



KPMG Japan Tax Newsletter

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2021 TAX REFORM PROPOSALS

AMENDMENTS TO THE ELECTRONIC PRESERVATION SYSTEM FOR ACCOUNT BOOKS, ETC.

I. Preservation System for National Tax-Related Account Books and Documents by Electromagnetic Records	2
II. Scanner Preservation System for National Tax-Related Documents	4
III. Preservation System for Electromagnetic Records related to Transaction Information of Electronic Transactions	6
IV. Timing of Application	8

The ruling coalition (the Liberal Democratic Party and Komeito) agreed on the 'Outline of the 2021 Tax Reform Proposals' (Proposal) on 10 December 2020 and the Cabinet decided the Proposal on 21 December 2020. We have set out below a brief summary of the Proposal for the revisions to the electronic preservation system for account books, etc.

The Proposal itself is only an indicative outline and is unclear with respect to some of the contemplated changes. The details of the tax reform will be unveiled in the bills revising the tax laws and the succeeding amended tax laws, cabinet orders and ministerial ordinances. Please note that the final tax reform could differ from the Proposal depending on the outcome of discussions in the Diet.

I. Preservation System for National Tax-Related Account Books and Documents by Electromagnetic Records

Based on the increasing digitalization of the economy and society, the procedures for electronic preservation of national tax-related account books and documents will be drastically amended in order to contribute to improvements in productivity by the digitalization of accounting, promotion of telework and improvements of bookkeeping by utilizing cloud accounting software, etc.

1. Abolition of pre-approval system

Where a person, who is obliged to preserve the national tax-related account books and documents ('preservation obligor'), creates all or part of the national tax-related account books and documents consistently (in case of the national tax-related account books, the preservation obligor creates all or part of the national tax-related account books consistently from the first record) by using a computer and obtains the approval from the competent tax office, the preservation obligor is permitted to maintain and preserve electromagnetic records of the national tax-related account books and documents, instead of the paper-based versions of them.

By virtue of the 2021 tax reform, the pre-approval system by the competent tax office will be abolished.

2. Amendments to the requirements of the preservation system for national tax-related account books and documents by electromagnetic records

(1) Classification of national tax-related account books and documents

The national tax-related account books and documents will be classified into '(A) general national tax-related account books and documents' and '(B) certain superior national tax-related account books' as follows:

(A)	General national tax-related account books and documents ^(*1)	Where a preservation obligor creates the national tax-related account books and documents consistently by using a computer and satisfies certain requirements: → The preservation obligor will be able to preserve electromagnetic records regarding the national tax-related account books and documents.
(B)	Certain superior national tax-related account books	Where a preservation obligor preserves the electromagnetic records regarding certain national tax-related account books ^(*2) that satisfy the current strict preservation requirements and there is a high possibility of post-verification ^(*3) , etc.: → If the preservation obligor files an amended tax return or receives a reassessment on income tax, corporation tax or consumption tax related to the matters recorded in the electromagnetic records ^(*4) , the rate of additional tax for understatement levied on the omission of the declaration related to such recorded matters will be reduced by 5%.

(*1) The national tax-related account books are limited to those recorded in accordance with the principles of orderly bookkeeping.

(*2) Certain national tax-related account books are journals, general ledger and other necessary books that must be preserved by the blue-return filing

companies/individuals for income tax or corporation tax or books that must be preserved by a business entity for consumption tax.

(*3) Notification form for the application of this classification must be submitted in advance.

(*4) Except for the cases where there is a fact that the omission of the declaration has been concealed or disguised

(2) Requirements of the preservation system for national tax-related account books and documents by electromagnetic records

The following is a comparison of the requirements of the current preservation system for national tax-related account books and documents by electromagnetic records with the requirements of the proposed preservation system for '(A) general national tax-related account books and documents' and '(B) certain superior national tax-related account books' in the Proposal:

Requirements		Current law	Proposal	
			(A) General national tax-related account books and documents	(B) Certain superior national tax-related account books
Pre-approval by the competent tax office		○	- (refer to 1.)	- (refer to 1.)
Ensuring truthfulness	Use of a computer processing system by which the facts and contents of correction/deletion/addition of electromagnetic records can be verified	○	-	○
	Ensuring the interrelationship of recorded matters between account books	○	-	○
	Maintenance of documents related to the development of computer processing systems (system outline, system specifications, operation manuals, administration manuals, etc.)	○	○	○
Ensuring visibility	Equipment of readable devices (computers, programs, displays, printers and their operation manuals, etc.) and timely output in an orderly format and in a clear state of electromagnetic records on the display screen	○	○	○
	Ensuring search function	○	-	○ ^(*)
Follow the request for download of electromagnetic records regarding the national tax-related account books and documents by the National Tax Agency, etc. based on its rights of question and inspection		-	○	-

(*) Requirement after the amendments introduced in '(3) Amendments to requirement for ensuring search function' below

(3) Amendments to requirement for ensuring search function

The current requirements for ensuring there is a search function are to enable certain search functions for the recorded matters in electromagnetic records regarding the national tax-related account books.

The above ‘certain search functions’ are the functions that satisfy all of the following requirements of (i) to (iii). These requirements will be amended as follows:

Current law		Proposal
(i)	Transaction date, account name, transaction amount and other main recorded matters depending on the types of national tax-related account books (‘search items’) can be set as search conditions.	Search items will be limited to transaction date, transaction amount and counterparty.
(ii)	Search conditions can be set for search items of dates or amounts by designating the scope.	Where the preservation obligor follows the request for download of electromagnetic records by the National Tax Agency, etc. based on its rights of question and inspection, (ii) and (iii) on the left will not be required.
(iii)	Search conditions can be set by combining two or more search items arbitrarily.	

II. Scanner Preservation System for National Tax-Related Documents

The procedures and preservation requirements of the scanner preservation system will be significantly relaxed from the viewpoint of further promoting paperless operations and collateral measures will be provided to prevent fraudulent activities such as falsification of electronic data.

1. Abolition of pre-approval system

Where a preservation obligor records the matters described in all or part of the national tax-related documents in electromagnetic records by using a scanner, and obtains the approval from the competent tax office, the preservation obligor is permitted to preserve the electromagnetic records of the national tax-related documents (scanned documents), instead of the paper-based versions of them.

By virtue of the 2021 tax reform, the pre-approval system by the competent tax office will be abolished.

2. Amendments to the requirements of the scanner preservation system for national tax-related documents

In order to apply the scanner preservation system for the national tax-related documents, some requirements must be met to ensure truthfulness and visibility according to the classification of the national tax-related documents (i.e. important documents, general documents and important documents for the past).

By virtue of the 2021 tax reform, the following three requirements (1) to (3) will be amended or abolished:

(1) Amendments to time stamping requirement

The time stamping requirement will be amended as follows:

Classification of national tax-related documents	Current law	Proposal
Important documents	<p>A preservation obligor must put a time stamp on important documents at the time of scanning them with a scanner.</p> <p>(if a recipient, etc. of the important documents scans them, the recipient, etc. must <u>sign</u> and put a time stamp on the important document <u>particularly promptly (approximately within 3 business days)</u> after the receipt, etc.)</p>	<ul style="list-style-type: none"> • It will not be necessary for a recipient, etc. of the national tax-related documents to sign them when the recipient, etc. scans them with a scanner. • The period during which a time stamp must be put (current law: within 3 business days) will be amended to the same as the period during which the recorded matters can be input (up to approximately 2 months).
General documents	<p>A preservation obligor must put a time stamp on general documents at the time of scanning them with a scanner.</p> <p>(if a recipient, etc. of the general documents scans them, the recipient, etc. must put a time stamp on the general documents at the time of scanning them with a scanner or <u>sign</u> and put a time stamp on the general document <u>particularly promptly (approximately within 3 business days)</u> after the receipt, etc.)</p>	<ul style="list-style-type: none"> • Where the electromagnetic records are preserved by using a system by which the fact and contents of corrections or deletions of electromagnetic records can be confirmed (including a system in which corrections or deletions can not be made), time stamping will not be required.

(2) Abolition of appropriate administration requirements

By virtue of the 2021 tax reform, appropriate administration requirements^(*) will be abolished.

(*) Requirements for establishment of rules regarding mutual supervision, regular inspections and recurrence prevention measures necessary to ensure appropriate implementation of each process from the preparation or receipt of the national tax-related documents to the input of recorded matters related to the documents and processing of each process in accordance with the rules

(3) Amendments to requirement for ensuring search function

The requirements for ensuring there is a search function in the scanner preservation system will be amended to the same as in I. 2. (3).

3. Measures to ensure appropriate preservation of electromagnetic records

(1) Increase of heavy penalty tax

If a preservation obligor of the national tax-related documents preserved by using a scanner files a tax return after the filing due date or files an amended tax return or receives a reassessment or determination based on the fact that the recorded matters in the electromagnetic records are concealed or disguised, the rate of heavy penalty tax levied on the omission of the declaration about the recorded matters will be increased by 10%.

(2) Treatment where the requirements of the scanner preservation system are not satisfied

The electromagnetic records which do not satisfy the requirements of the scanner preservation system, including the requirements after amendments (or abolition) shown in 2. above, will be treated as follows:

- (i) A preservation obligor of the national tax-related documents preserved by using a scanner must also preserve the electromagnetic records even if the electromagnetic records do not satisfy the preservation requirements.
- (ii) The electromagnetic records which do not satisfy the preservation requirements will not be treated as the national tax-related documents.
- (iii) Where a preservation obligor proves that the preservation obligor could not preserve the electromagnetic records in accordance with the preservation requirements due to a disaster or other unavoidable circumstances, the preservation requirements will be unnecessary after the day when such circumstances occur.

III. Preservation System for Electromagnetic Records related to Transaction Information of Electronic Transactions

Where a preservation obligor regarding income tax (excluding withholding income tax) and corporation tax carries out electronic transactions in which transaction information is exchanged by electromagnetic methods, the transaction information must be preserved by electromagnetic records, etc.

By virtue of the 2021 tax reform, the preservation system for electromagnetic records related to transaction information of electronic transactions will be amended as follows:

1. Amendments to the requirements of the preservation system for electromagnetic records related to transaction information of electronic transactions

In order to apply the preservation system for electromagnetic records related to transaction information of electronic transactions, some requirements must be met to ensure truthfulness and visibility. Among these requirements, the following two requirements in (1) and (2) below will be amended:

(1) Amendments to time stamping requirement

The time stamping requirement will be amended as follows:

Current law	Proposal
A preservation obligor must put a time stamp on recorded matters of the electromagnetic records related to transaction information of electronic transactions <u>without delay</u> after sending or receiving the transaction information, and make it possible to confirm the information about the preservation obligor who preserves the electromagnetic records, etc.	The period during which a time stamp must be put (current law: without delay) will be amended to the period up to approximately 2 months.

(2) Amendments to requirement for ensuring search function

The requirements for ensuring there is a search function in the preservation system for electromagnetic records related to transaction information of electronic transactions will be amended to the same as in I. 2. (3) and II. 2. (3).

In addition to the above, where a preservation obligor whose sales amount during the determination period^(*) is JPY10 million or less follows the request for download of electromagnetic records by the National Tax Agency, etc. based on its rights of question and inspection, all of the requirements for ensuring a search function will not be required.

^(*) In the case of a company, the fiscal year prior to the first preceding fiscal year of the fiscal year including the day on which the electronic transaction was made

2. Measures to ensure appropriate preservation of electromagnetic records

(1) Increase of heavy penalty tax

If a preservation obligor of the electromagnetic records related to transaction information of electronic transactions regarding income tax (excluding withholding income tax), corporation tax and consumption tax files a tax return after the due date/an amended tax return or receives a reassessment/determination based on the fact that the recorded matters in the electromagnetic records are concealed or disguised, the rate of heavy penalty tax levied on the omission of the declaration about the recorded matters will be increased by 10%.

(2) Abolition of measures for preserving output documents, etc.

The measures, under which a preservation obligor of the electromagnetic records related to transaction information of electronic transactions regarding income tax (excluding withholding income tax) and corporation tax can preserve the output documents of the electromagnetic records instead of the electromagnetic records, will be abolished.

(3) Treatment where the requirements of the preservation system for electromagnetic records related to transaction information of electronic transactions are not satisfied

The electromagnetic records which do not satisfy the requirements of the preservation system for electromagnetic records related to transaction information of electronic transactions, including the requirements after amendments in 1. above, will be treated as follows:

- (i) The electromagnetic records which do not satisfy the preservation requirements will not be treated as the national tax-related documents, etc.
- (ii) Where a preservation obligor proves that the preservation obligor could not preserve the electromagnetic records in accordance with the preservation requirements due to a disaster or other unavoidable circumstances, the preservation requirements will be unnecessary after the day when such circumstances occur.

IV. Timing of Application

The amendments from I. to III. above will come into effect on 1 January 2022. Note that the following items will be applied from the date specified for each:

Items	Timing of application
<ul style="list-style-type: none"> • Amendments related to the '(A) general national tax-related account books and documents' in I. 2. (1) • Amendments to the requirements of the scanner preservation system for national tax-related documents in II. 2. • Amendments related to the preservation of electromagnetic records which do not satisfy the preservation requirements of the scanner preservation system in II. 3. (2) (i) 	<p>Applicable to national tax-related account books and documents that are maintained or preserved on or after 1 January 2022</p>
<ul style="list-style-type: none"> • Amendments related to the '(B) certain superior national tax-related account books' in I. 2. (1) • Amendments to the increase of the heavy penalty tax in the case of concealment or disguise in II. 3. (1) and III. 2. (1) 	<p>Applicable to national tax for which the statutory tax return filing due date is on or after 1 January 2022</p>
<ul style="list-style-type: none"> • Amendments to the requirements of the preservation system for electromagnetic records related to transaction information of electronic transactions in III. 1. • Amendments to abolition measures for preserving output documents, etc. in III. 2. (2) 	<p>Applicable to transaction information of electronic transactions that are conducted on or after 1 January 2022</p>

The national tax-related account books and documents, which have been approved by the preservation system for electromagnetic records or scanner preservation system at the time of enforcement of the above amendments, will be treated in the same way as before the amendments.

Local tax will also be amended to take necessary measures in line with the amendments of national tax.

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