GLI GLOBAL LEGAL INSIGHTS

Corporate Tax

2021

Ninth Edition

Contributing Editor: **Sandy Bhogal**

glg global legal group

CONTENTS

Japan

Akira Tanaka & Hiroki Tsue
Anderson Mōri & Tomotsune

Introduction

The 2021 tax reform is mainly aimed at transforming the existing tax regulations in order to stimulate economic growth in the post-COVID-19 era. One of the changes that characterises this tax reform is the inclusion of a special measure allowing the deferral of taxation on capital gains accompanying the introduction of a new M&A method for the treatment of an acquirer's shares called "*Kabushiki Kofu*" under the Companies Act. This method generally applies to M&As between Japanese companies but may also be relevant to foreign companies (see the "Special measures…" section below).

The 2021 tax reform has also caused significant changes in the tax payment environment for foreign companies. Currently, taxpayers residing abroad have three methods of tax payment: payment by credit card; electronic payment; and payment through a Tax Agent. A fourth payment method for foreign taxpayers has been added under the 2021 tax reform and will take effect on 4 January 2022. In addition, some revisions have been made to the Tax Agent System, a system that allows taxpayers who do not have a permanent establishment ("PE")/domicile in Japan to pay taxes to the Japanese government (discussed further under the "Revision of the Tax Agent System" and "Additional tax payment method for foreign taxpayers" sections below).

In addition, the Group Tax Relief System, which has been drastically changed from the Consolidated Tax Return System by the 2020 tax reform, will be implemented with effect from 1 April 2022 (see the "Group Tax Relief System" section below). This new system will also be applicable to corporate groups comprising only Japanese companies, including Japanese companies whose ultimate parent company is a Japanese company whose shares are owned by a foreign company.

This chapter will summarise the above four notable changes in corporate tax law and practice that may affect foreign companies.

Special measures for deferral of taxation on capital gains accompanying the introduction of "*Kabushiki Kofu*"

Background

The 2019 revision of the Companies Act introduced a new M&A measure called "*Kabushiki Kofu*", which allows an acquiring stock company (*Kabushiki Kaisha*) to turn a targeted stock company into a subsidiary by issuing the acquirer's shares as consideration.

The method of providing an acquiring stock company's own shares as consideration for the shares of a targeted stock company has not been widely used to date. With that being said,

even before the tax reform of 2021, it was possible to make an acquisition using the shares of an acquiring company as consideration by having the shareholders of the target company contribute their shares in kind to the acquiring company and issuing the shares of the acquiring company to the shareholders. However, in such a case, because the shareholders of the target company have to contribute their shares in kind to the acquiring company, in principle, an investigation by an inspector is required (Article 207 of the Companies Act). If the value of the shares contributed in kind is substantially short of the price determined in advance at the time of determination of the subscription requirements for the issuance of new shares, the contributor is liable to compensate for the shortage (Articles 212 and 213 of the Companies Act). Because of these cumbersome requirements, up to now there have been very few cases where a target company was acquired in exchange for shares of the acquiring company.

The *Kabushiki Kofu* system aims to make it easier for companies to make acquisitions using their own shares, by allowing acquiring companies to avoid being subject to procedural burdens such as the abovementioned inspector's investigation and the risk of having to pay compensation. However, in order to encourage more companies to use the *Kabushiki Kofu* system, deferring taxation on the capital gains imposed on shareholders in respect of share transfers was considered to be necessary.

Outline of the special measures for deferral of taxation on capital gains accompanying the introduction of "*Kabushiki Kofu*"

In order to promote a company's flexible business restructuring and maintain or enhance its competitive power, taxation on the profits and losses from the sale of the shareholders' shares pursuant to a *Kabushiki Kofu* transaction shall be deferred from 1 April 2021. However, such taxation shall be deferred only if the following conditions are met:

(i) where the ratio of the acquirer's shares to the total amount of consideration paid to shareholders is 80% or more; and
(ii) in cases where a shareholder of the acquired company is a non-resident/foreign company, where the shareholder holds shares of the acquired company through its PE (i.e., these shares are registered in the name of its PE).

Strictly speaking, although the above deferral of taxation applies only to M&As between Japanese companies and not M&As that are carried out by foreign companies, foreign companies may still wish to take note of this new measure since it will apply to a foreign company who is a shareholder of the acquired company.

It should be noted that the deferral of taxation on share transfers from a foreign company will apply only to shares that are transferred by the foreign company's PE. In this regard, the Japanese tax authorities may impose taxation on the deferred gains or losses on capital gains or losses on shares managed by PEs of foreign companies when they are recognised. However, if the tax on share transfer gains and losses not managed by a PE is deferred, the authorities may no longer be able to tax the realised gains and losses at a later date. It seems that this is the reason why the scope of this rule as it applies to foreign companies is limited only to share transfers by the PEs of foreign companies.

Revision of the Tax Agent System

Background

The system for taxpayers who do not have a PE/domicile in Japan, the Tax Agent System, has been revised under the 2021 tax reform.

A foreign company that does not have, or does not intend to have, a PE/domicile in Japan may have to pay taxes to the Japanese government when it receives domestic source income in Japan. However, it may face difficulties in filing tax returns, receiving correction notices and reminders, and carrying out other administrative tasks relating to tax issues. As such, a foreign company is obliged to appoint and authorise a Tax Agent (i.e., an administrator who will conduct tax filings, tax payments or other procedures) in Japan to take care of such tasks on its behalf.

In spite of such obligation, however, prior to the 2021 tax reform, the National Tax Agency ("NTA") did not have any powers to compel a foreign company to appoint a Tax Agent. Therefore, the NTA had no effective measures to enforce the obligation, and faced difficulties in conducting tax investigations, sending out inquiry documents to foreign taxpayers who did not or did not intend to have a PE/domicile in Japan, and conducting tax audits on such uncooperative taxpayers.

Outline of the revision of the Tax Agent System

In order to solve these difficulties, a revised Tax Agent System will be implemented with effect from 1 January 2022.

(i) **Direction for appointment of a Tax Agent**
If a foreign company fails to notify the relevant authorities that it has appointed a Tax Agent, the district director of the tax office or the director of the regional taxation bureau (hereinafter referred to as the "Director") has the authority to request the foreign company to notify the relevant authorities of the appointment of its Tax Agent within a certain period of time not exceeding 60 days. In such case, the Director must specify the tax matters that the Tax Agent is required to handle.

(ii) **Request by Director for Domestic Facilitator to act as a Tax Agent**
If a taxpayer who is required to appoint a Tax Agent fails to notify the relevant authorities of the same, the Director may request a person who has the ability to handle the abovementioned specified tax matters (limited to those having a domicile or residence in Japan, hereinafter referred to as the "Domestic Facilitator") to become the Tax Agent of the taxpayer.

(iii) **Authority to appoint a Specified Tax Agent**
If a taxpayer who has received the request set forth in (i) above ("Specified Taxpayer") fails to notify the relevant authorities that it has appointed a Tax Agent by the designated date, the Director may designate the Domestic Facilitator mentioned in (ii) above ("Specified Tax Agent") to handle the specified tax matters by written notice to the Specified Taxpayer and Specified Tax Agent.

The categories of Domestic Facilitators that may be assigned by the Director to a foreign company are limited to the following:

(a) a company that has a relationship with a Specified Taxpayer such that either the Specified Taxpayer or the company holds 50% or more of the other company's issued shares or any other special relationship;
(b) an officer or a spouse or any other relative of an officer of the Specified Taxpayer, who has attained the age of majority and who shares living expenses with the officer;
(c) a person who has a close relationship with the Specified Taxpayer based on a contract with the Specified Taxpayer with regard to facts that are to be used as the basis of the calculation of the tax base or tax amount of the national tax of the Specified Taxpayer; and
(d) a business operator that provides a platform where the Specified Taxpayer continuously carries out transactions using an electronic data processing system or other transactions.

Additional tax payment method for foreign taxpayers

Traditionally, payment of national taxes by foreign taxpayers has been limited to payment by credit card, electronic payment, and payment through a Tax Agent as described above. The 2021 tax reform has added a new payment method.

The additional payment method, which will take effect on 4 January 2022, is a method whereby a taxpayer who has a domicile/residence outside Japan may pay for its national taxes by making a bank transfer from a financial institution outside Japan to a domestic deposit account of a national tax collector in a bank in Japan. After the remittance is made, the foreign taxpayer must send a statement of payment and the document of the proof of the remittance to the relevant authority. The relevant authority will then check and confirm whether the remittance of the tax has been completed. Where a foreign taxpayer makes a tax payment by this method, the provisions concerning delinquent tax and interest tax shall be applied by deeming that the national tax has been paid on the day on which the taxpayer remitted the tax via a financial institution outside Japan.

Group Tax Relief System

Background

Since the ban on pure holding companies was lifted in 1997 in Japan, the corporate taxation of group companies has been widely discussed. In addition, the lifting of the ban on the establishment of bank holding companies in 1998 has led to a rapid progression in business mergers, mainly among the major banks in Japan. Due to this, from around 2000, there was a trend toward creating corporate groups, and legislation for group companies was developed accordingly. The Consolidated Tax Return System introduced in 2002 is one such tax system for group companies.

Under the Consolidated Tax Return System introduced in 2002, a corporate group is regarded as one entity, and the profits and losses of individual companies belonging to the same group can be aggregated within the group. The Consolidated Tax Return System focuses on the economic unity of the corporate group. In other words, by aggregating the profits and losses of individual companies in the group, the group is taxed as if it were a single company.

However, due to the drastic revision of the Consolidated Tax Return System in the 2020 tax reform, corporate groups have to decide whether they will be subject to the new system – the Group Tax Relief System. This new system will take effect in April 2022. Consolidated parent and subsidiary companies that had obtained approval for the Consolidated Tax Return System as of 31 March 2022 will, in general, be deemed to have obtained approval for the Group Tax Relief System as of 1 April 2022. As a result, consolidated parent and subsidiary companies already subject to the Consolidated Tax Return System are automatically subject to the Group Tax Relief System unless they submit a notice to the district director of the tax office by the day before the first business year starting on or after 1 April 2022. On the other hand, it is also necessary for parent and subsidiary companies that are not currently subject to the Consolidated Tax Return System to examine whether they should be subject to the Group Tax Relief System in their fiscal years beginning on or after 1 April 2022. Accordingly, many corporate groups are required to make a choice as to whether they will be subject to aggregate group taxation from 2022 onward.

Outline of the Group Tax Relief System

The main points of the Group Tax Relief System are as follows.

Necessity of approval

Similar to the Consolidated Tax Return System, the application of the Group Tax Relief System is at the choice of the taxpayer. In order to be eligible for this new system, approval from the Commissioner of the NTA is required.

Reduction of administrative burden

The Group Tax Relief System simplifies procedures so that the administrative burden on group companies will be reduced. For example, if there is a change in the taxable income or corporate tax amount of one of the companies in a group (Company A), such change will not affect the calculation of the taxable income or corporate tax amount of the other companies in the group in the event of a subsequent revision or reassessment of the filing of a corporate tax return by Company A.

Scope of application and filing obligation

Both the Group Tax Relief System and the Consolidated Tax Return System are, where approved by the Commissioner of the NTA, only applicable to groups consisting of only Japanese companies that are all wholly owned (whether directly or indirectly) by the ultimate parent of the group, including Japanese companies whose ultimate parent company is a Japanese company that is a subsidiary of a foreign company. Under the Consolidated Tax Return System, corporate income tax is calculated based on the group's consolidated income and payable by the domestic controlling company as the taxpayer. On the other hand, under the Group Tax Relief System, each company within the group is required to individually calculate the amount of its corporate tax, by offsetting profits and losses within the group, and file a tax return or a claim for refund.

Aggregation of profits and losses and tax adjustments

The Group Tax Relief System allows approved corporate groups to aggregate the amount of losses incurred by one company with the amount of income of the other companies in the group on a *pro rata* basis.

Akira Tanaka
Tel: +81 3 6775 1190 / Email: akira.tanaka@amt-law.com

Akira Tanaka is a partner at Anderson Mōri & Tomotsune. He has broad experience and expertise in various tax practices, ranging from tax planning to tax litigation. He also has extensive experience working on general dispute resolution matters. He has represented numerous Japanese and foreign companies in litigation and other dispute resolution procedures, in areas such as international transactions, M&A and financial transactions. He has external experience at the Institute for Monetary and Economic Studies, Bank of Japan (2010–2011). He is a graduate of the University of Tokyo (LL.B., 2005) and the University of Tokyo School of Law (J.D., 2007). He is admitted to practise in Japan (2008).

Hiroki Tsue
Tel: +81 3 6775 1600 / Email: hiroki.tsue@amt-law.com

Hiroki Tsue is an associate at Anderson Mōri & Tomotsune. He advises on various areas of law, including tax regulations, information law and financial regulations. He is a graduate of the University of Tokyo (Bachelor of Laws, 2015) and the University of Tokyo School of Law (J.D., 2017). He is admitted to practise in Japan (2019).

Anderson Mōri & Tomotsune

Otemachi Park Building 1-1-1 Otemachi, Chiyoda-ku, Tokyo 100-8136, Japan
Tel: +81 3 6775 1000 / URL: www.amt-law.com

www.globallegalinsights.com

Other titles in the **Global Legal Insights** series include:

AI, Machine Learning & Big Data
Banking Regulation
Blockchain & Cryptocurrency
Bribery & Corruption
Cartels
Employment & Labour Law
Energy
Fintech
Fund Finance
Initial Public Offerings
International Arbitration
Litigation & Dispute Resolution
Mergers & Acquisitions
Merger Control
Pricing & Reimbursement

GLI GLOBAL LEGAL INSIGHTS