

E-Transaction Data Retention Requirements: Details of Proposed Transitional Measure under the 2022 Tax Reform

January 2022

In brief

As noted in our previous Japan Tax Update, the ruling party (LDP) released tax reform proposals on December 10, 2021 (the '2022 Tax Reform Proposal') which contained a new transitional measure (the 'Transitional Measure') that potentially provides taxpayers an exemption from the requirement to maintain e-Transaction data digitally, in compliance with mandatory e-Storage Act rules that came into effect from January 1, 2022.¹ Specifically, the Transitional Measure effectively allows taxpayers who were unable to satisfy the requirements by the original January 1, 2022 deadline due to an unavoidable situation (such as not yet being able to practically comply with the rules) an additional two years to become compliant with relevant e-Storage Act requirements, as long as the taxpayer is able to print out the e-Transaction data on request by a tax examiner.

On December 27, 2021, the Ministry of Finance released an ordinance setting out enforcement rules regarding the Transitional Measure, and on the next day the National Tax Agency ('NTA') released a Circular (the 'Circular') and a Q&A (the 'Q&A') on its website further explaining certain aspects of the Special Exemption. We discuss the main points from the Circular and the Q&A below.

In detail

1. Application of Transitional Measure for Two Years, beginning Jan. 1, 2022

As a general rule, where a person subject to document retention requirements with regard to Income Tax or Corporate Income Tax undertakes an e-Transaction, they must satisfy the requirements of the e-Storage Act rules with regard to maintaining such data in digital form. Put another way, taxpayers do not generally have the option of printing out e-Transaction data if they cannot satisfy requirements under the e-Storage Act to maintain such data digitally. As an exception, however, where a person is unable to maintain e-Transaction data in accordance with the e-Storage Act requirements due to a disaster or some other unavoidable situation, a special exemption applies to allow the taxpayer to maintain the data digitally, even if the taxpayer does not satisfy relevant e-Storage Act requirements (the 'Special Exemption').²

¹ "E-Storage Rules: Proposed Transitional Measure regarding e-Transaction Data Retention Requirement under 2022 Tax Reform", <https://www.pwc.com/jp/en/taxnews/pdf/jtu-20211215-en-197.pdf>

² See e-Storage Act Enforcement Rules, Art. 4 Sec. 3. The Special Exemption that applies in the case of a natural disaster or other unavoidable situation came into effect in the previous year's tax reforms.

Under the Transitional Measure in the 2022 Tax Reform Proposal, the scope of the existing Special Exemption was expanded.³ In addition to allowing relaxation of the requirements in the case of a “natural disaster or some other unavoidable situation”, the Transitional Measure allows a taxpayer to maintain data digitally, even if all the e-Storage Act requirements are not met, in a situation where the tax authorities recognize that a taxpayer faced an unavoidable situation and could not maintain e-Transaction data in compliance with the rules, as long as the taxpayer is able to output the data in response to a request by a tax examiner in an orderly and legible manner. This expansion of the scope under the Transitional Measure would apply with regard to e-Transactions taking place from January 1, 2022 until December 31, 2023.

2. Meaning of “an Unavoidable Situation”

The Special Exemption was originally promulgated to respond to a situation in which taxpayers would have a difficult time complying with the e-Storage Act’s requirements regarding e-Transaction data due to a natural disaster or the like. Under the Transitional Measure, even if it was arguably the taxpayer’s own fault that they could not comply with the e-Transaction data storage rules; for example, because the taxpayer was not able to set up appropriate systems or internal work-flows by the January 1, 2022 deadline, the law would recognize this as an “unavoidable situation”.⁴

3. Retaining Data in Hard Form

When a taxpayer makes use of the Transitional Measure due to the existence of an unavoidable situation, it is necessary that the taxpayer be able to present the e-Transaction data to a tax examiner in response to a request. Where a taxpayer maintains data from e-Transactions undertaken from January 1, 2022 until December 31, 2023 in hard copy, the taxpayer will thus be regarded as maintaining e-Transaction data in compliance with the requirements of the law.⁵

Where data is kept in hard form, only such data that is printed in an orderly and legible manner will be considered to satisfy the requirements of the law. More concretely, the law requires that data printed out in hard copy must have the same degree of orderliness as a paper-based document (*i.e.* a print out of raw, disorganized data would likely not satisfy this requirement) and that letters in the printed text be distinguishable from one another (*i.e.*, the printed material must be legible).

As noted, it is necessary that a taxpayer taking advantage of the Transitional Measure be able to present the e-Transaction data in response to a request by a tax examiner. Under the requirements of the e-Storage Act, it is necessary that where data is maintained in hard form, it be maintained for a length of time and in a location appropriate with the content of the data. Likewise, under the Transitional Measure, where data is maintained in hard form, it is necessary that the taxpayer maintain the data for the length of time that the data could be subject to audit, and in an appropriate location.⁶

4. Necessity of Undertaking Procedures at the Tax Office

Where a taxpayer wishes to take advantage of the Transitional Measure, it is not necessary that the taxpayer file any sort of request with the tax office. Rather, the tax office will confirm the existence of an “unavoidable situation” and review e-Transaction data kept in hard copy in a tax audit, as an examiner deems necessary. Where an examiner asks a taxpayer about the “unavoidable situation” that caused the taxpayer to be unable to maintain the e-Transaction data digitally in accordance with the rules, the examiner would likely expect the taxpayer to be able to explain what the company is currently doing in order to try and be in compliance with the rules, and the actions the company expects to undertake going forward so as to be in compliance with the rules.⁷

³ See Ministry of Finance Ordinance, sec. 80.

⁴ Treatment Circular 7-10.

⁵ Treatment Circular 7-11.

⁶ Q&A no. 41-4.

⁷ Q&A nos. 41-2, 41-3, and 41-5.

5. Treatment After the Transitional Measure Expires

The Transitional Measure will have effect with regard to e-Transactions taking place from January 1, 2022 until December 31, 2023. For e-Transactions taking place from January 1, 2024, taxpayers are required to comply with the e-Storage Act's requirements governing maintaining e-Transactions digitally. The authorities thus expect taxpayers to make preparations during the two-year period that the Transitional Measure is in effect to be fully in compliance with the e-Storage Act's requirements regarding maintaining e-Transaction data digitally for e-Transactions occurring January 1, 2024 and onward.⁸

The takeaway

Many taxpayers had expressed concern that they were not yet prepared to be in compliance with new more strict e-Transaction data maintenance requirements that were coming into effect on January 1, 2022. Under the 2022 Tax Reform Proposal, taxpayers have effectively been given a two-year period (until January 1, 2024) to prepare to be in compliance with requirements under the e-Storage Act. **It is highly recommended that taxpayers take advantage of this two-year period to ensure they have proper technical systems and internal workflows in place, so that they will be fully in compliance with the law when the Transitional Measure expires, and the e-Document rules become mandatory for e-Transactions taking place from January 1, 2024.**

⁸ Q&A nos. 41-2 and 41-3.

Let's talk

We would be happy to discuss how these rules may apply to your company, or to answer any questions. Please feel free to contact us.

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