

Business Tax Law Newsletter**JUN 9,
2020****COVID-19 and Recent Tax Developments in Japan**

Yasutaka Nishikori, Tsuyoshi Ito

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The global economy has seen an unprecedented downturn due to COVID-19, and Japan's economy is no exception. In response, the Japanese government is taking various measures to help taxpayers facing this difficult business environment. In this edition of the business tax newsletter, we highlight some tax measures likely to be considered important by readers interested in Japanese business.

I. Deferral of deadlines for tax filings and tax payments

Due to COVID-19, many people in Japan have been working remotely. As a result, these taxpayers face difficulty preparing tax returns and filing documents in the manner and timeframes to which they are accustomed. In consideration of these unique circumstances, the National Tax Agency of Japan (the "NTA") announced that it would remain flexible in its approval of extension requests.

Further, although the national tax statutes already provide a mechanism for general tax payment deferrals, the recent tax measures established a special tax deferral system for taxpayers suffering from the impacts of COVID-19. Specifically, if for any period greater than one month after February 2020 a taxpayer experiences a decrease in revenue of 20% or more, compared to the same period in the previous year, and finds it difficult to pay their national taxes in a lump sum, the taxpayer may request a special deferral of national taxes which are or will be due in the period from February 1,

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2020 to January 31, 2021. The special deferral cannot exceed one year but, unlike a general tax payment deferral, no collateral will be required and no delinquent taxes will be charged.

II. General tax loss carry-back refund

The reform temporarily relaxes loss carry-back restrictions. General loss carry-backs work the same in Japan as they do in many other countries; corporations that experience a net operating loss in one fiscal year may apply the derived tax benefits to the prior (more successful) fiscal year's tax burden. However, to take advantage of this option in Japan, taxpayers must be "blue return system"¹ participants. While the Corporate Tax Act of Japan prescribes the general tax loss carry-back rules, the Tax Special Measures Act of Japan suspended the use of loss carry-backs for all but a few types of taxpayers. Typically, small corporations (i.e. those with stated capital of JPY 100 million or less) are excluded from this suspension, while larger Japanese corporations are not (leaving them ineligible for general loss carry-backs). However, the reform allows all blue return corporations with stated capital of JPY 1 billion or less² to claim tax loss carry-back refunds when they suffer net operating losses in a fiscal year ending between February 1, 2020 and January 31, 2022. As the Japanese business environment was relatively strong before these changes, we believe that more than a few corporations could make up a part of their losses from COVID-19 through this process, helping them to feel as if they have avoided some of the injustice wrought by the pandemic.

III. Casualty loss carry-back refund

"Casualty loss" refers to net operating losses resultant of damage to, or loss of, fixed assets or inventory due to casualties (i.e. disasters or acts of God). Japanese corporations are allowed to claim carry-back refunds on casualty losses, regardless of their stated capital amount, for the previous fiscal year and, if it continues to file blue form tax returns, for the previous two fiscal years. Thus, more Japanese corporations are potentially qualified to claim casualty loss carry-back refunds than general carry-back refunds.

With that said, however, there are questions surrounding what losses fall within "casualty losses" in the context of the on-going COVID-19 pandemic. The relevant statutes assume casualty losses are damages and losses affecting assets of a corporation. As long as they relate to damages and losses on assets caused by casualties, casualty losses include, not only direct losses and damages concerning disposal of, or value decrease in, assets of a corporation, but also the costs and expenses for repairing such assets and urgent necessary measures for preventing occurrence or expansion of such losses and damages. The FAQ published by the NTA illustrated that casualty losses include losses on disposal of equipment used by a person found to be infected with COVID-19; expenses for disinfecting facilities and equipment; costs for purchasing masks, sanitizers and air cleaners placed in offices to prevent the spread of COVID-19; and losses on disposal of goods and commodities caused by cancelling events due to COVID-19. On the other hand, sales decreases due to customer reluctance to visit shops and wages paid to employees during shop closures do not fall within the scope of "casualty losses", even if they are caused by COVID-19, because they are not losses or damages incurred on assets of a corporation.

¹ A special NTA program in which filers, after completing the appropriate application procedures, maintain books and other records with supporting documentation, based on certain guidelines, and then calculate and pay their annual income taxes in accordance with these books and records.

² Excluding certain categories of corporations, such as those wholly-owned by corporations having stated capital exceeding JPY 1 billion.

IV. Rent reduction, debt waivers and other support for businesses impacted by COVID-19

Due to COVID-19, many retail shops and restaurants have been forced to close and have begun to negotiate rent reductions and waivers with building owners. Although rent reductions and waivers could help shops and restaurants suffering a serious downturn caused by COVID-19, building owners should be aware of their tax implications. The corporate income tax statutes provide for so-called “donation taxation”. For corporate income tax purposes, donations are defined as gifts or donations of monies, assets, or other economic benefits given without consideration. Donations which exceed a certain amount, set forth in the corporate income tax statutes, are generally not deductible from a corporation’s taxable income. As such, building owners from whom tenants request rent reductions or waivers due to COVID-19 should be concerned about whether those rent reductions or waivers are subject to the donation taxation rules.³ In this regard, the FAQ published by the NTA makes it clear that rent reductions of certain extents do not qualify as donations, referring to the provisions in the Corporate Tax Basic Circular which the NTA originally introduced after the Great Hanshin-Awaji Earthquake in 1995.

Further, the same rules can apply to debt waivers by financial institutions intending to support any kind of business enterprise experiencing financial difficulties due to COVID-19. The applicable provisions in the Corporate Tax Basic Circular are titled “waivers, etc., of customers accounts receivables in the case of casualty” and, according to the title, seem to cover only accounts receivables in general supply chains and commercial distributions. Different from the impression given by their title, however, the provisions actually apply to loans and similar kinds of debts. Therefore, financial institutions may rely on the provisions when they provide a borrower with financial support, such as a reduction or waiver of loan interest and/or principal.

Having said that, support given to other entities which exceeds a certain extent is subject to the donation taxation rules. A taxpayer should consult with a tax advisor before providing “generous” support.

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The COVID-19 pandemic may give rise to unprecedented adverse business circumstances. We hope that this newsletter helps those involved in Japanese business.

³ If a rent reduction is recognized as a donation, in principle such rent reduction is not deductible from taxable income, which results in a tax burden. If a rent reduction is not recognized as a donation, such rent reduction is deductible from taxable income.



[Yasutaka Nishikori](#)

Partner
E-mail: y_nishikori@jurists.co.jp

Yasutaka Nishikori is a Partner at Nishimura & Asahi who specializes in domestic and international tax affairs. He has acted as counsel in numerous financial transactions and has taken advantage of this experience to provide practical tax advice to clients at the structuring stage of such transactions and during tax disputes, especially in relation to complicated financial instruments. From 2010 to 2013 he acted as a visiting associate professor of Tokyo University for its tax courses. He successfully represented Tokyo Marine & Nichido Fire Insurance in contesting a tax assessment on a cross-border reinsurance transaction ceding earthquake-related risks.



[Tsuyoshi Ito](#)

LPC Partner
E-mail: t_ito@jurists.co.jp

Tsuyoshi Ito is an LPC Partner at Nishimura & Asahi. Mr. Ito has significant experience in tax counseling and tax controversies and has represented major corporations in numerous tax disputes and tax lawsuits. In March 2020, he won a significant corporate tax dispute that challenged a tax assessment of approximately USD 367 million in taxable income before the Tokyo District Court after a protracted six-year battle. In August 2014, he won a tax dispute involving securitization transactions of domestic housing loans before the Tokyo High Court. In addition to excellent achievements in major tax disputes, Mr. Ito generally advises on domestic and cross-border taxation issues in various transactions, such as M&A, joint ventures, fund formation and equity/debt investments.