

KPMG Japan tax newsletter

Consumption Tax Treatment of Cross-Border Supplies of Services



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Under the current Japanese consumption tax law, the place of taxation for cross-border supplies of services is determined by the place of the office of the service supplier if the place where the services are provided is not clear.

Thus, supplies of digital content (e.g. e-books and music) or internet advertising by foreign suppliers are not subject to consumption tax, while such supplies by domestic suppliers are subject to consumption tax. The difference in the consumption tax treatment has caused distortion in the competitive conditions between foreign and domestic suppliers.

In relation to this issue, a report entitled 'Consumption Tax Treatment of Cross-Border Supplies of Services and Intangibles,' which summarized discussions on this issue by various experts, was submitted by the Ministry of Finance to the Tax Commission in November 2013, and further discussion has subsequently taken place.

On 26 June, a proposed framework for the consumption tax treatment of cross-border supplies of services was discussed at a meeting of the International Taxation Discussion Group of the Tax Commission and was reported to the full Tax Commission on 27 June.

We have set out in this newsletter the main points of the proposed framework based on the information submitted at the above meetings. Although it is anticipated that amendments to the tax law in line with the proposed framework will be included in the 2015 tax reform, the timing of the

implementation and further details are expected to be decided after further discussion.

I. CHANGE OF THE PLACE OF TAXATION

1. Change to the Destination Principle

It is proposed that the principle for the place of taxation for cross-border supplies of services will be changed as follows. Under the proposal, cross-border supplies of services from foreign suppliers to domestic businesses and domestic consumers will be categorized as domestic transactions subject to consumption tax, which is the same tax treatment as in EU countries.

		Current rule	Proposal
Place of service provision is clear		Place where the service is provided	No change
Place of service provision is <i>not</i> clear	International transportation International communication International postal services	Place of departure or destination	
	Insurance	Place of the office of the insurance business operator concluding the insurance contract	
	Provision of information relating to plant construction, etc.	Place where most of the materials for the plant construction, etc. are procured	
	Other than the above (e.g. cross-border supplies of services)	Place of the office of <u>the supplier</u> of the service	Location of <u>the recipient</u> of the service (Destination principle)

Note that the current rule leaves ambiguity as to whether supplies of digital content (e.g. e-books and music) should be categorized as 'supplies of services' or 'sale/lease of assets.' It is therefore expected that the categorization of such supplies of digital content as 'supplies of services' will be made clear for consumption tax purposes.

2. Clarification of Transactions Subject to Change

If the provision of a service is completed outside Japan in substance, such provision will be treated as a foreign transaction (i.e. not subject to consumption tax). In order to address concerns from businesses that certain transactions might inadvertently be treated as domestic transactions (i.e. subject to consumption tax), the treatment of certain transactions as foreign transactions is expected to be clarified under the law. For example:

- Collection and analysis of information relating to things outside of Japan, where such activities are performed outside Japan (including delivery of the result from such activities)
- Provision of services in connection with acquisition, management or transfer of assets located outside Japan, where such activities are performed outside Japan (including reporting of the results from such activities)

However, even if the provision of a service appears to have been completed outside Japan, the new principle on the place of taxation for cross-border supplies of services discussed in 1. above will be applied where such service is provided as a package with a service provided in Japan.

(Example) Cases where services provided outside/inside Japan as a package

- Provision of two kinds of services ((i) system development performed outside Japan and (ii) installation of the system in the offices located in Japan) as a package upon requests from a domestic business customer
- Provision of two kinds of services ((i) R&D activities performed outside Japan and (ii) adoption of the result of the R&D activities to product manufacturing conducted in Japan) as a package upon requests from a domestic business customer

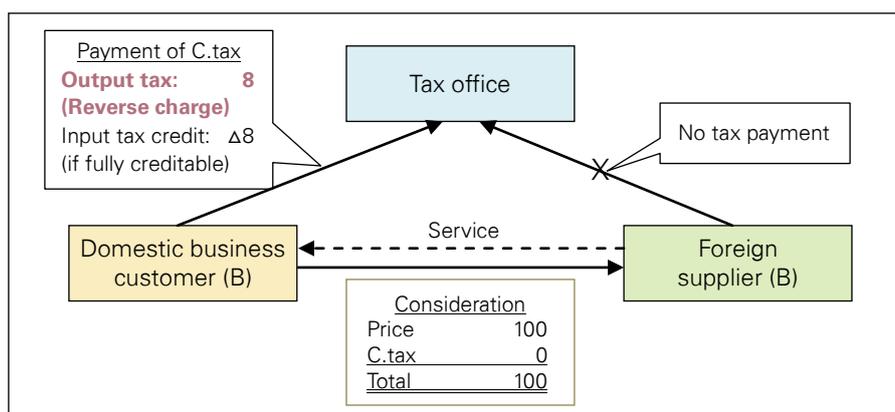
II. DEFINITION OF 'B2B SUPPLIES' AND 'B2C SUPPLIES'

In EU countries, VAT identification numbers are used for the purpose of recognizing whether the customer is a consumer or a business customer. However, as Japan has not adopted a VAT identification number system, it is proposed that for the supplies of services by foreign suppliers that will be newly categorized as domestic transactions due to the change in the principle of taxation, 'B2B supplies' and 'B2C supplies' will be defined as follows based on characteristics of the services or the terms and conditions of the transaction:

B2B supplies	Cross-border supplies of services through telecommunications channels (e.g. internet and telephone) where it is <u>clear that recipients of the services are business customers</u> from the characteristics of the services or the terms and conditions of the transaction
B2C supplies	Cross-border supplies of services through telecommunications channels (e.g. internet and telephone) where it is <u>not clear that recipients of the services are business customers</u>

III. COMPLIANCE RULES – 'B2 B SUPPLIES' (REVERSE CHARGE MECHANISM)

It is proposed that for 'B2B supplies,' the obligation to declare/pay output tax on 'B2B supplies' will be imposed on the domestic business customer under the reverse charge mechanism.



In connection with the above, the following matters are also being proposed:

An obligation imposed on foreign suppliers

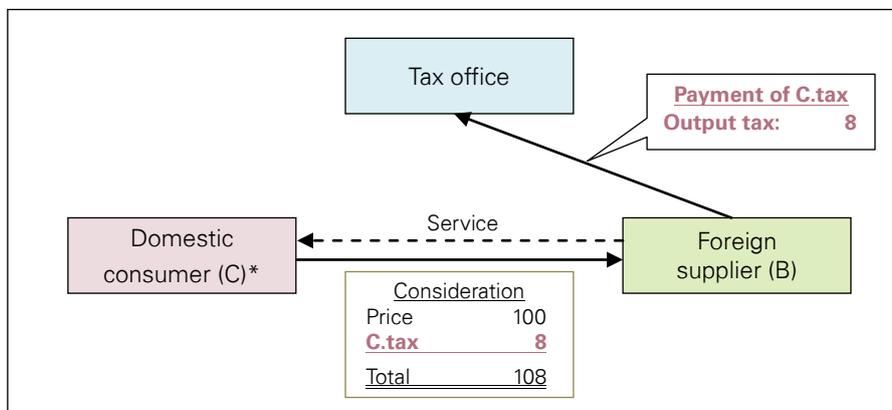
- The foreign supplier will have an obligation to notify service recipients that the service is subject to the reverse charge mechanism. The timing of the notification will be further considered.
- The method of taxation will not be affected by whether or not the foreign supplier makes proper notification.

Countermeasures related to administrative burden for domestic business customers

- In order to minimize the incremental administrative burden due to the introduction of the reverse charge mechanism, certain domestic business customers, such as those whose taxable revenue ratio (the ratio of taxable sales over the sum of taxable and non-taxable sales) is greater than or equal to a certain threshold (e.g.95 percent), will not be required to apply the reverse charge mechanism for a certain period of time, on the assumption that the output tax on services subject to the reverse charge is the same as the creditable input tax on the services.

IV. COMPLIANCE RULES – ‘B2C SUPPLIES’ (FOREIGN SUPPLIER FILING SYSTEM)

It is proposed that an obligation to file a consumption tax return and pay consumption tax to the Japanese government will be imposed on foreign suppliers in ‘B2C supplies.’



(* Domestic business customers could be included.)

The proposed framework also mentions the following issues in connection with the above rule:

Filing obligations by foreign suppliers

- The Japanese government will aim to ensure that foreign suppliers fulfill their obligation to lodge consumption tax returns through cooperation with foreign tax authorities under tax information exchange agreements and Conventions on Mutual Administrative Assistance in Tax Matters.
- The current rules which provide an exemption from filing a consumption tax return for certain suppliers will apply to foreign suppliers as well as to domestic suppliers. Thus, foreign suppliers will generally only be obliged to file a consumption tax return under the above new rule if their taxable sales are over JPY 10 million.

Issues when domestic business customers receive services from foreign suppliers

- As there is a potential limitation on the ability of the Japanese government to collect consumption tax from foreign suppliers due to jurisdictional barriers, when a domestic business customer receives services categorized as ‘B2C supplies’ from a foreign supplier, the domestic business customer will not be allowed to take a credit for the input tax for the services.

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