



# RECENT CHANGE IN CONSUMPTION TAX IN JAPAN

## INTRODUCTION

The OECD Global Forum on VAT held meetings in Tokyo on 17–18 April 2014. These meetings follow the Global Forum's first meeting in Paris in November 2012. The meetings in Tokyo were part of a series of events commemorating the 50th anniversary of Japan's participation in the OECD and endorsed new OECD guidelines with respect to cross-border application of VAT<sup>1</sup>.

The Global Forum's meetings presented an opportune time to discuss VAT in Japan as Consumption Tax, which is similar to VAT in European countries, is in a transition period. The Consumption Tax rate increased on 1 April 2014 for the first time in 17 years and is scheduled to rise again in 2015.

## RAISING THE CONSUMPTION TAX RATE

The legislation to raise the Consumption Tax rate was enacted by the Diet on 10 August 2012. The legislation called for the Consumption Tax rate to increase from 5% to 8% on 1 April 2014 and from 8% to 10% on 1 October 2015. While the 2014 increase has taken effect, the legislation contains a provision which could postpone the 2015 increase depending on the economic situation at that time. The government decided to raise the Consumption Tax rate because Japan's low birth coupled with its aging population has strained the finances of the social insurance system. The additional revenue generated by the increased Consumption Tax rate is intended to be used for expenditures for pensions, medical care, nursing care and well as measures to attempt to solve the low birth rate issue. The Prime Minister will determine whether

the 2015 increase will be implemented as scheduled by the end of this year after considering the need for an increase and Japan's economic performance this summer, according to news reports.

## CURRENT RULES FOR CROSS BORDER E-COMMERCE

While the 2015 Consumption Tax rate increase is still under discussion, the government is also considering other tax reforms. One important issue that is being discussed is taxation on cross border e-commerce services. Under the Consumption Tax Act (Act No. 108 of 1988), a service rendered in Japan is subject to Consumption Tax, and the criteria to determine whether a service is rendered in Japan or outside of Japan varies depending on the nature of the service. Under the current rules, the performance of e-commerce services, such as the sale of digital books and music distribution, are determined based on the location of the service provider's office. As such e-commerce services provided online by offshore service providers to Japanese customers are not subject to Japanese Consumption Tax under current legislation.

## PROPOSED AMENDMENT

The Ministry of Finance (MOF) is studying this situation and considering changes due to pressure from domestic e-commerce service providers. The domestic e-commerce service providers complain the fact that their sales are subject to Consumption Tax while offshore competitors are not subject to Consumption Tax, makes competing with offshore service providers challenging. They also

<sup>1</sup> The guidelines are available at the OECD's website (<http://www.oecd.org/ctp/consumption/international-vat-gst-guidelines.htm>). The meeting endorsed the first three chapters of the guidelines, which include standards to ensure VAT neutrality and making taxes on B to B transaction in services destination-based. The remaining chapters, including VAT application to cross-border B to C service transactions will be finalized at the next meeting of the Forum in November 2015.



argue that competing will be even more difficult if the Consumption Tax rate increases to 10%. Based on these concerns, the MOF is planning to amend the Consumption Tax Act, to look at the location of the performance of services based on the “the location of the recipient of the service”, rather than “the location of the office of the service provider”. This will allow the National Tax Agency (NTA) to tax foreign e-commerce service providers. The MOF is considering following the system which is to be introduced by EU member states in March 2015.

Under the MOF’s proposed system, there will be two ways of taxing cross border e-commerce services depending on the nature of the service rendered (i.e. “B to B” or “B to C”), which is similar to the rules implemented in the EU. As for B to B transactions, a “Reverse Charge Construction” has been proposed. Under the Reverse Charge Construction system, the fees collected for the cross border e-commerce services are subject to Consumption Tax but the offshore service provider would be exempted from the obligation to pay the Consumption Tax to the NTA. Instead, Japanese purchaser would be required to pay the Consumption Tax to the NTA.

On the other hand, with respect to cross border B to C e-commerce transactions, the offshore service provider will have an obligation to collect Consumption Tax from their customers in Japan and to pay such collected Consumption Tax to the NTA (referred to as the “Foreign Supplier Registration/Filling System”). In this case, the MOF is planning to require offshore providers to nominate a Tax Agent (an agent in Japan who handles tax procedures for foreign companies/residents pursuant to the law) to pay the Consumption Tax through the Tax Agent.

The criteria to determine whether a transaction is B to B transaction or B to C transaction has not been specified. However, under the proposed system, a typical B to B transaction would be providing services such as the delivery of advertisements or legal services and a typical B to C transaction would be providing services such as the sale of digital books and music distribution.

## FUTURE PROSPECTS

It has been reported that the government will make its decision with respect to the increase of the Consumption Tax rate to 10% in 2015 and announce the decision later this year. The amendment of Consumption Tax Act in order to impose Consumption Tax on cross border e-commerce services is scheduled to be approved in March next year, and there will be further discussions based on the above-mentioned new OECD guidelines. The change will be effective by the end of March in 2016, according to news reports.

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