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Tax Update

NATIONAL TAX AGENCY — ADMINISTRATIVE GUIDANCE RELATED TO THE JAPANESE IIR

By virtue of the 2023 tax reform, new tax measures equivalent to the Income Inclusion Rule ('IIR') were introduced as 'corporation tax on the international minimum tax amount for each applicable fiscal year' (hereinafter 'Japanese IIR') in response to the Global Minimum Tax in Pillar 2 agreed by the OECD/G20 Inclusive Framework on BEPS.

On 29 September 2023, the National Tax Agency released the administrative guidance (Japanese only) related to the Japanese IIR.

For example, the administrative guidance includes the following treatments of De Minimis Exclusion and the Transitional Country by Country Report ('CbCR') Safe Harbor:

1. De Minimis Exclusion

Where constituent companies, etc. (excluding Investment Entities) of the Specified MNE Group, etc. satisfy both of the following conditions and provide the Global Information Return of the Specified MNE group, etc. for each applicable fiscal year, the De Minimis Exclusion is applicable that allows the 'current International minimum tax amount by country for applicable fiscal year' in the calculation of the 'Jurisdictional top-up tax' to be treated as zero:

- (i) The average of income of the Specified MNE Group, etc. for the applicable fiscal year and the two applicable fiscal years immediately preceding the first mentioned applicable fiscal year in the country, where the constituent companies, etc. are located, is less than the amount equivalent to EUR10 million.
- (ii) The average profit or loss of the Specified MNE Group, etc. for the applicable fiscal year and the two applicable fiscal years immediately preceding the first mentioned applicable fiscal year in the country, where the constituent companies, etc. are located, is less than the amount equivalent to EUR1 million.

<Treatment of the De minimis Exclusion where there are the Specified Constituent Companies, etc.>

The administrative guidance states that the amount of income in (i) above and the amount of adjusted income/adjusted loss related to the

calculation of (ii) above are calculated without distinguishing between the Specified Constituent Companies, etc.^(*) (excluding Investment Entities) and constituent companies, etc. other than the Specified Constituent Companies, etc.

(*) Minority-owned Constituent Companies, etc., Minority-owned Parent Constituent Companies, etc. ('MOPE'), Subsidiary of the MOPE and Investment Entities

<Non-application of the De minimis Exclusion to Stateless Constituent Companies, etc.>

The administrative guidance states that the De Minimis Exclusion is not applicable to Stateless Constituent Companies, etc.

2. Transitional CbCR Safe Harbour

Where constituent companies, etc. of the Specified MNE Group, etc. (excluding certain constituent companies, etc.) provide CbCR of the Specified MNE Group, etc. for each applicable fiscal year to the competent tax office in Japan, etc., the Transitional CbCR Safe Harbour is applicable that allows the 'Jurisdictional top-up tax' of the country, where the constituent companies, etc. are located, to be treated as zero, as long as the constituent companies, etc. satisfy either (i) De Minimis Requirement, (ii) Simplified Effective Tax Rate Requirement or (iii) Ordinary Income Requirement for the applicable fiscal years beginning on or after 1 April 2024 but on or before 31 December 2026 (but only for applicable fiscal years ending on or before 30 June 2028), and also satisfy certain conditions (e.g., filing of the Global Information Return of the Specified MNE group, etc. for each applicable fiscal year).

The '(iii) Ordinary Income Requirement' above is satisfied if '(a) ≤ (b)' below:

- (a) The amount of adjusted income before tax of the country, where the constituent companies, etc. are located, reported in the CbCR for the applicable fiscal year
- (b) The amount of Substance-based Income Exclusion

< Transitional treatment for the Substance-based Income Exclusion >

The amount of 'Substance-based Income Exclusion' related to the calculation of the 'Jurisdictional top-up tax' in the calculation of the 'International minimum tax amount by country for applicable fiscal year' is calculated by multiplying the amounts of eligible payroll costs and the amount of eligible tangible assets by 5 percent, respectively. However, transitional measures provided by the 2023 tax reform allows the amount to be calculated based on a certain percentage instead of 5 percent for a certain period depending on the beginning date of the applicable fiscal year.

The administrative guidance states that the amount of 'Substance-based Income Exclusion' in '(iii) Ordinary Income Requirement' of the Transitional CbCR Safe Harbour is also calculated based on the above

certain percentage for a certain period depending on the beginning date of the applicable fiscal year as a transitional treatment.

The explanatory statements for the main items in the administrative guidance state the background and consideration points of this administrative guidance as follows:

- The model rules and the commentaries approved by the OECD/G20 Inclusive Framework on BEPS in December 2021 and March 2022 ('Model Rules, etc.') do not obligate each country/jurisdiction to introduce the Global Minimum Tax and are regarded as a common approach. However, where each country/jurisdiction introduces the Global Minimum Tax, its operation is required to be in accordance with the Model Rules, etc.
- Because of this background, the laws and regulations were interpreted in this administrative guidance for Japanese IIR in full consideration with the purpose of the Model Rules, etc. In addition, since tax laws and accounting rules in other countries vary widely, only examples are provided for cases in which a uniform treatment cannot be determined.
- Therefore, care should be taken not to fall into an interpretation that does not meet the purpose of the laws and regulations and the background of the introduction of Japanese IIR, because of a lack of examples or statements, etc. in the administrative guidance.

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