



Japan: does reduction in corporate effective tax rate mean actual reduction of tax burden?

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Japan's amended Corporation Tax Act is now in force.

Pursuant to the act, which came into force on 1 April 2016, the corporate tax rate has been reduced from 23.9 percent to 23.4 percent, with effect from the business year commencing on and after 1 April 2016.

The tax rate under the act will be further reduced to 23.2 percent, with effect from the business year commencing on and after 1 April 2018. Further, the amended Local Tax Act also came into force on the same day, reducing the standard rate of the per income levy of corporate business tax, a local tax applicable to enterprises with capital over JPY100 million (the large enterprises; other enterprises are hereinafter referred to as the SMEs), which are subject to pro forma tax of corporate business tax.

As a result of these amendments, the effective corporate tax rate applicable to large enterprises has fallen below 30 percent.

What is the "effective corporate tax rate"?

Enterprises generating income in Japan are subject to corporate tax (national tax) as well as local corporate tax (national tax), corporate residents' tax (local tax) and corporate business tax[1] (local tax), of which the local corporate tax may be deducted in determining the taxable income for the corresponding business year. The ratio of the income tax burden actually borne by enterprises may be calculated by adding up the rates of corporate tax, local corporate tax, corporate residents' tax and corporate business tax on the enterprises' income, with the impact of the deduction from the taxable income for business tax in mind. This ratio of actual income tax burden is called the effective corporate tax rate.

Changes in effective corporate tax rates

The following table shows the changes in, and the breakdown of, the effective corporate tax rates in and after 2015.

	SMEs				Large Enterprises			
	2015	2016	2017	2018	2015	2016	2017	2018
(a) Corporate tax	23.9%	23.4%	23.4%	23.2%	23.9%	23.4%	23.4%	23.2%

(b) Local corporate tax	1.05%	1.03%	2.41%	2.39%	1.05%	1.03%	2.41%	2.39%
(c) Corporate residents' tax^{1,3}	3.08%	3.02%	1.63%	1.62%	3.08%	3.02%	1.64%	1.62%
(d) Corporate business tax^{2,3}	9.6%	9.6%	9.6%	9.6%	6.0%	3.6%	3.6%	3.6%
Total of (a) to (d)	37.63%	37.05%	37.05%	36.81%	34.03%	31.05%	31.05%	30.81%
Effective corporate tax rate	34.33%	33.80%	33.80%	33.59%	32.11%	29.97%	29.97%	29.74%

1 Corporate residents' tax also includes corporation levy imposed on an income basis as well as per capita levy imposed based on the number of employees and capital (including investments, etc.), which are not considered here.

2 The Large Enterprises are subject to per income levy imposed on an income basis as well as added-value base, which is imposed on the basis of the sum of compensation/salary, net interest expense, net rent expense and single year's gains/losses, and capital base, which is imposed on the basis of a capital amount, which are not considered here.

3 The figures in (c) and (d) referred to above differ from the tax rates prescribed by law. This is because the tax base of tax rates prescribed by law is a corporate tax amount, and the above figures are calculated by multiplying a relevant tax rate prescribed by law by the corporate tax rate (*i.e.*, corporate tax-to-income ratio) for the purpose of illustration. With respect to (c) and (d), each local government may set different tax rates at its own discretion.

As the above table clearly shows, **regardless of the reduction of corporate tax, the effective corporate tax rate of the SMEs exceeds 30 percent.** This is because the corporate business tax rate (and the special local corporate tax rate) applicable to the SMEs is not scheduled to be changed. Enterprises with capital over JPY100 million, however, are said to account for only 1 percent of all enterprises in Japan (in 2012)[2]; the effective corporate tax rate of the overwhelming majority of enterprises remains over 30 percent. In contrast, as a result of the 2016 tax reform, **the tax rate of per income levy imposed on added value and on capital bases applicable to large enterprises has increased.** Therefore, the pro forma corporate tax rate will increase in and after 2016. Because the pro forma corporate tax is imposed regardless of level of income, a situation may arise where only the tax burden increases while the income remains the same. It is, therefore, not appropriate to suggest that the reduction of the effective corporate tax rate has reduced the tax burden borne by large enterprises.

Conclusion

As discussed in our previous newsletter, the Japanese government has been looking at the reduction of corporate tax as a way to attract foreign enterprises, and it is expected that the government will continue to reduce the corporate tax rate in order to increase its competitiveness against foreign countries. However, a reduction of tax rate does not necessarily mean an actual reduction of tax burden. Further, the pro forma corporate tax has yet to be introduced for SMEs, but, as this has been examined by the government for some time, progress is expected to be made in the near future.

Find out more about these and other issues around tax in Japan by contacting either of the authors.

[1] In addition, the enterprises will also remain subject to a special local corporate tax until 2016.

[2] See this page.

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