

20 November 2013

KPMG Japan tax newsletter

Report on 'Consumption Tax Treatment of Cross-Border Supplies of Services and Intangibles'



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On 14 November 2013, a report entitled 'Consumption Tax Treatment of Cross-Border Supplies of Services and Intangibles' ('Report') was submitted by the Ministry of Finance to a meeting of the International Taxation Discussion Group of the government's Tax Commission.

The Report is a summary of the discussions conducted by the 'Study Group on the Consumption Tax Treatment on Cross-Border Supplies of Services and Intangibles' consisting of various experts. The Study Group was set up in July 2012 and discussed how cross-border supplies of services and intangibles should be treated for consumption tax purposes from the perspective of taxation neutrality and ensuring taxing rights of Japan, referring to the framework being developed by the OECD's Committee on Fiscal Affairs and the tax system in European countries.

We have set out in this newsletter the main points indicated in the Report.

Please note that the proposals in the Report are subject to further discussion and change since such proposals entail various challenges, such as operational issues for the tax authorities and administrative burden for domestic business customers and foreign suppliers.

I. CURRENT SITUATION

Japanese consumption tax is imposed on sales/leases of assets and provision of services carried out by a business operator in Japan. Whether this is conducted in Japan is generally determined by the place where the asset is located at the time of the sale/lease or by the place of the service provision.

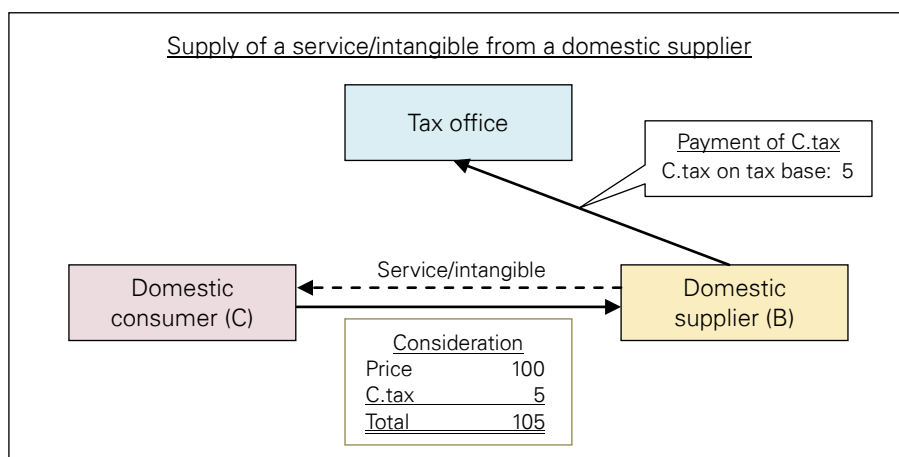
However, with respect to cross-border supplies of services and intangibles^(*) made by foreign suppliers, the place of taxation for such supplies is determined based on the location of the office of the foreign suppliers, resulting in such supply being treated as free of consumption tax and the issues as discussed below.

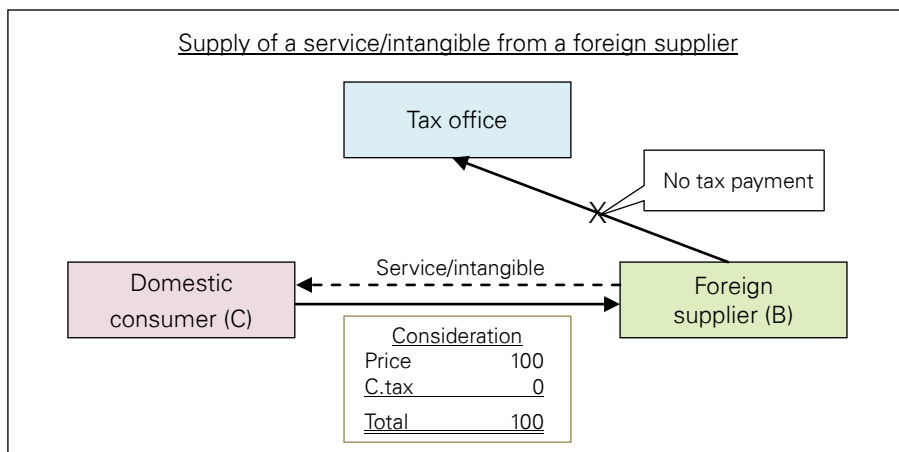
^(*) A supply of digital content (e.g. e-books, music, movies, games and software) is raised as a typical example of cross-border B to C supplies of services and intangibles. Note that 'B to C supplies' and 'B to B supplies' have the following meanings:

- B to C supplies: supplies of services and intangibles from business suppliers to consumers
- B to B supplies: supplies of services and intangibles from business suppliers to business customers

1. B to C Supplies

As the consumption tax burden of a consumer with respect to supplies of services and intangibles differs depending on the place of the supplier, a domestic supplier as a result does not have a level playing field with a foreign supplier.

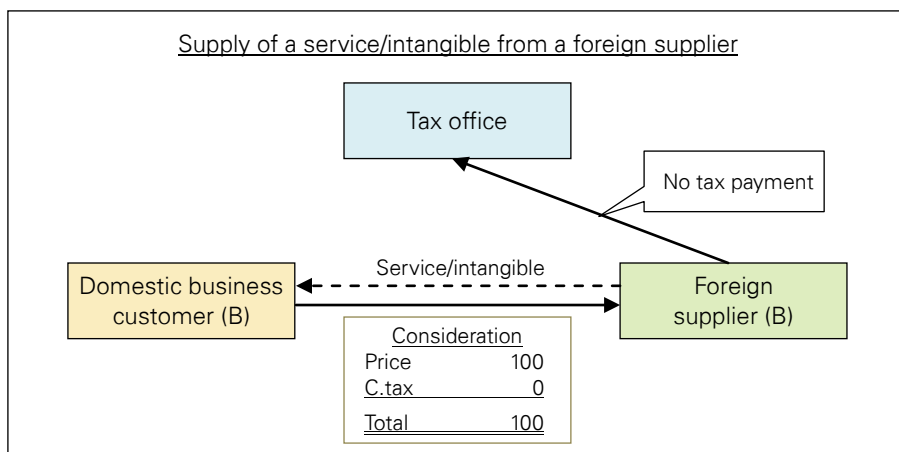
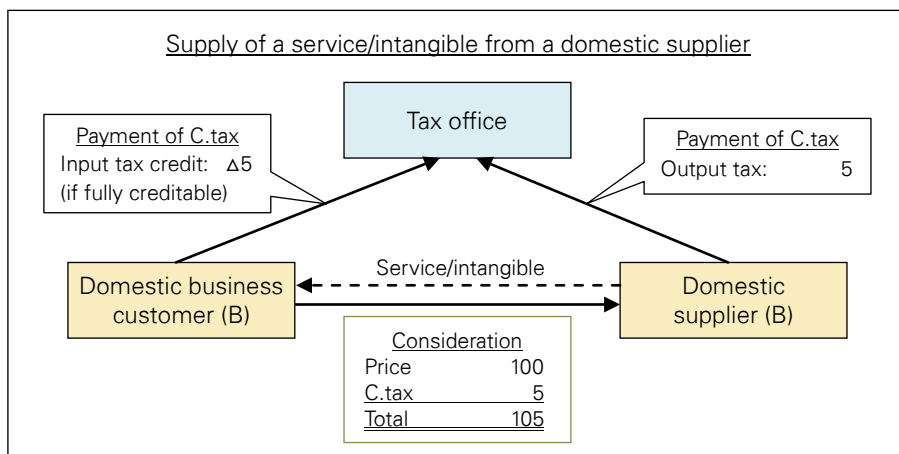




2. B to B Supplies

In the case of a B to B supply, there is no difference between a supply from a domestic supplier and a supply from a foreign supplier, where a business customer is entitled to full input tax credit in respect of such supply, although the consumption tax burden of a business customer could increase, e.g. when input tax on a supply from a domestic supplier is not creditable since the customer purchases the supply exclusively for the sake of non-taxable sales transactions.

Meanwhile, differences in the displayed prices (i.e. a price shown by a domestic supplier is reflective of consumption tax, while a price shown by a foreign supplier does not reflect consumption tax) may affect a business customer's decision when choosing suppliers, etc.

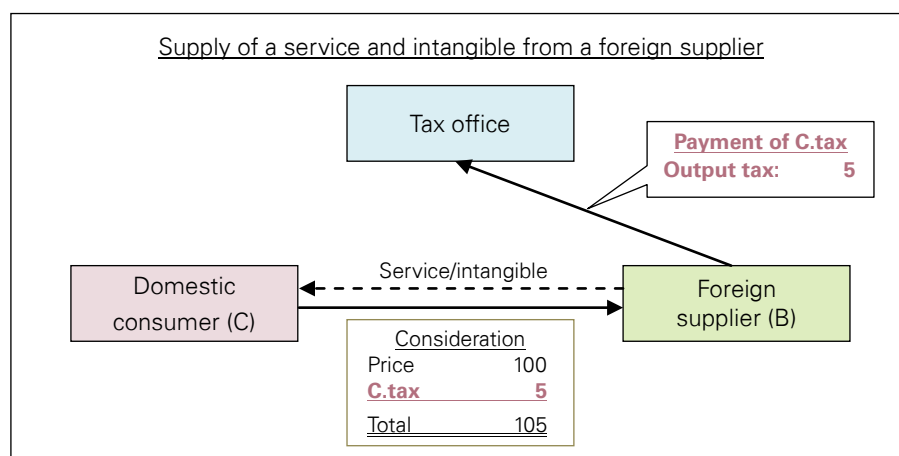


II. CHANGE OF THE PLACE OF TAXATION

The Report proposes that the place of taxation with respect to cross-border supplies of services and intangibles should be determined based on the place of consumption of the supplies (the destination principle). Thus, under the proposal, cross-border supplies of services and intangibles from a foreign supplier to a domestic consumer/business customer will be categorized as domestic transactions subject to consumption tax, which is the same tax treatment as in European countries.

III. COMPLIANCE RULES – B TO C SUPPLIES

The Report proposes to impose an obligation to file a consumption tax return and pay consumption tax to the Japanese government on foreign suppliers of services and intangibles to domestic consumers.



[Issues]

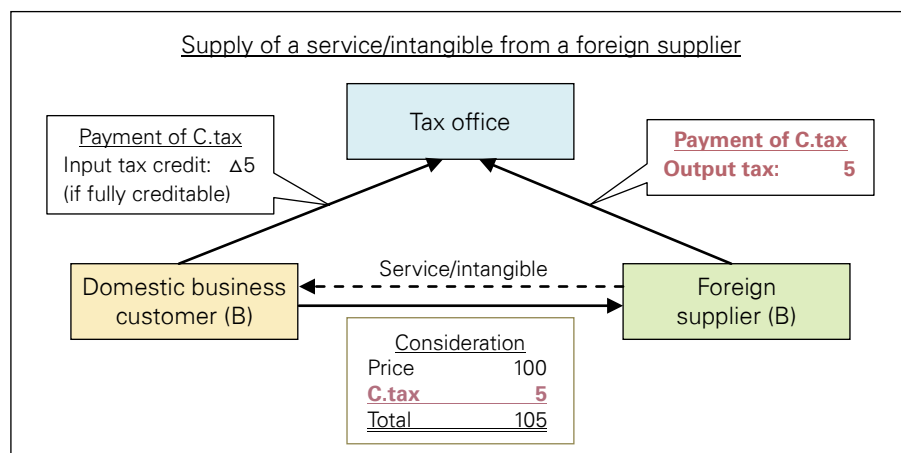
- Cooperation with foreign tax authorities such as information exchange/ assistance in collection of taxes under tax treaties will be required in order to ensure proper filing and payment by foreign suppliers who are not covered by Japan's taxing jurisdiction. As consumption tax is not included in the scope of taxes subject to information exchange/assistance in collection of taxes under some tax treaties, this will need to be considered in future negotiations.
- A foreign supplier will need to recognize whether its customer is a domestic consumer or not. Thus, it is necessary to develop a compliance system, considering administrative burden on foreign suppliers, which allows for this to be practicable. (Note that if proposal 1 or proposal 3 discussed in IV. below is applied to B to B supplies, a foreign supplier will not need to recognize whether its customer is a consumer or a business customer.)

IV. COMPLIANCE RULES – B TO B SUPPLIES

The Report indicates three proposed methods for collecting consumption tax on cross-border B to B supplies of services and intangibles.

1. Proposal 1 – Foreign Supplier Registration/Filing System

Under this proposal, a foreign supplier of services and intangibles to a domestic business customer will be obliged to file a consumption tax return and pay consumption tax to the Japanese government. As this method is the same as that for B to C supplies, a foreign supplier will not need to recognize whether its customer is a consumer or a business customer.

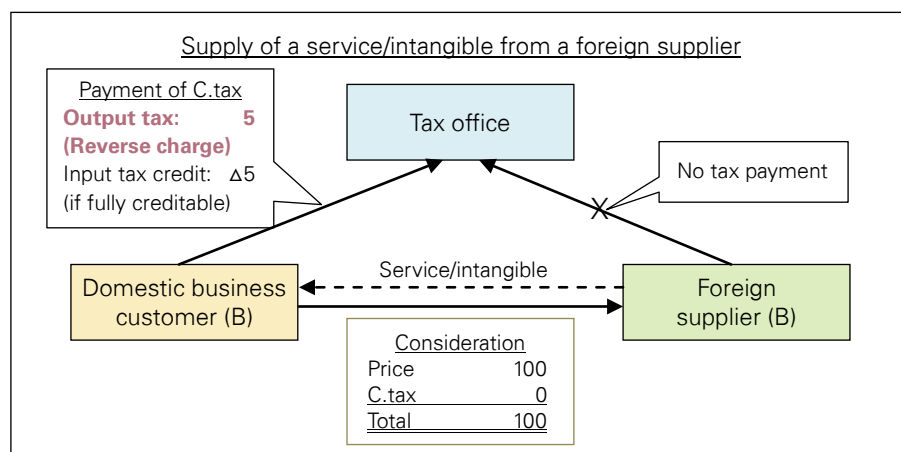


[Issues]

- As discussed in the first bullet point in [Issues] in III., cooperation with foreign tax authorities such as information exchange/assistance in collection of taxes under tax treaties will be required.
- A system will need to be prepared to prevent a domestic business customer from taking an input tax credit for a supply on which output tax is not properly declared/paid by a foreign supplier. A system to register a foreign supplier should be set up and keeping an invoice including the registration number of the foreign supplier should be one of the conditions for the domestic business customer to take an input tax credit on the supply.

2. Proposal 2 – Reverse Charge System

Under this proposal, an obligation to declare/pay output tax on cross-border supplies of services and intangibles will be imposed on a domestic business customer, which is the reverse charge system adopted in European countries. Adoption of such a system should prevent a situation where a domestic business customer takes an input tax credit on a supply with respect to which a foreign supplier has not properly declared/paid output tax.



[Issues]

- A system which allows a foreign supplier of services and intangibles to recognize whether its customer is a consumer or a business customer will be required. In European countries, VAT identification numbers are used for the purpose of recognizing whether the customer is a consumer or a business customer. If Japan adopts the reverse charge system, a system to register domestic business operators will be required. (Note that under the current tax law, neither the credit-invoice method nor registration system are applied in Japan.)

3. Proposal 3 – Combined System

Under this proposal, both of the two systems will be adopted as follows. One of the advantages of this proposal is that a foreign supplier conducting both B to C and B to B supplies will not be required to recognize whether its customer is a consumer or a business customer. Also, as the reverse charge system will be applied to a foreign supplier conducting only B to B supplies, proper filing/payment will be ensured with respect to supplies from such foreign supplier.

Foreign suppliers	Methods to collect consumption tax
Foreign suppliers conducting both B to C and B to B supplies	Proposal 1 - Foreign supplier registration/filing system
Foreign suppliers conducting only B to B supplies	Proposal 2 – Reverse charge system

[Issues]

- The administrative burden for a domestic business customer of cross-border supplies of services and intangibles will increase since they will need to know the status of the foreign supplier.

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