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Tax Update

National Tax Agency — Administrative Guidance related to the Japanese IIR

By virtue of the 2024 tax reform, the Japanese Income Inclusion Rule (hereinafter 'J-IIR'), which is equivalent to the Income Inclusion Rule ('IIR') of the Global Minimum Tax in Pillar 2 agreed by the OECD/G20 Inclusive Framework on BEPS and which was established in the 2023 tax reform, was amended from the perspective of clarifying the rules based on the content of the administrative guidance issued by the OECD and international discussions, etc.

On 9 August 2024, the National Tax Agency released the administrative guidance (hereinafter 'AG', Japanese only) corresponding to the amendments to the J-IIR under the 2024 tax reform.

For example, the AG explains the following treatments regarding the QDMTT Safe Harbour and the Transitional CbCR Safe Harbour:

1. QDMTT Safe Harbour

By virtue of the 2024 tax reform, the QDMTT Safe Harbour was established, which allows the 'Jurisdictional top-up tax' in the country where constituent companies, etc. in the specified MNE group, etc. are located to be treated as zero for the applicable fiscal year as long as the constituent companies, etc. are subject to the QDMTT that satisfies certain requirements in the jurisdiction other than Japan.

The above 'certain requirements' include the following:

(i) If all constituent companies, etc. belonging to the specified MNE group, etc. prepare the 'financial statements in their country of residence'(*), the amount equivalent to the current net profit or loss of these constituent companies, etc. must be calculated in accordance with the financial accounting standards for the 'financial statements in their country of residence', and

(ii) If any of the constituent companies, etc. do not prepare the 'financial statements in their country of residence'(*), the amount of the current net profit or loss of these constituent companies, etc. must be calculated in accordance with certain provisions.

(*) Only those for which the period of preparation is the same as the applicable fiscal year of the specified MNE group, etc.

The AG added the following explanation regarding the QDMTT Safe Harboour:

<Where the 'financial statements in the country of residence' are not prepared>

The case where the period for which the 'financial statements in their country of residence' is prepared is not the same period as the applicable fiscal year of the specified MNE group, etc., falls under the above case (ii) 'if any of the constituent companies, etc. do not prepare the "financial statements in their country of residence".'

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).

Corresponding to the various amendments to the Transitional CbCR Safe Harbour under the 2024 tax reform, the AG added the following explanations.

<Transitional treatment: Accounting treatments equivalent to the Specified Accounting Treatments>

By virtue of the 2024 tax reform, it was prescribed that the country-by-country reporting must be prepared based on the consolidated financial statements (excluding consolidated financial statements to which the Specified Accounting Treatments or accounting treatments equivalent to the Specified Accounting Treatments are applied, except for certain cases) in case where constituent companies, etc. apply the Transitional CbCR Safe Harbour.

The AG explains that the above 'accounting treatments equivalent to the Specified Accounting Treatments' means the accounting treatments applied to the so-called 'consolidation package' for the ultimate parent company, etc., prepared based on the book value of the assets and liabilities of the company, etc. in the consolidated financial statements of the ultimate parent company, etc. of an enterprise group, etc. when a company, etc. newly participates in the enterprise group, etc.

<Transitional treatment: Example of equivalent amount>

By virtue of the 2024 tax reform, it was prescribed that the amount of adjusted pre-tax income must be calculated without deducting certain

expenses or losses related to fund raising transactions included in the consolidated financial statements of constituent companies, etc. for the applicable fiscal year (excluding the transactions made on or before 15 December 2022) financed directly or indirectly by the constituent companies, etc. from the financing company, etc., as long as the certain expenses or losses related to the transactions meets certain conditions.

One of the 'certain conditions' in the above is that 'there is no amount included in taxable income related to the transactions' in the calculation of the amount of taxable income of the financing company, etc.' and the portion of 'the amount included in taxable income', which corresponds to a certain amount treated as deductible expenses under the tax loss carry-forward system in the calculation of the taxable income of the financing company, etc. or any other amount equivalent thereto, etc., are excluded from the above 'amount included in taxable income'.

The AG explains that the above 'any other amount equivalent thereto' includes the amount which corresponds to an amount treated as deductible expenses under the disallowed interest payment carry-forward system of the earning stripping rules (including the equivalent amount in foreign countries), for example.

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The explanatory statements for the main items in the AG state the background and consideration points of the AG as follows, which is consistent with those written in the explanatory statements of the administrative guidance released last year(*):

- 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 the AG 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, examples are only 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 AG.

(*) We set out information concerning the explanatory statements in the e-Tax News No.291 'Administrative Guidance for the IIR' issued on 3 October 2023.

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