

Japan Corporate and Tax Quarterly Update: July Issue

In brief

In this issue, we focus on the FY2023 Tax Reform Enforcement Order and Enforcement Regulations and the Guidelines on Respecting Human Rights in Responsible Supply Chains.

On the tax side, the Cabinet Order Partially Amending the Order for Enforcement of the Income Tax Act ("Cabinet Order") and the Ministerial Order Partially Amending the Ordinance for Enforcement of the Income Tax Act in relation to the 2023 Tax Reforms ("Ministerial Order") were published in a special extra (No. 25) of the Official Gazette dated March 31, 2023.

On the corporate side, in April 2023, the Ministry of Economy, Trade and Industry of Japan published the "Reference Material on Practical Approaches Enabling Business Enterprises to Respect Human Rights in Responsible Supply Chains" (the "Reference Material"). The Reference Material provides in-depth explanations and examples of considerations and steps that business enterprises may undertake, including "formulating a human rights policy" and "identifying and assessing adverse impacts on human rights."

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- Potential implementation of "deemed reseller approach" imposing Japanese consumption tax obligations on digital platform operators
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- Revisions to Tender Offer Rule and Large Shareholding Reporting Rule

Enforcement Order and Enforcement Regulations of the Tax Reform for Fiscal Year 2023

A Cabinet Order for Partially Amending the Order for Enforcement of the Income Tax Act ("Cabinet Order") and a Ministerial Order for Partially Amending the Ordinance for Enforcement of the Income Tax Act in relation to the 2023 Tax Reform ("Ministerial Order") were published in a special extra (No. 25) of the Official Gazette dated March 31, 2023, in connection with the 2023 Tax Reform.

The existing cabinet order and ministerial order were revised and new provisions were added in the areas related to the Act Partially Amending the Income Tax Act ("Tax Reform Related Law"), published on February 3, 2023. However, the Order for Partially Amending the Order for Enforcement of the Corporation Tax Act and the Ordinance for Enforcement of the Corporation Tax Act corresponding to the Proposal of Corporation Tax on the International Minimum Tax Amount for Each Relevant Fiscal Year listed in Part II, Chapter II of the partial amendment of the Corporation Tax Act were not included in the Cabinet Order or the Ministerial Order, in response to global minimum taxation.

The expansion of the scope of subjects for which all search requirements are unnecessary when preserving electronic transaction data (those whose sales in the base period are between 10 million yen and 50 million yen, or those required to preserve output documents with electromagnetic records for each transaction date and counterparty) and the rationalization/clarification of the determination of books subject to the reduction of additional tax in the case of underpayment of income tax in relation to high-quality electronic books were planned in the 2023 Tax Reform Omnibus, yet these items were not confirmed in the Tax Reform Related Law, since applicable provisions were stipulated in the ministerial ordinances.



These revisions were found to be reflected in the Ministerial Ordinance Partially Amending the Ordinance for Enforcement of the Act on Special Provisions Concerning Preservation Methods for Books and Documents Related to National Tax Prepared by Means of Computers, which was released this time.

Further Developments on the Enforcement Order and Enforcement Regulations of the Japanese IIR

On June 16, 2023, the Cabinet Order to Partially Amend the Enforcement Order of the Corporation Tax Law (Cabinet Order No. 208) was published in the Official Gazette. Following this, the Ministerial Regulations for the Income Inclusion Rule ("IIR") were promulgated on June 30, 2023. The computation of Global Anti-Base Erosion ("GloBE") income or loss, adjusted covered taxes, effective tax rate, jurisdictional blending and top-up tax is intended to be consistent with the Model GloBE Rules provided by the Inclusive Framework on BEPS.

The Cabinet Orders and Ministerial Regulations included the following key items of the Japanese IIR:

- Scope of specified multinational enterprise ("MNE") groups
- Computation of GloBE income or loss
- Computation of Adjusted Covered Taxes
- Jurisdictional blending
- Substance-based income exclusion
- De minimis rule
- Rules for intermediate parent companies
- Partially owned parent companies
- Minority owned companies and investment companies, and
- Filing rules

It is expected that further clarification will be provided by the Basic Directive on the Corporation Tax Act and FAQs regarding the Japanese IIR, since the Income Tax Act has been amended and will be applicable for fiscal years beginning on or after April 1, 2024.

Potential implementation of "deemed reseller approach" imposing Japanese consumption tax obligations on digital platform operators

Japan recently began considering changes to the current Japanese consumption tax (JCT) rules that, if implemented, would impose an obligation on digital platform operators (e.g., business operators running app stores, online marketplaces, etc.) to collect JCT on transactions between third party sellers and Japanese customers conducted via their platforms.

Key takeaway

Japan is considering the introduction of a "deemed reseller" approach for JCT purposes, similar to that adopted by the EU under which platform operators may become the deemed supplier when they facilitate certain cross-border B2C transactions by third party sellers. Such platform operators would therefore be liable to collect (and possibly report/remittance depending on whether certain conditions are met) JCT due from consumers. If implemented, the deemed reseller approach may have a significant impact on various platform operators, as they would be required to take on JCT obligations related to sales. The approach could be included as part of the 2024 tax legislation bill to be enacted on 1 April 2024. We will monitor the situation (e.g., via press reports, Tax Commission discussions (which are disclosed on the Commission's website), etc.), and will provide updates when further action is taken.

In depth

Cross-border digital transactions between Japanese customers and overseas sellers conducted via digital platforms have become increasingly common. Japan has therefore begun considering updates to the JCT system to ensure that



JCT is properly collected/paid for such transactions. Under the current JCT rules, the JCT treatment of digital transactions conducted via digital platforms depends on whether the customer is a business or individual (i.e., whether it is a B2B or B2C transaction). For B2C transactions, the third party seller is responsible for collecting JCT on sales to customers in Japan, but depending on the seller's JCT taxpayer status, it may not be required to remit the JCT collected to the Japanese tax authorities. The National Tax Agency (NTA) is aware of both unintentional non-compliance (such as failure to submit JCT tax filings) and/or malicious cases (such as exploiting loopholes in the JCT law).

To combat these issues, the Government Tax Commission (Cabinet Office) discussed introducing a "deemed reseller" approach for JCT purposes during its meeting on 26 October 2022. This approach is similar to that adopted by the EU under which platform operators may become the deemed supplier when they facilitate certain cross-border B2C transactions by third party sellers. Such platform operators would therefore be liable to collect (and possibly report/remit depending on whether certain conditions are met) JCT due from consumers. If implemented, the deemed reseller approach may have a significant impact on various platform operators, as they would be required to take on JCT obligations related to sales (although they would not take on other obligations, such as product liability).

Further to the Tax Commission discussion in October 2022, the 2023 Japanese Tax Legislation Proposal (by the ruling parties) briefly mentioned the deemed reseller approach as an item to be considered in future tax legislation (we have included links to the relevant documents below, although only Japanese versions are available). Legislation proposals in Japan are fairly unique in that they contain not only items to be enacted as part of a current proposal, but also other important policy items to be considered in the future. The fact that these items have been included with the current year's proposed tax legislation as priority policy issues generally means that we can expect legislation related to them in the future. As such, while the deemed reseller approach was not included as part of the 2023 tax legislation bill, it appears likely that Japan will introduce legislation to implement the deemed reseller approach in the future. At the earliest, the approach could be included as part of the 2024 tax legislation bill to be enacted on 1 April 2024.

In terms of the details, the Tax Commission's discussions appear to have focused solely on app sales through platforms. Platforms that facilitate other types of transactions (e.g., the booking of accommodations) are not included. Thus, while discussions are still developing, if the deemed reseller approach were to be introduced at this stage, it may not have any adverse tax consequences for platform operators that are not facilitating transactions involving app sales. However, this may change when actual legislation is introduced in the future, and further analysis will be needed at that time to assess the potential impact.

In addition to the above, it may take time to introduce the deemed reseller approach into the JCT system, as doing so will require substantial changes to the systems used by offshore platform operators. Thus, we speculate that a transition period (e.g., one or two years) will be provided. Therefore, even if the 2024 tax legislation includes the deemed reseller approach, a transition period may be given to allow time to assess the changes and take necessary measures.

Note that when legislation is introduced, the government may hold explanatory sessions for foreign multinationals to help them understand the new rules. The Ministry of Finance and the Ministry of Economy, Trade and Industry held such sessions in 2015 when the JCT rules for electronically supplied services (ESS) were introduced. We have been notified that some big four accounting firms have been mentioning to clients that the government will be holding industry consultations regarding the implementation of a deemed reseller approach. However, we are not aware of any concrete information regarding the timing/nature of such industry consultations at this stage. We will continue to monitor the situation (e.g., via press reports, Tax Commission discussions (which are disclosed on the Commission's website), etc.) and will provide updates when further action is taken.

[Government Tax Commission meeting on 26 October 2022](#) (only in Japanese)
[2023 Tax Legislation Proposal](#) (only in Japanese)



2023 Update of Grand Design for New Capitalism and its Implementation Plan

On June 16, 2023, the "2023 Update of Grand Design for New Capitalism and its Implementation Plan ("the 2023 GNCI")" drafted by Headquarters for Achieving New Capitalism (committee under Cabinet Secretariat) was approved by the Cabinet.

The 2023 GNCI seems to focus on, among other things, (a) rationalizing labor law practices and encouraging job market liquidity to help boost salaries; (b) encouraging investment in growth areas, start-ups, and research and development; (c) facilitating energy transition; and (d) boosting investment by changing household financial assets from bank deposits to marketable securities.

The 2023 GNCI included a number of changes that may have legal and tax implications, but as the 2023 GNCI is simply a proposal or recommendation, implementation of most of the changes included will require amendment of existing law or enactment of new laws.

1. Job market liquidity

The 2023 GNCI proposes to amend the retirement payment deduction for income tax purposes, which currently allows for a deduction of JPY 700,000 per service year in excess of 20 years of service (JPY 400,000 for less than 20 years of service), as such an incentive may demotivate people to change to more attractive jobs.

Furthermore, the 2023 GNCI recommends raising the maximum amount of iDeCo (defined contribution plan) contributions and deferring the starting age for receiving iDeCo benefits.

The 2023 GNCI also proposes to amend the model "Labor Regulations" issued by Ministry of Health, Labor and Welfare to ensure fair treatment of retirement payments, regardless of length of service years and abolish the system of reducing retirement payments in cases of voluntary resignation.

2. Encouraging research and development

One interesting item to note in the 2023 GNCI is its suggestion to potentially introduce a tax regime that can enhance investment in the area of research and development with respect to producing competitive intellectual properties. The new tax regime would be aligned with the METI initiatives led by the "Study Group for Enhancing Private Sector Investment in Innovation in Japan," which recommends introducing a "patent box" type tax regime. This would provide a much more enticing incentive to companies than the current corporate tax regime, which only provides certain tax credits for qualifying R&D expenditures. However, it is unclear whether Japan could introduce such a regime given the current international tax environment in which "patent box" type regimes are considered harmful tax regimes by the OECD.

3. Attracting highly skilled foreign professionals

As the ratio of highly-skilled professionals in Japan that are foreigners is less than 1% (in comparison with the ratios in the UK, US, and Germany which are 23%, 16% and 13%, respectively), the 2023 GNCI suggests analyzing issues with respect to attracting highly-skilled foreign professionals to Japan and exploring options to rationalize the Japanese tax regime and regulatory issues that affect such highly-skilled foreign professionals. The 2023 GNCI cited feedback from foreign MNCs and their expatriates which stated that, in addition to language barriers, difficulties with administrative processes and high income tax rates are key issues for them in relocating to Japan. Although there have been several tax reform measures introduced in last 10 years aimed at attracting more highly skilled foreigners, including an exemption from inheritance/gift tax on foreign situs assets for resident taxpayers having certain temporary visas, the 2023 GNCI seems to suggest that more comprehensive measures may be necessary to increase Japan's ratio of highly skilled foreign professionals.

4. Green transformation ("GX")

GX has recently been one of the most popular words in the business community, and the 2023 GNCI spends several pages providing suggestions and recommendations in this area, including: ways to enhance the FIP (Feed in



Premium) program to ensure that it can achieve its target renewable energy ratio of 36% - 38% by 2030, regulatory reform for expanding offshore wind projects to EEZ (exclusive economic zones), and ways to facilitate the expansion of clean energy such as hydrogen and ammonia. The 2023 GNCI also includes a proposal to implement a "Growth-Oriented Carbon Pricing Plan," which consists of several recommendations including JPY 20 trillion of "GX Transformation Government Bonds" as part of JPY 150 trillion of investment into GX sectors by the government and private sectors, establishment of an emission trading system in 2026, and assistance for green financing, as well as transition financing by way of guarantees provided by government entities.

5. Support for start-ups

The 2023 GNCI also emphasizes the implementation of the "Five Year Plan for Increasing Start-Ups," which was issued by the Headquarters for Achieving New Capitalism in November 2022 by saying that statistics indicate that a higher ratio of new entry/exit will result in greater economic growth. In particular, the 2023 GNCI noted the following issues:

(a) Stock based compensation

Under the Japanese Companies Act, stock options must be issued within one year after the shareholder resolution, and certain terms of the stock options, such as exercise price and exercise period, cannot be delegated to the board or directors. The 2023 GNCI suggests removing these restrictions to allow for more flexibility in issuing stock options. It also suggests that further tax reform with respect to stock options, including raising or removing the maximum amount of tax-qualified stock options, which is currently JPY 12 million per year and providing clearer guidance regarding the valuation of shares in private companies to facilitate stock-based compensation for private companies.

(b) Restricted stock units (RSUs)

The 2023 GNCI noted that RSUs, a form of equity compensation that grants employees a certain number of company shares on a future date, are commonly used by start-up companies in the US to incentivize their management and employees. However, in Japan it can be more difficult for start-ups to implement RSU plans due to certain issues, such as uncertainties regarding the applicability of disclosure requirements to RSUs for new share issuances of JPY 100 million or more under the Financial Instrument and Exchange Act. The 2023 GNCI suggests trying to resolve such issues.

(c) Extend the preferable individual tax regime to include investments in listed venture capital

Under the current tax law, individual taxpayers investing in certain start-ups can qualify for a special tax deduction, known as the "angel tax regime." The 2023 GNCI suggests considering expanding the scope of the angel tax regime to include investments in listed venture capital.

(d) Attracting foreign investors

The 2023 GNCI indicates that further tax reform, in addition to the exemption for foreign LP investors from Japanese capital gain tax for the sale of shares in a Japanese company f introduced in 2021, should be considered for promoting investment from foreign investors (LP) in funds that have a Japan resident GP.



Guidelines on Respecting Human Rights in Responsible Supply Chains

1. Introduction

In September 2022, the Government of Japan released the "Guidelines on Respecting Human Rights in Responsible Supply Chains" (the "Guidelines")¹. Based on the UN Guiding Principles, the OECD Guidelines for Multinational Enterprises, the ILO MNE Declaration, and other international standards, the Guidelines have been established to help deepen business enterprises' understanding and promote their efforts by explaining the activities that business enterprises are requested to undertake to respect human rights, in a concrete and easy-to-understand manner, which is tailored to the actual situation of business enterprises engaging in business activities in Japan.

Further, in April 2023, the Ministry of Economy, Trade and Industry of Japan published the "Reference Material on Practical Approaches for Business Enterprises to Respect Human Rights in Responsible Supply Chains" (the "Reference Material")². The Reference Material provides in-depth explanations and examples of considerations and steps that business enterprises may undertake in compliance with the Guidelines, including "formulating a human rights policy" and "identification and assessment of adverse impacts on human rights (human rights risks)". Specifically, the Reference Material presents examples of components to be included in a human rights policy and explanations thereof, explanations of steps that can be taken to identify the areas of a supply chain where high risks arise (or may arise), and additional reference documents that are useful in finding such risks.

In this article, we briefly outline the main content of the Guidelines together with the explanation in the Reference Material.

2. Formulating a human rights policy

The Guidelines describe the requirements for a human rights policy and points to be considered during and after the formulation of the policy.

In establishing a human rights policy, the following steps can be taken.

(1) Understanding the current status of the company

Identifying the relevant human rights which the company may adverse impact by collecting information from each internal department (e.g. marketing, human resources, legal affairs / compliance, procurement, manufacturing, business planning, and research and development) and holding dialogues and discussions with stakeholders who are familiar with the business enterprise's industry, etc.

(2) Drafting a human rights policy

The Reference Material identifies the following items for consideration in a human rights policy:

- (a) Position of the human rights policy in the company and its consistency with the management philosophy and code of conduct of the company.
- (b) Clarification on whether the human rights policy applies to the company alone or other group companies as well.
- (c) Clarification on what is expected of the company's employees, business partners, and other stakeholders in relation to the respect for human rights.
- (d) Statement of commitment to respect internationally recognized human rights.
- (e) Statement of compliance with applicable laws and regulations and its relationship with respecting internationally recognized human rights.
- (f) Key issues for the company in relation to its respect for human rights.
- (g) Ways to implement initiatives to respect human rights.

¹ A provisional English translation of the Guidelines is published [here](#).

² A provisional English translation of the Reference Material is published [here](#).



- (3) Obtaining the company's management approval for the human rights policy
- (4) Publishing the human rights policy

It is noteworthy that the formulation and publication of a human rights policy is not the end of the process - the human rights policy should be firmly established throughout the company and put into practice in a concrete and detailed manner. As such, it is important to disseminate the human rights policy internally and to reflect the details of the human rights policy in the company's code of conduct and procurement guidelines.

3. Human rights due diligence - Identification and assessment of adverse impacts

The first step of any human rights due diligence is to identify and assess any actual or potential adverse human rights impacts which the company may be involved in. This may be done by holding dialogues with the relevant stakeholders such as its employees, labour union / workers' representatives, civil society organizations, human rights defenders, and local residents.

Below are the steps which may be taken in the identification and assessment of adverse human rights impacts. It should be noted that these steps are on the presumption that the company knows and is aware of its suppliers for the purposes of ensuring the traceability of the company's products and services.

- (1) Identification of business fields with material risks

The company should identify the business fields where the probability of adverse human rights impacts is high and material risks exist.

- (2) Identification of the processes where adverse impacts arise

The company should examine each of its operational processes and specifically identify the relevant point at which adverse human rights impacts can occur, as well as the relevant individual and how it affects such individual's human rights. If business fields with material risks have been identified in (1) above, the company should first examine and identify from these business fields.

- (3) Assessment of the company's involvement in adverse impacts and prioritization

To decide on an appropriate response, the company should assess its involvement in adverse human rights impacts, in particular, by assessing:

- (a) whether the company caused or contributed to the relevant human rights risk; and
 - (b) whether the relevant human rights risks directly related to the company's operation, products or services.
- If (a) is applicable, the company should take measures to prevent or mitigate the relevant human rights risk. If (b) applies to the company, the company should work with companies that have caused or contributed to the human rights risk to prevent or mitigate the human rights risk.

4. Are the Guidelines legally binding?

No, the Guidelines clearly state that they are not legally binding³. However, it is expected that all business enterprises engaging in business activities in Japan strive in their efforts to respect human rights in their business enterprise, group companies, suppliers (including but not limited to direct business partners), etc. inside and outside of Japan to the fullest extent possible in line with the Guidelines.

³ Section 1.3 of the Guidelines.



5. How should foreign investors deal with human rights issues in Japan?

As noted in this article, with the establishment of the Guidelines and the Reference Material, the Government of Japan expects companies in Japan to consider more seriously what kind of human rights initiatives are appropriate, taking into account their circumstances and other factors.

The Guidelines state that there are benefits for companies in fulfilling their responsibility to respect human rights. For example, the proper implementation and publication of efforts to respect human rights often leads to an improved corporate brand image, increased attractiveness as a target of investment, improved relations with business partners, development of new business partners, and the attraction and retention of excellent employees, etc. These enhance the competitiveness of the company within and outside of Japan and increases shareholder value⁴.

Although the Guidelines are not legally binding, it is expected that compliance with the Guidelines will become increasingly important for companies in Japan to conduct businesses in Japan and overseas. Therefore, foreign investors should pay attention to the human rights due diligence practices when considering any investment in Japanese companies.

Revisions to Tender Offer Rule and Large Shareholding Reporting Rule

The Financial Services Agency (FSA) has begun considering revisions to the tender offer rule and the large shareholding reporting rule which are stipulated in the Financial Instruments and Exchange Act (the "FIEA"). The FIEA underwent major reform in 2006, introducing, among other things, stricter thresholds for mandatory tender offers, enhanced disclosure and an offeror's obligation to accept all offers tendered under certain conditions. While, these rules have not been significantly revised since 2006, in light of recent changes in the capital market environment, the rules will be reviewed from the perspective of ensuring market transparency and fairness and promoting constructive dialogue between listed companies and investors.

The first meeting of the Financial System Council Working Group on the Tender Offer Rule and the Large Shareholding Reporting Rule on June 5, 2023 identified several issues for consideration. In connection with the tender offer rule, these include whether market purchases and third-party allotments (new share issuances) resulting in the acquisition of more than one-third of the voting rights should be subject to mandatory tender offer regulations and measures to address coercive tender offers (e.g., partial tender offers).

Also, regarding the larger shareholding reporting rule, the issues for consideration at the first meeting include the clarification of scope of the important suggestion and joint holders and increased transparency of substantial shareholders (i.e., beneficial shareholders). For institutional investors, the deadline and frequency for submission of a large shareholding report is relaxed by a special reporting rule in consideration of the excessive administrative burden of disclosure. However, this rule does not apply to cases where the purpose of holding is to make important suggestions. The lack of clarity in the terms joint holder and important suggestions has been considered as one of challenges in collaborative engagement.

⁴ Section 1.2 of the Guidelines.



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