Japan Tax Bulletin

Tax reform on the sized-based business taxation

August 2024

The size-based business taxation system was introduced in 2004.

The size-based business taxation system imposes “a value-added tax” and “a capital-based tax” on companies with stated capital of more than JPY100 million. The taxes are levied even where a corporation is in currently loss position. A value-added tax is levied based on the sum of the distribution of earnings (comprising remuneration and salaries, net interest paid and net rent paid) and profit or loss for a single year, and a capital tax is levied based on the amount of stated capital, capital reserve, other capital surplus etc. as defined by the Corporation Tax Law.

The current system has been the subject of two principal critiques.

(i) The number of companies subject to the sized-based business taxation system has decreased by approximately two-thirds compared to when the system was introduced, primarily due to factors such as a reduction in stated capital to less than JPY100 million.

(ii) Corporate actions are being taken with the deliberate intention of setting the amount of stated capital in order to avoid the application of the sized-based business taxation system. This is exemplified by the setting of the stated capital of wholly-owned subsidiaries at JPY100 million or less.

In response to this situation, a review of the sized-based business taxation system was conducted as part of the 2024 tax reform.

1. *Addition of Eligible Corporations*

Due to the 2024 Tax Reform, in addition to corporations currently subject to the sized-based business taxation system (a), corporations that fulfil all the requirements in (b) will also be subject to the sized-based business taxation system for corporate enterprise taxation.

(a) Corporations with stated capital exceeding JPY100 million as at the end of the current financial year.

(b) Corporations that meet all of the following requirements:

(i) Corporations with stated capital or investments exceeding JPY100 million as at the end of the previous financial year;

(ii) Corporations whose amount of stated capital at the end of the current financial year is JPY100 million or less; and

(iii) Corporations whose amount of paid-in capital (the sum of capital and capital surplus) as at the end of the current financial year exceeds JPY1 billion.

The above reform shall be applicable to fiscal years beginning on or after 1 April 2025.

However, for the initial financial year beginning on or after 1 April 2025 (hereafter referred to as the 'first financial year'), transitional measures are provided, and corporations that meet all of the following requirements will be subject to the sized-based business taxation system:

(a) Corporations that are subject to the sized-based business taxation system for any fiscal year from the fiscal year preceding the fiscal year that includes the effective date (30 March 2024) to the fiscal year preceding its first financial year;

(b) Corporations with stated capital of JPY100 million or less at the end of the first financial year; and

(c) Corporations with paid-in capital (the sum of stated capital and capital surplus) exceeding JPY1 billion at the end of the first financial year.

2. *Wholly-owned subsidiaries, etc.*

In addition to 1, wholly-owned subsidiaries, etc. are also subject to the sized-based business taxation system if they meet all of the following requirements:

(a) Corporations with stated capital of JPY100 million or less as at the end of the current financial year;

(b) A corporation that has a complete control relationship with a specified corporation* or a corporation in which all of its issued shares are held by more than one specified corporation within a 100% group; and

(c) A corporation whose paid-in capital (the sum of its capital and capital surplus) exceeds JPY200 million as at the end of the current financial year.

* Specified corporations: Corporations whose paid-in capital (the total of stated capital and capital surplus) exceeds JPY5 billion (excluding corporations that are not subject to the sized-based business taxation system), and mutual companies and foreign mutual companies provided for in the Insurance business law.

The above tax reform will apply to fiscal years beginning on or after 1 April 2026.

However, in order to mitigate the impact of the above tax reform on wholly-owned subsidiaries, the following mitigation measures are provided for subsidiaries that are newly subject to this sized-based business taxation system.

(a) For each financial year beginning between 1 April 2026 and 31 March 2027

2/3 reduction of the tax amount in excess of the amount calculated under this taxation system.

(b) Each financial year beginning between 1 April 2027 and 31 March 2028

1/3 reduction of the tax amount in excess of the amount calculated under this taxation system.