



## **EBC Position on the Introduction of a Consolidated Tax System in Japan**

(日本における連結納税制度導入に関する  
欧州ビジネス協会の見解)

**European Business Community in Japan (EBC)<sup>1</sup>**

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### *Background*

The Government of Japan is widely expected to introduce legislation creating a system for taxing groups of companies on a consolidated basis in May of this year. If implemented according to plan, these new laws would take retroactive effect for business years starting from April 1, 2002.

At its most basic, a consolidated tax system allows groups of companies to transfer tax losses and operating profits between members of the group. The European Business Community (EBC) in Japan has long supported the implementation of such a system in Japan, for the following reasons:

- A consolidated tax system would help facilitate corporate restructuring by giving groups of companies more options to manage their tax burden
- A consolidated tax system would give tangible meaning to the new Japanese holding company structure
- A consolidated tax system would bring Japanese tax practice more in line with international best practice as most other modern industrialised nations have introduced consolidated tax systems, including most countries in Europe

The EBC has raised this issue repeatedly through such forums as the EU Japan Business Dialogue, position papers such as the *EBC Report on the*

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<sup>1</sup> The European Business Community is the trade policy arm of the combined European national Chambers of Commerce in Japan.



*Japanese Business Environment 2001*, and through direct dialogue with the Ministry of Economy Trade and Industry and the Ministry of Finance.

After nearly a decade of deliberation, an implementation date has finally been set and the legislation needed to bring the consolidated tax system into existence is slowly starting to take shape.

Unfortunately, many of the details emerging from the debate thus far regarding the introduction of the consolidated tax system in Japan have not been encouraging.

The EBC's main concerns are outlined below.

#### *Issues*

1. **Process** – The EBC has been disappointed with the nearly decade long process surrounding the implementation of a consolidated tax system in Japan. We feel strongly that such a substantive reform should have been developed through a more transparent consultative process. Unfortunately, business was not adequately consulted and as a result it appears likely that only a limited number of firms will actually make use of the new rules once they are adopted. Even now, one month before the Government is supposedly to introduce the relevant bills to the Diet for approval, no draft legislation has been released to the general public for comments. It is deeply regrettable that the Government of Japan plans to introduce a consolidated tax system that so few firms actually intend to use.
2. **2% Surtax** – In order to offset losses in government revenue expected as a result of the introduction of a consolidated tax system, the Government of Japan has decided to levy a 2% surtax on companies that choose to adopt the system. The EBC feels strongly that the introduction of this surtax (and other fiscal countermeasures described below) defeats the original purpose of the reform – to facilitate desperately needed change and restructuring within the Japanese economy. The EBC also feels that Government of Japan's position on the need for fiscal countermeasures is in itself overstated. The allegation that 70% of Japanese companies are not paying corporate tax as reason for introducing fiscal countermeasures is misleading and not fit for international comparison. No European country has imposed a



consolidated surtax, and the EBC feels strongly that no surtax should be imposed in Japan.

3. **Local tax** – It will not be possible to consolidate local corporate taxes under the proposed consolidated tax system in Japan. This is a serious omission as aggregate local tax (15.5%) represents more than 1/3 of the 42% effective tax rate in Japan. The EBC feels that local tax should also be subject to tax consolidation. Consolidation for local tax purposes could facilitate a fairer allocation of local tax revenues, if the allocation factor were to be based on non-profit factors such as wages or revenues. Separate plans to further broaden the tax base to non-profit factors such as wages and revenues would be even more counterproductive to the reform and resurrection of the Japanese economy.
4. **Implementation date** – Legislation introducing a system for taxing groups of companies on a consolidated basis will likely be submitted to the Diet in May of this year, and once passed by the Diet, will apply retroactively to April 1, 2002. This discriminates against foreign firms that do their accounting on a calendar year basis, as they will not be able to make use of the new system until 2003. It should be noted that tax reforms implemented last fiscal year allowed foreign companies to enjoy beneficial tax treatment on any transaction that took effect after April 1, 2001, even if the business year had already started for these companies on January 1, 2001.
5. **Scope** – The range of tax consolidation being planned will be limited to a parent company and its 100% subsidiaries<sup>2</sup>, all of whom must be incorporated in Japan. The EBC feels that this is too restrictive. Limiting the applicability of the planned system to 100% subsidiaries would fail to accommodate situations where it is impossible (or undesirable) for otherwise fully integrated companies to achieve complete ownership. In principal, the EBC feels that the 100% rule should be replaced by a 50% threshold. At the very least, a *de minimus* clause should be introduced that would consider only voting shares. The 100% rule may in fact invite abuse by taxpayers who want to avoid the application of consolidated taxation rules on certain 100% subsidiaries by simply transferring one share to an independent third party. A *de minimus* clause would help to avoid such abuses.

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<sup>2</sup> For calculation purposes, shares granted to directors/employees for stock options will be disregarded.



6. **Temporary exclusion of subsidiaries held for less than five years** - Subsidiaries that have not been obtained in the course of a qualified reorganisation and that have been held for less than five years will be temporarily excluded from the planned system. The EBC feels that this will be counterproductive since it will penalize firms that have reorganised over the past five years while no reorganisation rules were applicable.
7. **Election and de-election** – Under the rules currently being planned, the application of tax consolidation rules will be elective, but once chosen, tax consolidation will irrevocably apply. The EBC recommends that termination be an option after a certain period (e.g. 5 years) and allow termination without notice for special reasons, such as the sale of the business.
8. **Adjustment of values of subsidiary shares** – Under the proposed consolidated tax system, the assets (and liabilities) of consolidated subsidiaries must to be re-valued (and taxed if there are any gains) if the parent decides to sell the subsidiary after consolidation takes effect. This again would discourage corporate restructuring, as companies would lose the incentive to divest themselves of under-performing subsidiaries due to the potentially detrimental tax consequences of this decision. The EBC feels that this requirement should be removed before the proposed consolidated tax system is introduced in Japan.