KPMG Japan Tax Newsletter

10 March 2023

2023 Tax Reform

Controlled Foreign Company (CFC) Regime

— Amendment to Exemption Threshold of Effective Tax Rate for Full-inclusion Rules Applied to Specified CFC

By virtue of the 2023 tax reform, a new tax measure equivalent to the Income Inclusion Rule (IIR), which is one of the rules in the Global Anti-Base Erosion Rule (GloBE Rule) of Pillar 2 agreed among the OECD/G20 Inclusive Framework on BEPS, will be introduced(*).

Corresponding to the introduction of the new tax measure, the exemption threshold of the effective tax rate (ETR) for full-inclusion rules applied to a Specified CFC and the attachments to tax returns, etc. will be amended under the Controlled Foreign Company (CFC) regime taking into account the additional administrative burden for companies subject to the new tax measure.

In this newsletter, we will provide an outline of the amendment to the exemption threshold of ETR for full-inclusion rules applied to a Specified CFC and explain the possible impact from the amendment on deferred tax accounting for the fiscal years ending on or after 31 March 2023.

(*) We set out details of the proposed amendments related to the IIR in the Tax Newsletter 'Outline of the 2023 Tax Reform Proposals' issued on 22 December 2022.

I. Amendment to Exemption Threshold of Effective Tax Rate for Full-inclusion Rules Applied to Specified CFC

1. Overview of the amendment

Where the ETR of the foreign subsidiary that falls under the Specified CFC definition (Paper Company, Cash Box and Black-List Company) is less than 30 percent, the adjusted income of the Specified CFC for a fiscal year must be included in its Japanese shareholders' income (full-inclusion rules) under current tax law.

By virtue of the 2023 tax reform, the exemption threshold of the ETR for the full-inclusion rules applied to a Specified CFC will be reduced to 27 percent from 30 percent as shown in the below table.

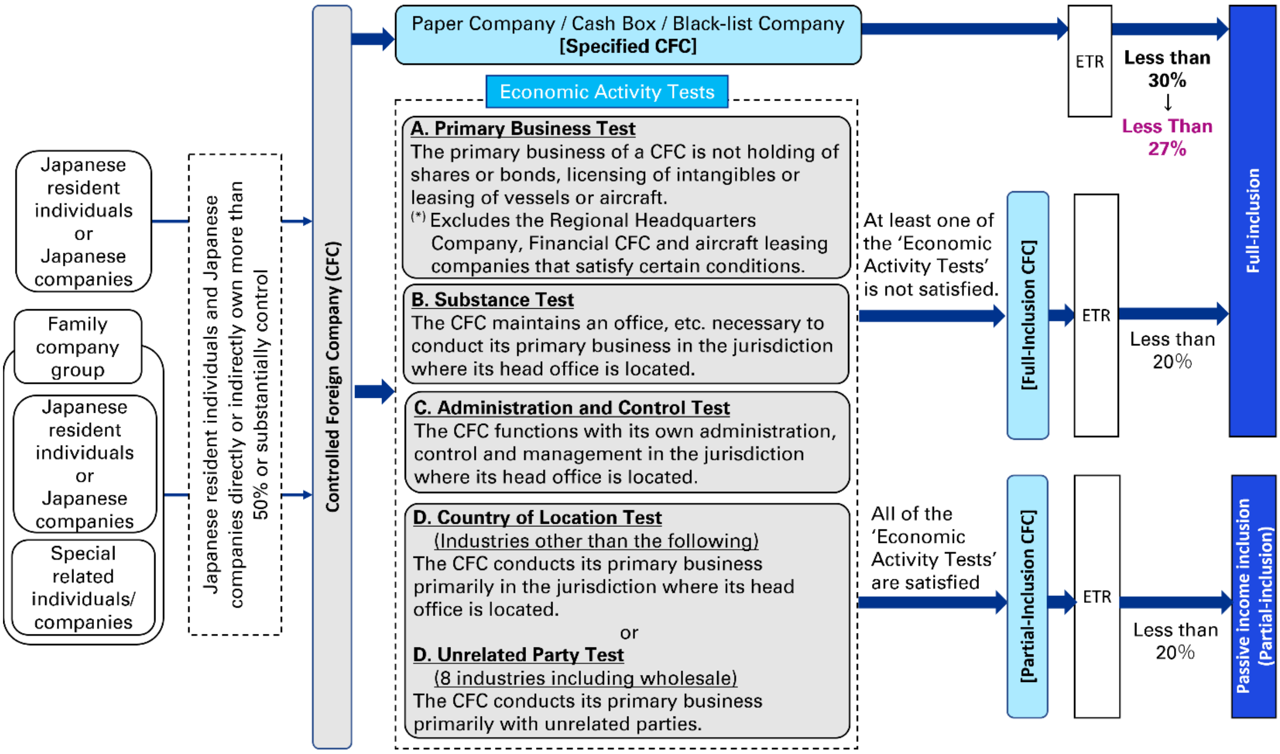
[Current tax law]

ETR / Classification of CFC		Under 20%	20% or more & less than 30%	30% or more
Specified CFC (Paper Company, Cash Box and Black-List Company)		Full-inclusion	Full-inclusion	No income inclusion
Other than Specified CFC	Full-Inclusion CFC (At least one of the Economic Activity Tests is not satisfied.)	Full-inclusion	No income inclusion	No income inclusion
	Partial-Inclusion CFC (All of the Economic Activity Tests are satisfied.)	Partial-inclusion	No income inclusion	No income inclusion

[Proposal]

ETR / Classification of CFC		Under 20%	20% or more & **less than 27%**	**27% or more**
Specified CFC (Paper Company, Cash Box and Black-List Company)		Full-inclusion	Full-inclusion	No income inclusion
Other than Specified CFC	Full-Inclusion CFC (At least one of the Economic Activity Tests is not satisfied.)	Full-inclusion	No income inclusion	No income inclusion
	Partial-Inclusion CFC (All of the Economic Activity Tests are satisfied.)	Partial-inclusion	No income inclusion	No income inclusion

The following picture shows the flow chart of how to determine the application of the CFC regime indicating the proposed amendments under the 2023 tax reform.



Source: Ministry of Finance '2023 Tax Reform (Proposal)' (translated into English and modified by KPMG Tax Corporation)

2. Effect of the amendment

According to the '2023 Tax Reform related to the economy, trade and industry' published by the Ministry of Economy, Trade and Industry, the list of countries having statutory tax rates ranging from 27 percent to 30 percent includes Germany, South Korea, and California and New York state in the US (please see the chart below), where many Japanese companies have operations. According to the survey based on a mechanical estimate approximately 40 percent of certain foreign subsidiaries subject to the CFC regime are expected to be exempted from the application of the full-inclusion rules.

Reduction of thresholds

Subject to full-inclusion	Statutory tax rate	Country / Region
×	30%	Australia, Mexico
○→×	29.0～29.9%	Germany (956 companies), Illinois state in the US (295 companies), etc.
○→×	28.0～28.9%	New Zealand (120 companies), California state in the US (1,034 companies), etc.
○→×	27.0～27.9%	Italy (271companies), South Korea (966 companies), New York state in the US (388 companies), etc.
○	25.8%	France, Netherlands
○	25.2%	India
○	25%	China, Spain
○	20%	Thailand, Vietnam

Source: Ministry of Economy, Trade and Industry '2023 Tax Reform related to the economy, trade and industry' (translated into English and modified by KPMG Tax Corporation)

The amendment is expected to reduce the administrative burden on companies to a certain extent. However, the ETR of foreign subsidiaries located in the countries having a statutory tax rate around 27% may be required detail examination.

3. Timing of application

The amendment in 1. above will be applied to the full-inclusion rules under the CFC regime in fiscal years beginning on or after 1 April 2024 for the Japanese shareholder company.

II. Impact on Deferred Tax Accounting

As indicated in I.1. above, where the ETR of the Specified CFC held by a Japanese company is less than 30 percent, the Specified CFC is subject to the full-inclusion rules under current tax law.

By virtue of the 2023 tax reform, where the ETR of the Specified CFC held by a Japanese company is less than 27 percent, the Specified CFC will be subject to the full-inclusion rules.

Therefore, for example, a Japanese company which is required the assessment of the recoverability of the deferred tax assets should pay attention to a possible negative impact on the estimated future taxable income used in the assessment in the fiscal year ending 31 March 2023, because the Specified CFC, whose estimated ETR is more than 27 percent but less than 30 percent, will be excluded from the application of the full-inclusion rules.

KPMG Tax Corporation

Tokyo Office
Izumi Garden Tower,
1-6-1 Roppongi, Minato-ku,
Tokyo 106-6012
TEL : +81 (3) 6229 8000
FAX : +81 (3) 5575 0766

Osaka office
Osaka Nakanoshima Building 15F,
2-2-2 Nakanoshima, Kita-ku,
Osaka 530-0005
TEL :+81 (6) 4708 5150
FAX :+81 (6) 4706 3881

Nagoya office
Dai Nagoya Building 26F,
28-12 Meieki 3-chome, Nakamura-ku,
Nagoya 450-6426
TEL : +81 (52) 569 5420
FAX : +81 (52) 551 0580

Kyoto Office
Nihon Seimei Kyoto Yasaka Building 7F,
843-2 Higashi Shiokoji-cho,
Shiokoji-dori Nishinotoin-higashiiru, Shimogyo-ku,
Kyoto 600-8216
TEL : +81 (75) 353 1270
FAX : +81 (75) 353 1271

Hiroshima Office
Hiroshima Kogin Buiding 7F,
2-1-22 Kamiya-cho, Naka-ku,
Hiroshima 730-0031
TEL : +81 (82) 241 2810
FAX : +81 (82) 241 2811

Fukuoka Office
Kamiyo Watanabe Building 4F,
1-12-14 Tenjin, Chuo-ku,
Fukuoka 810-0001
TEL : +81 (92) 712 6300
FAX : +81 (92) 712 6301

info-tax@jp.kpmg.com
home.kpmg/jp/tax-en