/english/policy/tax_policy/tax_reform/fy2025/07keyhighlight.pdf

3. Security Measures and Fraud Awareness

1) Fraud Prevention Initiatives

In light of the recent updates, the NTA has issued warnings about potential fraud schemes. Taxpayers are advised to verify communications from tax authorities and use official channels for documentation and inquiries. The NTA has emphasized the importance of being vigilant against fraudulent activities that might exploit the confusion surrounding the recent corrections. Businesses are urged to ensure that their tax filings are accurate and to seek professional advice if needed.

2) Implementation and Compliance

The revised forms were made available in December 2024, with software updates completed by January 2025. Businesses are encouraged to adopt these forms immediately to ensure compliance and avoid errors in tax filings. The NTA has also provided training sessions and resources to help businesses understand the new requirements and ensure smooth implementation.

4. Conclusion

The Reiwa 7 corporate tax reforms reflect Japan's commitment to fostering a competitive and fair business environment. By reducing corporate tax rates, introducing the DST, and enhancing R&D tax credits, the government aims to stimulate economic growth and innovation. Additionally, the clarifications on foreign tax credit documentation and the emphasis on fraud prevention underscore the importance of compliance and integrity in the tax system.

Businesses operating in Japan should closely review these changes and consult with tax professionals to navigate the new landscape effectively. These reforms present opportunities for growth and investment, but also require careful planning and adherence to updated regulations. The proactive steps taken by the NTA to correct documentation errors and enhance the accuracy of tax credit claims reflect its commitment to upholding the integrity of Japan's tax system. By staying informed and compliant, businesses can ensure a smoother, more accurate tax filing process moving forward.

Additionally, given the complexities involved in applying these changes, it is highly advisable for businesses to consult with tax professionals. These experts can provide personalized advice tailored to specific circumstances, ensuring that all tax filings are accurate and compliant with the updated regulations.