

Client Alert

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Japan to Increase R&D Tax Credit

On June 19, 2009, the Japanese Diet passed new legislation that will increase the current R&D tax credit from 20% of a taxpayer's entire income tax or corporate tax amount (as the case may be)¹ to 30% for the next two taxable years. This alert briefly explains the R&D tax credit increase.

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Framework of R&D Tax Credit – Two-Tier Credit

The R&D tax credit system consists of two separate tax credit systems: one for "ordinary" R&D expenses and another for "special" R&D expenses, as described below.

First Tier

Currently, certain qualified taxpayers (i.e., individual and corporate taxpayers filing "blue tax returns") are allowed to take a tax credit of up to 10% of certain qualified R&D expenses deductible in the taxable year, with a limit set at 20% of the taxpayer's income tax or corporate tax amount, as the case may be. If the 20% limit is exceeded, any excess amount can be carried over to the next taxable year (but no further), but only if the amount of qualified R&D expenses deductible in the following taxable year exceeds that of the previous taxable year.

Qualified R&D expenses are defined to be the "necessary testing and research expenses for manufacturing, technical improvements and inventions designated in the regulations," and includes the cost of raw materials, expert labor costs, overhead expenses, and costs paid to other institutions to which the R&D activities are outsourced by the taxpayer.

Second Tier

In addition to the above, qualified taxpayers are allowed to take a tax credit for up to "12% minus the percentage taken in the first tier credit system" of certain qualified "special" R&D expenses deductible in the taxable year, with a limit set at "20% minus the percentage taken in the first tier credit system" of its income tax or corporate tax amount.

¹ Income earned by an individual taxpayer is subject to income tax, and income earned by a corporate taxpayer is subject to corporate tax.

Qualified "special" R&D expenses are roughly defined to be qualified R&D expenses that are used for (i) R&D activities jointly conducted with, or outsourced to a government institution or an academic institution, and (ii) R&D activities for medical products for rare diseases.

A simplified one-tier tax credit is applicable to certain SMEs and agricultural cooperatives.

Increase in the R&D Tax Credit

The new legislation will increase the credit limit for both tiers from 20% to 30% of the income tax amount or corporate tax amount. In addition, the new legislation will allow taxpayers to carry over any excess amount sustained in the 2009 and 2010 tax years, and up to the 2012 tax year, whereas the carryover is usually limited to one taxable year, as explained above. This increase will be effective for taxable years starting and ending between April 1, 2009 and March 31, 2011.