Japan Corporate and Tax Quarterly Update: December Issue

Introduction

On 19 December 2025, Japan announced its 2026 tax reform proposal, which contains a number of changes that may impact multinational companies doing business in Japan. This update provides a brief overview of the relevant items likely to have the largest impact on such companies.

Japan Tax Update

Outline of Tax Reform for Fiscal Year 2026

On 19 December 2025, the Liberal Democratic Party and the Japan Innovation Party (the new "Ruling Coalition" organized on 20 October 2025) announced its 2026 tax reform proposal (the "**Proposal**"), which is expected to be approved by the Cabinet in late December 2025. The Proposal is expected to be enacted after approval by the Diet (Japan's parliament), which is normally scheduled around the end of March.

The items outlined below are those likely to have the largest impact on multinational corporations doing business in Japan. Please note, however, that the Proposal is merely an outline and has not yet been enacted.

In this regard, while historically the content of tax reform proposals generally does not undergo material changes before being approved by the Diet, there may be some changes to the current Proposal before approval by the Diet, as the Ruling Coalition does not have a majority in the House of Councilors (or Upper House of Japan's National Diet), although they do have a majority party in the House of Representatives.

Japanese Consumption Tax ("JCT") Matters

1. Taxation Specified Low-Value Goods

Recently, there has been an increasing trend of foreign businesses selling physical goods into Japan via online sales, which has resulted in certain tax imbalances when compared with sales by domestic businesses.

Currently, if a foreign seller transfers ownership of goods prior to customs clearance, the sale is considered a transfer of assets outside Japan and is categorized as an "out of scope" transaction for JCT purposes. Even if a large number of online sales are conducted in this manner, there is no requirement to pay JCT on the physical goods, as such transactions are considered out of scope of JCT, i.e., not subject to JCT. However, under the Proposal, online sales of physical goods shipped to Japan from overseas (tentatively named "sales of specified low-value goods") will now be subject to JCT.

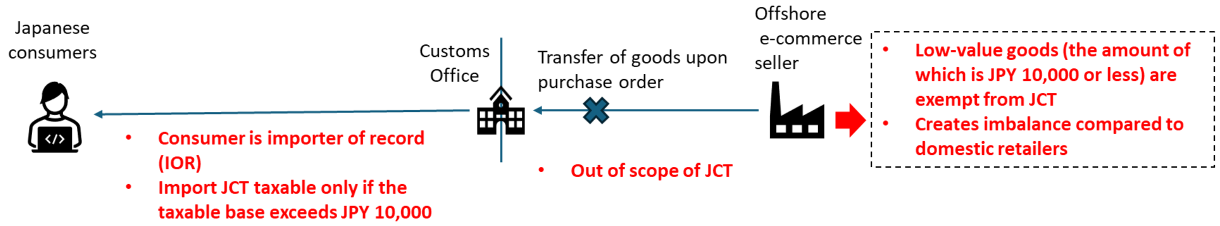
When selling specified low-value goods, the seller must apply and register as a "specified low-value goods business"[1], as well as include certain information on the invoice or another document related to the shipment (e.g., the registration

[1] A "specified low-value goods business" generally includes a business (excluding a tax-exempt business) that transfers specified low-value goods. To register, the business must submit an application to the relevant in charge tax office, and for foreign businesses (i.e., those without an office, place of business, etc. in Japan) certain other additional requirements must be met when applying for registration, such as having a tax agent for JCT matters.

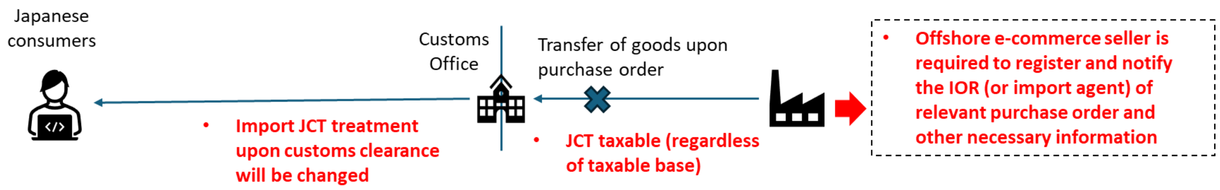
number of the specified low-value goods business and a statement indicating that the assets being transferred are specified low-value goods). The seller must then inform the importer of record (or import agent) of the relevant purchase order and other specified information.

The illustration below shows how the rules will operate prior to and after the proposed change.

Current JCT treatment



Proposal treatment



Note that the following will be important aspects of the proposed change:

i. In the case of a transfer of specified low-value goods prior to customs clearance, the “situs rule” and/or “taxpayer status” for JCT purposes will change (i.e., such transfers will now be “in scope of” and subject to JCT), and

ii. In response to this, measures will be taken to exempt import JCT from being levied on taxable goods falling under sales of specified low-value goods when they are removed from bonded areas (JCT will be imposed on transactions prior to customs clearance, so adjustments will be required with respect to import JCT taxation at the time of customs clearance).

The proposed amendments will go into effect from 1 April 2028 (the registration procedure for a "specified low-value goods business" will commence on 1 October 2027).

2. Expansion of the Scope of the Platform Taxation Regime

Japan’s 2024 tax legislation introduced a platform taxation regime requiring that certain digital platform operators (i.e., “Specified Platform Operators”[2]) assume the obligation to report and pay JCT on electronically supplied services (“**ESS**”) provided by foreign sellers to B2C Japanese customers via the digital platforms. These rules went into effect on 1 April 2025.

The Proposal expands the current platform taxation rules. Under such expansion, the term “Specified Platform Operators” (i.e., for ESS) will be renamed to “Type 1 Platform Operators” (tentative name), and the scope of the rules will be expanded to include certain sales of physical goods made via digital platforms. In this regard, if a foreign seller transfers physical goods to the Japanese warehouse of a platform operator in advance of sale, and sells the goods via the online platform, the JCT reporting and payment obligations for such sales will shift from the foreign sellers to the platform operator if the platform operator meets the prescribed thresholds. Such physical goods platform

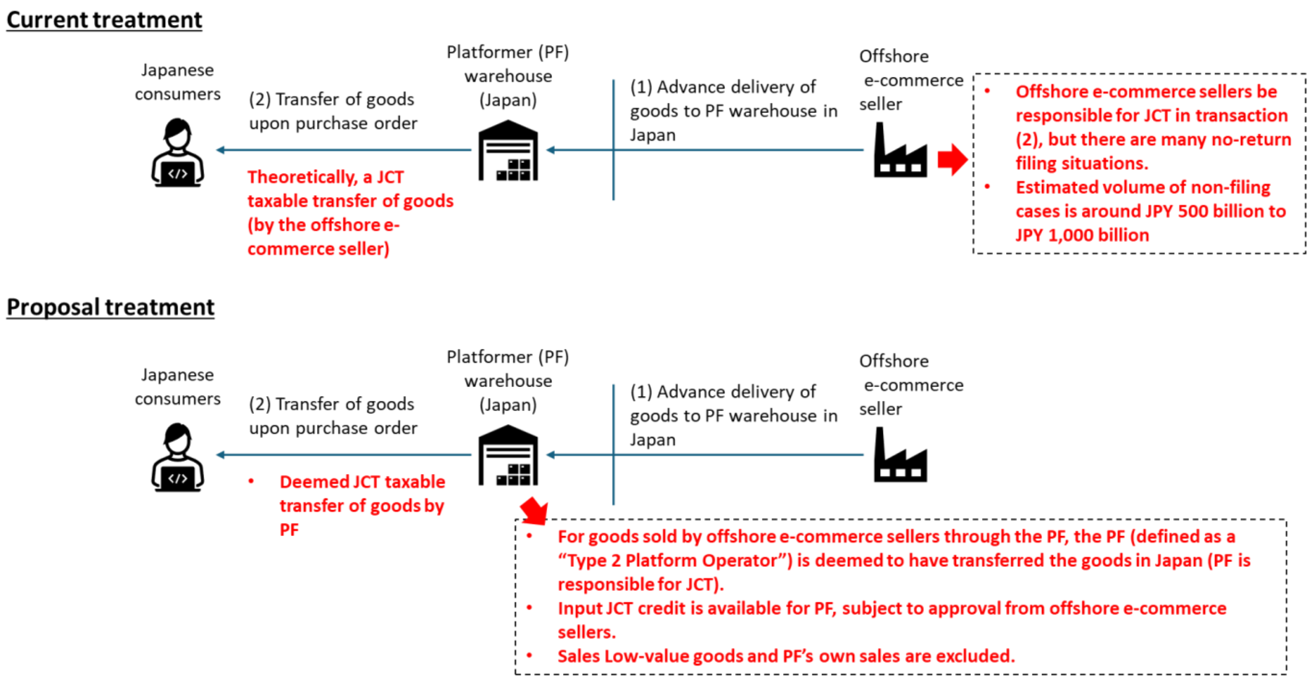
[2] Broadly, digital platform operators whose annual JCT taxable sales from foreign B2C providers made via the platform exceed JPY 5 billion.

operators will be designated as (the tentatively named) "Type 2 Platform Operators" (i.e., for physical goods).[3] Note that sales of low-value goods and the platform operator's own sales are excluded from the determination of whether the relevant thresholds are met.

If the Type 2 Platform Operator receives prior consent from the foreign sellers, the Type 2 Platform Operator will be able to apply input JCT credits for (a) taxable purchases made in Japan by foreign sellers, and (b) for import JCT on the removal of goods from bonded areas by such foreign sellers as needed for the sale of assets that are subject to platform taxation by deeming such input JCT to have been paid by the Type 2 Platform Operator.

The proposed amendments will go into effect from 1 April 2028.

The illustration below depicts the treatment of sales of applicable goods through online platforms prior to and after the revisions.



Note that under the current platform taxation rules, the scope is limited to B2C ESS sales by foreign sellers via the platform, so issues related input JCT credits for applicable transactions are not practically relevant for Specified Platform Operators (ESS). However, for the new Type 2 Platform Operators (physical goods), prior consent from foreign sellers will be required, as noted above, so platform operators who will fall into the category of the new Type 2 Platform Operators will need to consider how to collect supporting documentation (such as import declarations where the foreign seller is the importer) from foreign sellers for purposes of claiming input JCT credits. Therefore, practical, non-tax issues, such as internal systems changes, will also need to be considered, keeping in mind the effective date of the new rules.

3. Revision of JCT Rules Related to Non-resident Purchases of Real Estate Located in Japan

The purchase of Japanese real estate by non-residents (i.e., persons located outside of Japan) continues to increase, but under the current JCT rules, brokerage fees and other fees paid by non-residents when buying or selling real estate located in Japan are treated as export exempt for JCT purposes (even though the transaction is domestic, the transactions are considered exempt because the recipient of the services is a non-resident). To create a level playing

[3] If "the total amount of consideration for the sale of physical assets through a digital platform for the period from January 1, 2027 to March 31, 2027 (i.e., the three-month period) multiplied by 4" exceeds JPY 5 billion (tax inclusive), the platform operator must notify the National Tax Agency and will be designated as a "Type 2 Platform Operator." The notification requirement will go into effect from April 1, 2028.

field for both residents and non-residents, these brokerage fees and other fees paid by non-residents will be subject to JCT and no longer considered export exempt.

These changes will apply to purchases occurring on or after January 1 of the year following the enforcement date of the amended Financial Instruments and Exchange Act.

4. Qualified Invoice System Transitional Measures

Under the qualified invoice system that went into effect on 1 October 2023, receipt of a qualified invoice is required to able to claim an input JCT credit on purchases. However, as a transitional measure, input JCT credits can still be claimed up to a certain percentage, even if no qualified invoice is received. In this regard, the applicable percentages and their effective periods are as follows:

– Taxable purchases made from 1 October 2023, to 30 September 2026: 80%

– Taxable purchases made from 1 October 2026, to 30 September 2029: 50%

The Proposal modifies and extends the application period of the transitional measures until 30 September 2031, as follows:

– Taxable purchases made from 1 October 2023, to 30 September 2026: 80%

– Taxable purchases made from 1 October 2026, to 30 September 2028: 70%

– Taxable purchases made from 1 October 2028, to 30 September 2030: 50%

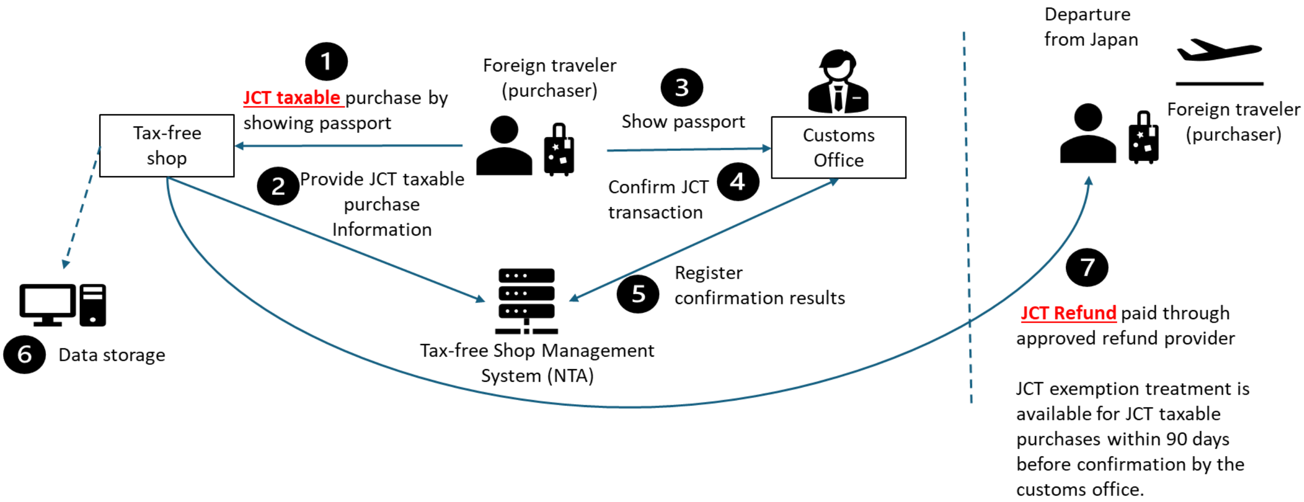
– Taxable purchases made from 1 October 2030, to 30 September 2031: 30%

Under the current rules, the maximum amount of input JCT credits that can be claimed during a taxable period under these transitional measures is JPY 1 billion yen, but the Proposal reduces this amount to JPY 100 million.

5. Tax-free System for Foreign Travelers

A new JCT refund method, which will replace the current JCT exemption at the time of purchase, was introduced as part of Japan's 2025 tax legislation (and will take effect on 1 November 2026) and was intended to (i) prevent situations in which large quantities of goods are purchased at tax-free shops (as JCT exempt purchases) and resold within Japan, and (ii) simplify the JCT exemption procedures for foreign travelers.

The illustration below provides an overview of how the new JCT refund method will operate.



While no further updates regarding the refund method are included in the Proposal, the Proposal states that further improvements of the JCT refund method will be considered from the perspective of potential abuse, as well as facilitating Japan's tourism-friendly policy.

6. Other Matters

In addition to the items above, the Proposal includes the following items that are worth noting. Please note that the below items will also take effect on 1 November 2026.

- Abolishment of special packaging requirements for consumable goods.
- Abolishment of the cap amount for consumable goods (currently up to JPY 500,000).
- Abolishment of requirement to confirm eligible tax-free (JCT exempt) goods by tax-free shops.

International Tax Matters

1. Changes to the Pillar Two Rules

2025 marked a turbulent year which saw a number of developments related to Pillar Two, including the US contemplating the introduction of the Section 899[4] retaliatory tax measures against countries that impose "unfair foreign taxes" and the G7's response.

Following international consultations among the G7 nations, Section 899 was ultimately withdrawn by the US. However, this was conditional on the G7 agreeing to exclude US-parented groups from the application of income inclusion rules and undertaxed profits rules (i.e., the "side-by-side approach"). In this connection, the Japan Ministry of Finance published a "G7 Statement on Global Minimum Taxes"[5] ("**G7 Statement**") on 29 June 2025. However, the G7 Statement did not include any specific measures and was unclear as to how Japan would respond.

In this context, the Proposal does not include any specific measures related to Japan's response to the side-by-side approach, and simply notes that "...international discussions are ongoing, and if an international agreement is reached in the near future, we will consider promptly revising the rate in accordance with that agreement..." Related to Pillar Two, the Proposal only includes certain revisions (which will apply to relevant fiscal years beginning on or after April 1, 2026) to the calculation of adjusted covered taxes with respect to the deferred tax asset or deferred tax liability recognized in fiscal years before the transition year, etc.

It will be important for taxpayers to monitor any future developments regarding Japan's response to the side-by-side approach.

2. Revisions to the Japanese CFC Rules

Similar to previous years, the Proposal states that the government will continue to monitor the Japanese CFC rules in light of their overlap with the Pillar Two rules and their increase in the administrative burden placed on companies that fall within the scope of such rules.

The Proposal contains some items related to the CFC rules, but these are limited to minor adjustments to the current regime, and no items related to the overlap of the CFC and Pillar Two rules were included.

3. Special Tax Treatment for Foreign Partners

Funds structured as partnerships, such as Japanese civil law partnerships (*nin'i kumiai*), investment limited partnerships, and foreign limited partnerships, are not themselves subject to corporate tax, etc., and therefore, income generated from the partnership's business is considered to be directly attributable to the partners based on

---

[4] The proposed amendments to the US Internal Revenue Code would have imposed an additional tax (retaliatory tax) of up to 20% on income (dividends, interest, royalties, etc.) received by companies and investors in countries that have implemented a digital services tax or global minimum tax.
[5] https://www.mof.go.jp/policy/international_policy/convention/g7/g7_20250628_2.pdf.

their ownership ratios in accordance with the pass-through nature of such partnerships. These partnership-type funds are generally considered to be operated jointly by the partners, so if a partner (typically a general partner) has a permanent establishment ("**PE**") in Japan, other partners in the partnership will also be deemed to have a Japanese PE. If foreign partners are treated as having a PE in Japan, certain partnership income allocated to the foreign partners would be subject to tax in Japan, and the foreign partners would be required to file corporate tax (or income tax) returns in Japan, which raises concerns that such rules would hinder investment into Japan from overseas.

In response to this, Japan's 2009 tax legislation introduced special tax treatment for foreign partners which would exempt them from being deemed to have a PE by virtue of their passive investment in a partnership, if certain conditions are satisfied.[6] In particular, to qualify for this special treatment, foreign partners must meet the following requirements:

i. Partner is a limited partner of an investment partnership established by an investment partnership agreement,

ii. Partner does not carry out operations of the partnership business,

iii. Partner holds less than 25% of the interests in the partnership assets,

iv. Partner does not have a special relationship with the general partner of the investment partnership, and

v. Partner does not have any other PE in Japan.

While it has been nearly 15 years since the special tax treatment for foreign partners was established, there is still uncertainty as to whether the requirement of not carrying out operations of the partnership business (requirement (ii) above) includes advisory board activities, and some concerns have been raised that this requirement is not consistent with the actual practice of how partnership funds operate. In this context, the Proposal relaxes the relevant requirements as follows:

- The requirement of holding less than 25% of the interests in the partnership assets (i.e., requirement (iii) above) will be changed to "less than 50%", if the partnership establishes a certain committee composed of limited partners, etc.
- The Proposal clarifies the scope of allowable activities that partners can carry out without being considered to be "carrying out operations of the partnership business" (i.e., approval of "conflict-of-interest" transactions) in connection with requirement (ii) above.
- The requirement that a foreign partner have no other PE in Japan (i.e., requirement (v) above) will be abolished.

Finally, although not explicitly stated in the Proposal itself, it is expected that the Government will introduce a "Declaration regarding special tax treatment for foreign partners in investment partnership agreements"[7] form that will need to be submitted to apply the special tax treatment, which may result in additional administrative burden.

4. <u>Establishment of Special Provisions for Document Retention Related to Transactions within Corporate Groups</u>

The Proposal provides that when a domestic corporation conducts a "specified transaction" with a related party, if the transaction-related documents do not contain a description or record of the matters necessary to calculate the amount of consideration for the transaction, such as (i) details of the provision of assets or services related to the transaction,

---

[6] In addition, the special tax treatment also allows mitigation of the so-called "5/25 rule", which states that if the partnership disposes of 5% or more of the shares of a Japanese company in a given fiscal year and has owned 25% or more of said company at any time during the three years prior to the last day of the fiscal year in which disposal occurs, gain on the sale of such shares would be subject to tax in Japan. For purposes of calculating the 5/25 rule threshold percentages, ownership of limited partners should generally be aggregated. However, after 2009 tax legislation, foreign limited partners ownership percentages will not be aggregated if they satisfy the five conditions described below and met certain other requirements (thus, preventing the limited partners from being subject to Japanese corporate tax on capital gain from the sale of shares).
[7] https://www.nta.go.jp/taxes/tetsuzuki/shinsei/annai/gensen/annai/1648_56.htm (National Tax Agency homepage – only in Japanese).

or (ii) details of the calculation of the amount of consideration to be paid by the domestic corporation for the transaction, the domestic corporation must obtain or prepare and preserve documents (including electronic records) that clarify the matters that are not described or recorded.

For purposes of the rule, the term "related parties" is determined based on the same criteria as those for related parties under the transfer pricing rules, and the term "specified transactions" will include the transfer or lending of certain industrial property rights, etc.[8] and the provision of certain services but primarily focuses on shared cost transactions, etc. led by foreign related parties and allocated to domestic corporations, as well as the transfer or license of intangible assets to domestic corporations.

Failure to retain documents in accordance with these new storage obligations may result in the tax authorities taking additional measures, such as revoking blue-form taxpayer status (if revoked, typically, the taxpayer cannot enjoy certain special depreciation measures, special tax credits, etc. and will be unable to carryforward any net operating losses).

In practice, in order to prove and justify the deductibility of expenses allocated from overseas, it is necessary to prepare contracts regarding such allocated expenses and documents that clarify the calculation process. Taxpayers generally prepare such documents. However, depending on the size of the foreign parent company and its Japanese subsidiary, there may be cases where it is difficult for a Japanese subsidiary to obtain relevant documents from its foreign parent company in a timely and appropriate manner. Therefore, practical measures will need to be considered in the future.

In particular, for transactions that do not meet the “local file” requirement for transfer pricing purposes (based on the transaction value thresholds), in practice, the basis for calculating the relevant consideration and the underlying contracts may not be drafted until a tax audit is conducted. Obtaining and storing detailed calculations and necessary accompanying information for transactions of a scale that are out of scope of the local file requirement is expected to significantly increase the tax administrative burden on taxpayers.

Further, the addition of the document preservation requirement increases the risk that the hurdles (or borderlines) for applying so-called “presumptive tax assessments” and “secret comparables”, which are triggered when the tax authorities "request the presentation or submission of accounting documents or copies thereof that are deemed necessary to calculate arm's length prices, and the corporation fails to present or submit these documents without delay," will be lowered.

Corporate Tax Matters

1. Changes to Tax Credits and Incentives

Tax credits and incentives are regularly reviewed and updated in Japan’s annual tax reform, and the Proposal also includes several changes in this regard, with some of the more notable changes described below. Most of these changes reflect new Prime Minister Takaichi’s 17 priority investment areas that were selected at the Japan Growth Strategy Council held on 10 November 2025 to encourage public and private investment.

- Tax credit for investment in specified productivity-enhancing equipment

  On the basis of amending the Industrial Competitiveness Enhancement (“**ICE**”) Act, the Proposal includes the establishment of tax incentives to promote investment in specified productivity-enhancing equipment[9], which will allow taxpayers to select either (i) special depreciation (i.e., immediate, accelerated depreciation) up to the acquisition cost of the asset, or (ii) a tax credit of 7%[10] of the asset’s acquisition cost, with a deduction cap of

[8] Generally, these include Industrial property rights and other rights relating to technology, production methods using special technology, or the like; copyrights (including publishing rights and other similar rights); and program copyrights.
[9] Requires certification under the ICE Act, as well as certain other conditions such as the acquisition cost of the production facilities listed in the investment plan to be JPY 3.5 billion or more (JPY 500 million or more for small and medium-sized enterprises, agricultural cooperatives, etc.), and the investment plan must be expected to achieve an average annual return on investment of 15% or more.
[10] 4% for buildings and attached structures.

20% of the corporate tax amount (excess deduction can be carried forward for up to three years).

- R&D credit

  The R&D credit will be revised to increase tax deductions for priority industrial technology testing and research expenses (and specific priority industrial technology testing and research expenses)[11] for certified R&D corporations.

- Tax credit for increasing salaries and wages

  The credit for increasing salaries and wages will be abolished for all corporate taxpayers on March 31, 2026, and the credit for businesses with 2,000 or fewer employees will be abolished on March 31, 2027.

In addition to the above, the Proposal will make it necessary to meet certain requirements, such as amount of payments to employees, etc. and amount of domestic capital investment, for applying various tax incentives, so taxpayers must be careful when applying tax incentives to ensure that all applicable requirements are met.

Other Matters

1. Strengthening of Financial Income Taxation (Individuals' Minimum Tax) for High-Income Earners

High income earners tend to have a higher proportion of their income subject to separate taxation, which applies a tax rate lower than the maximum 45% rate (i.e., the progressive tax rate, the rate is the ordinary national income tax only). This creates a "JPY 100 million barrier," whereby the income tax burden decreases once income exceeds a certain level.[12]

In response to this, 2023 tax legislation introduced a "reasonable tax burden for ultra high net income" (a so-called "minimum tax") which went into effect starting in 2025. Specifically, individuals (including non-resident individuals) whose annual base income exceeds JPY 330 million are subject to income tax at a rate equal to 22.5% of the amount in excess of JPY 330 million minus the standard income tax amount for that year. When the minimum tax was first introduced, it was estimated that the number of individuals subject to this tax would be around 300 individual taxpayers. An example of how the minimum tax is calculated under the current rules can be seen as follows:

- Example 1: Individual only has JPY 1 billion of capital gains from stock transfers.
  - Before minimum tax: JPY 1 billion x 15% = JPY 150 million
  - After minimum tax: (JPY 1 billion – JPY 330 million) x 22.5% = JPY 150.75 million
  - Additional tax due to minimum tax: JPY 750,000

The Proposal states that an enhanced individuals' minimum tax is expected to apply from 2027. Specifically, individuals whose income for the year exceeds JPY 165 million will be subject to income tax at a rate equal to 30% of the amount exceeding JPY 165 million minus the standard income tax amount for that year. After the revisions, the number of people subject to the minimum tax is expected to be around 2,000 individual taxpayers. An example of how the minimum tax will be calculated after the revision can be seen as follows:

- Example 2: Individual only has JPY 1 billion of capital gains from stock transfers.
  - Before minimum tax: JPY 1 billion x 15% = JPY 150 million
  - After minimum tax: (JPY 1 billion – JPY 165 million) x 30% = JPY 250.5 million
  - Additional tax due to minimum tax: JPY 100.5 million

[11] "Specific priority R&D" refers to R&D that has been confirmed as relating to priority industrial technologies (tentative name) under the Industrial Technology Enhancement Act (e.g., AI, advanced robotics, semiconductors, healthcare, fusion energy, space, etc.) that are expected to be commercialized at an early stage and that meet certain criteria.
[12] Third Expert Meeting on Life Course-Neutral Tax Systems for a Vibrant Longevity Society (13 November 2025) (see Cabinet Office homepage: https://www.cao.go.jp/zei-cho/gijiroku/life/2025/7life3kai.html (only in Japanese)).

Contact Us

Ryutaro Oka
Principal
Tokyo
ryutaro.oka@bakermckenzie.com

Shinichi Kobayashi
Partner
Tokyo
shinichi.kobayashi@bakermckenzie.com

Luke Tanner
Partner
Tokyo
luke.tanner@bakermckenzie.com

Koji Oshima

Partner
Tokyo
koji.oshima@bakermckenzie.com

Akihiro Kawasaki

Partner
Tokyo
akihiro.kawasaki@bakermckenzie.com

Ken Tomura

Counsel
Tokyo
ken.tomura@bakermckenzie.com

Corey Bass

Senior Associate
Tokyo
corey.bass@bakermckenzie.com

Shogen Yoshikawa

Associate
Tokyo
shogen.yoshikawa@bakermckenzie.com