

Overview of 2025 Tax Reform Proposals

January 2025

In brief

On December 27, 2024, the Japanese government approved the 2025 Tax Reform Proposals (the "2025 Tax Reform Proposals"). This newsletter will provide a summary of the major components of this 2025 Tax Reform Proposals. The full Japanese publication can be found [here](#).

For multinational enterprises, the proposals of most interest are likely to be (i) details of the implementation of the special taxation measures to strengthen defence capabilities that was introduced by the 2023 Tax Reform, and (ii) the further enactment of provisions covering BEPS Pillar Two, as Japan aligns its domestic law with the OECD. With the 2025 Tax Reform Proposals, Japan will introduce the undertaxed profits rule ("UTPR") and a qualified domestic minimum top-up tax ("QDMTT"). Some taxpayers may also be interested in the proposed changes arising from the issuing of the latest accounting standard in relation to leases.

In detail

1. Corporate Tax

a) Tax Measures to Promote Policy Objectives

i) Amendments to measures to promote regional investment

The currently effective Regional Investment Promotion Tax Measure (special depreciation or tax credit for capital investment made in accordance with an approved business plan) will be extended for three years. In addition, the size of investment required for such a plan to be approved by the relevant government body will increase from JPY 20 million or more to JPY 100 million or more. At the same time, the special depreciation rate for machinery, equipment, and fixtures is reduced to 35% (currently 40%).

In addition, a new type of "super" tax measure (50% special depreciation or 5% tax credit) for investment in machinery, equipment, and fixtures of JPY 1 billion or more will be added for certain to-be designated industries (industrial sectors meeting certain criteria for which prefectures provide priority support).

ii) Establishment of new measures to promote investment in resource recycling

Special depreciation of 35% will be available for certain capital investments made during the period from the enactment of the relevant law (currently scheduled for February 1, 2025) to March 31, 2028 by those who have received approval from the relevant government body for a resource recycling business plan. The capital investments eligible for special depreciation consist of machinery and equipment with a value of JPY 20 million or more per unit and fixtures of JPY 2 million or more per unit, up to a total amount of JPY 2 billion per company.

b) Compliance with New Lease Accounting Standard

On September 13, 2024, the Japanese Accounting Standard for Leases ("New Lease Accounting Standard") was issued, with mandatory adoption for fiscal years beginning on or after April 1, 2027 (voluntary adoption is permitted for fiscal years beginning on or after April 1, 2025). Under the New Lease Accounting Standard,

lessee companies must account for all leases on their balance sheet (i.e., the right-to-use and the lease liability). The same accounting treatment is expected to be applied to real estate lease transactions.

i) Impact for lessees

As there is no separate provision in the tax law for operating lease transactions, they have historically been treated for tax purposes in accordance with existing rules regarding treatment of leases under the Japanese Generally Accepted Accounting Principles. For operating leases this means that, consistent with other operating expenses, the lessee can deduct the amount paid under the operating lease contract only when the amount is fixed and determinable. On the other hand, as noted above, under the New Lease Accounting Standard, the right-to-use and the lease liability must be recorded. However, as it is intended to keep the existing treatment for tax purposes, new tax provisions will be established for operating lease transactions that will ensure this result. As a result, there will be a difference in the accounting and tax treatments for operating lease payments going forward.

For land or buildings under an operating lease, lease payments deductible under the corporate tax law will be treated as rental expenses for the purpose of calculating the value-added component of enterprise tax.

For the depreciation of assets under finance leases (straight-line method over the lease term) that are entered into on or after April 1, 2027, other than those involving a transfer of ownership, the guaranteed residual value will not be deducted from the acquisition cost (currently it is deducted), and it will be possible to depreciate the asset to 1 yen at the end of the lease term. In contrast to the above proposal for operating leases, this does align with the New Lease Accounting Standard, which also abolishes the practice of using the guaranteed residual value as the residual value for the depreciation of the right-to-use. In addition, a transitional measure allows the early application of this amendment.

ii) Impact for lessors

The special rule determining the fiscal year to which income and expenses arising from the transfer of a lease asset (instalment method) will be abolished. For lease asset transfers made before April 1, 2025, the instalment method can be applied to fiscal years beginning on or before March 31, 2027. However, if a lessor ceases to apply the instalment method for fiscal years beginning from April 1, 2025 and on or before March 31, 2027, transitional measures will be established to treat the amount of deferred lease income as revenue over five years in equal amounts.

In conjunction with the above, the instalment method for consumption tax on leases will also be abolished (see "4. Consumption Tax" below).

c) Taxation of Corporate Reorganisations

i) Transfer of net assets in a spin-off under the group relief system

For tax purposes, in a spin-off by way of share distribution, the "transferred net asset ratio*" of the corporation that is making the distribution is used to calculate the deemed dividend and the book value of the shares of the subsidiary to be received by shareholders.

* Essentially, it is the "book value of the shares in the subsidiary that are being distributed at the time immediately prior to distribution / book value of distributing corporation's total net assets" as of the end of the previous fiscal year.

If the corporation distributing the shares has adopted Japan's group tax relief system (which replaced Japan's tax consolidation regime for tax years beginning on or after 1 April 2022), the book value of that corporation's investment in its subsidiary must be adjusted when calculating the transferred net asset ratio, because the subsidiary will leave the group due to the spin off. This "investment book value adjustment" is calculated based on the book value of the leaving corporation's net assets at the time of withdrawal, while the investment book value adjustment equivalent (to be reflected both in the numerator and denominator in calculating the ratio) will be calculated based on the book value of the subsidiary's net assets as of the end of the previous fiscal year (i.e., not at the time immediately prior to the distribution) This will allow for timely

tax treatment of such spin offs when they occur, without having to wait for the subsidiary's financial statements to be finalized

Although the calculation of the investment book value adjustment is based on the book value of net assets as of the end of the previous period, it should reflect any increase or decrease in the amount of the subsidiary's capital up to the time of the spin off and any increase or decrease in the amount of retained earnings. In addition, if the subsidiary holds another subsidiary's shares, a chain calculation should be performed to reflect the investment book value adjustment accurately.

The above provisions shall also apply to a spin-off by way of a split-type demerger.

ii) Asset adjustment account calculation in non-qualified mergers without consideration

Historically, it has been unclear how the asset adjustment account should be calculated in a non-qualified merger where there is no consideration. Under the 2025 Tax Reform Proposals, the method for calculating the amount of the asset adjustment account in such a case will be clarified.

In addition, if the transferred assets exceed the transferred liabilities, and asset valuations have not been performed, the difference between the assets and liabilities will be considered an increase in the amount of capital.

d) Amendments to the e-Storage Act

Taxpayers using an e-storage system that meets the criteria set by the National Tax Agency, and who meet certain additional requirements for sending, receiving and storing data will be exempt from the additional 10% penalty tax. To apply for this exemption, a tax report will be required to be submitted in advance. This amendment will be applied to national taxes for which the statutory filing deadline is on or after January 1, 2027. [Note that the existing rules provide for a heavy penalty tax of 35% in the case of taxpayer fraud, but this proposal will eliminate an additional 10% heavy penalty tax that was specific to fraud in the context of e-storage matters.]

e) Taxation of Small and Medium-Sized Enterprises ("SMEs")

The following proposals are made to existing tax benefits or credits for SMEs:

- The special tax rate for SMEs, which provides that the tax rate for the first JPY 8 million of income is reduced from 19% to 15% will be extended for two years. However, if the SME income exceeds JPY 1 billion per year, the special tax rate will be 17%. In addition, the special tax rate is not available to corporations applying Japan's group tax relief regime.
- The SME Investment Promotion Tax Measure (special depreciation or tax credit for the acquisition of certain machinery and equipment) will be extended for two years.
- The SME Management Enhancement Tax Measure (special depreciation or tax credit for capital investment based on an approved business plan by the relevant government body) will be extended for two years, although certain changes are proposed to the criteria necessary to qualify for an approved plan.

2. Special Taxation Measures to Strengthen Defence Capabilities

Details of the special corporation tax to strengthen defence capabilities, which was announced in the 2023 Tax Reform are now provided. The tax will be applicable for fiscal years beginning on or after April 1, 2026. It will be calculated by multiplying the base corporate tax amount less the basic deduction of JPY 5 million by a tax rate of 4%. A separate tax return for this tax will be required.

3. International Taxation

a) Pillar Two

i) Undertaxed Profits Rule (“UTPR”)

A UTPR will be established and will apply to fiscal years beginning on or after April 1, 2026.

ii) Qualified domestic minimum top-up tax (“QDMTT”)

A QDMTT will be established and will apply to fiscal years beginning on or after April 1, 2026. In addition, a system for providing QDMTT information will be established.

iii) Revisions to the income inclusion rules (“IIR”)

The IIR will be revised to align in several areas with guidance published by the OECD in June 2024, including with respect to the methodology to be applied to the recapture of deferred tax liabilities, the cross-border allocation of deferred taxes and clarification as to the allocation of profits and taxes in structures including flow-through entities.

b) Japanese Controlled Foreign Corporation (“CFC”) Rules

Currently, the fiscal year of a CFC to be included in the income of a Japanese parent company is determined using the date after the CFC’s fiscal year end plus two months. That is, if the CFC has a December fiscal year end and the Japanese parent company has a March fiscal year end, the taxable income of the CFC each December will be included in the following March return of the Japanese parent company. In the 2025 Tax Reform Proposals, this period will be changed to the date after the CFC’s fiscal year end plus four months. In addition, certain documents that are required to be attached to the tax returns of the Japanese parent company will no longer be so required.

This amendment applies to the inclusion of CFC income for fiscal years of the Japanese parent company beginning on or after April 1, 2025 (although limited to the inclusion of income of CFCs for fiscal years ending on or after February 1, 2025). In addition, a transitional measure will allow the new rule to be applied to the fiscal years of Japanese parent companies beginning before April 1, 2025 (although limited to the fiscal years of CFCs ending between December 1, 2024 and January 31, 2025). An example for a Japanese parent company with a March 31 fiscal year end, and with CFCs having December 31 fiscal year ends, is provided in the table below.

Fiscal year end of CFCs		31 Dec 2024	31 Dec 2025	31 Dec 2026
Timing of inclusion into the taxable income of the Japanese parent company	New rule	31 March 2025	31 March 2027	31 March 2028
	Transitional measure	31 March 2026	31 March 2027	31 March 2028

4. Consumption Tax

a) Review of Consumption Tax Exemption System for Tourists

The consumption tax exemption system for tourists will be changed to a "refund system" (i.e., the consumption tax will be refunded after the goods have been exported as is applied in many other jurisdictions). In conjunction with this change, the scope of duty-free goods, procedures for duty-free sales, and requirements for permits for the sale of duty-free goods will also be revised. This revision will apply to sales of duty-free goods on and after November 1, 2026.

b) Consumption Tax Treatment for Leases

For lessors, the special rule determining the timing of the transfer of leased assets (instalment method) will be abolished. For transfers before April 1, 2025, the instalment method can be applied until fiscal years

beginning on or before March 31, 2030. If the instalment method is not applied for fiscal years beginning on or after April 1, 2025, transitional measures will be available, such as setting the balance of the instalment payments as the consideration for the transfer in equal instalments over 10 years (in contrast to the transitional measures for corporate tax, which will treat the amount of deferred lease income as revenue over five years in equal amounts, see “1(b) Compliance with New Lease Accounting Standard” above).

5. Individual Income Tax and Inheritance Tax

a) Individual Income Tax

Various changes are proposed to the taxation of individual income, including:

- Increase in the basic income tax deduction by JPY 100,000 for all income levels. Additional deductions will be available for those with dependent children (commencing in the 2025 income year).
- In line with the above, increase in the total income threshold for spouses and children of the same household (and various other taxpayer categories) to qualify for certain beneficial tax measures by JPY 100,000 (commencing in the 2025 income year).
- Exclusion of overlapping periods of service in the calculation of retirement income deduction (for retirement payments made on or after January 1, 2026).
- Increase in maximum deduction for life insurance premiums for dependent children (for premiums paid on or after January 1, 2026).
- Extension of mortgage and home renovation deductions for those with dependent children by one year (to the 2025 income year).
- Increase in contribution limits for corporate and individual defined contribution pension plans.
- Increased flexibility for NISA investments.

b) Angel Taxation

The angel taxation system (capital gains tax exemption on the transfer of shares if the proceeds are reinvested in a start-up company or if the taxpayer starts their own business) will be extended.

The current requirement that the transfer of shares and reinvestment must be made within the same fiscal year will be extended to include reinvestment in the following fiscal year. Specifically, if a taxpayer reinvests in a start-up company on or after January 1, 2026 and has not claimed the angel taxation exemption in the prior year, that taxpayer will be able to claim a refund of income tax for the corresponding amount for the prior year. To apply, the taxpayer must attach a statement to the effect that they expect to reinvest in a start-up company during the following year to their prior year tax return.

c) Inheritance Tax

Various changes are proposed, including that the tax exemption for lump-sum gifts in marriage and to funds for dependent children be extended for two years, as well as proposed changes to the calculation basis for inheritance payments in kind.

The takeaway

Although many of the 2025 Tax Reform Proposals that will impact multinational enterprises were anticipated, such as those relating to the further implementation of Pillar Two, others will require taxpayers to review their current tax accounting and compliance processes, such as the treatment of leases and the special corporation tax to strengthen defence capabilities. Taxpayers are advised to consult with their tax advisors

for further details of the 2025 Tax Reform Proposals, and of the laws themselves once enacted in March 2025.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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E-learning

PwC Tax Japan launched a new e-learning program called Tax Academy in October 2022, to support those wishing to develop their skills in the international tax field. For tax professionals outside Japan, the 'Introduction to Japanese taxes' series within Tax Academy provides a basic outline of the Japanese tax system, including corporate tax and consumption tax, and covers key points of international tax practice in English.

Please click here for details and to apply:

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