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Japan's New Consumption Tax Qualified Invoicing System

CFO Webinar

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Our presenters today



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Agenda

- Background & Context
- Supplier Perspectives
- Buyer Perspectives
- Record Retention
- Illustrative Case Study
- QI Readiness

Background & Context

Strategic reasons why businesses need to take action

As a Taxpayer

- Ensure compliance with JCT Law (tax governance)

As a Supplier

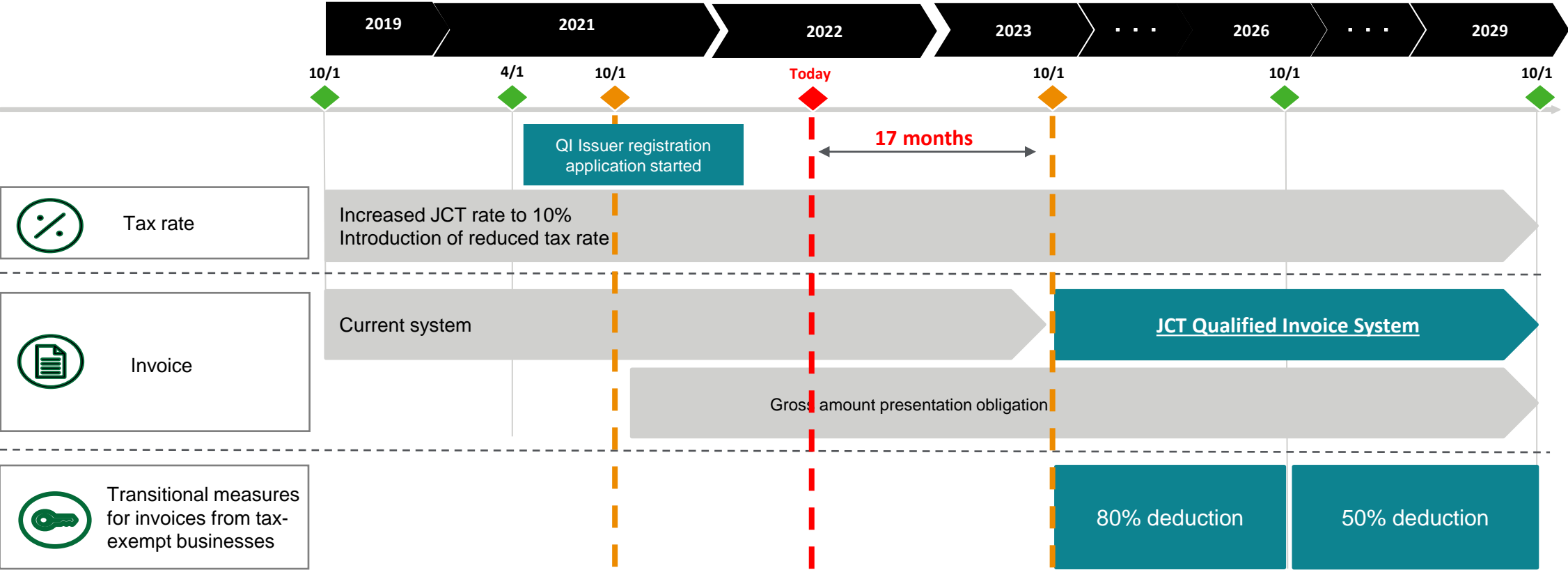
- Ensure competitive pricing of your goods and services

As a Buyer

- Avoid unexpected cash tax costs

Outline and Schedule of the Qualified Invoice System (QIS)

- ! QIS will be applied from 1 Oct 2023
- Obliges sellers to issue Qualified Invoices (“QI”) that meet certain requirements. Deduction of input JCT requires retention of QI
- To issue QI from 1 Oct 2023, business must register as a “QI Issuer” between 1 Oct 2021 and 31 March 2023.
- Tax authorities are concerned at slow pace of registration**
- After 1 Oct 2023, input JCT deduction for taxable purchases from tax-exempt businesses is limited. Transitional measures apply



Supplier perspectives

Rounding on Qualified Invoice

- JCT amount must **be rounded on an invoice level basis**

Rounding

	Receipt of order					Time of receipt of invoice				
Rounding Method	Rounding Per Line					Rounding Per Invoice				
Transaction example	Order Lines					Output Invoice				
	Product name	Tax-excluded value	Tax rate	Consumption tax	Price including tax	Product name	Tax-excluded value	Tax rate	Consumption tax	Price including tax
	Service A	1,024	10%	102	1,126	Service A	1,024			
	Service B	1,024	10%	102	1,126	Service B	1,024			
	Service C	1,024	10%	102	1,126	Service C	1,024			
	Service D	1,024	10%	102	1,126	Service D	1,024			
Accounting Entries Example	Total	4,096		408	4,504	Total	4,096	10%	410	4,506
	(AR)	4,504	(Sales)	4,096		(AR)	2	(JCT payable)	2	
Points to note	<ul style="list-style-type: none"> • If JCT amount is calculated and rounded line-by-line, an adjustment should be made in the accounting books at an invoice level. 									

Key exemptions from the requirement to issue Qualified Invoices

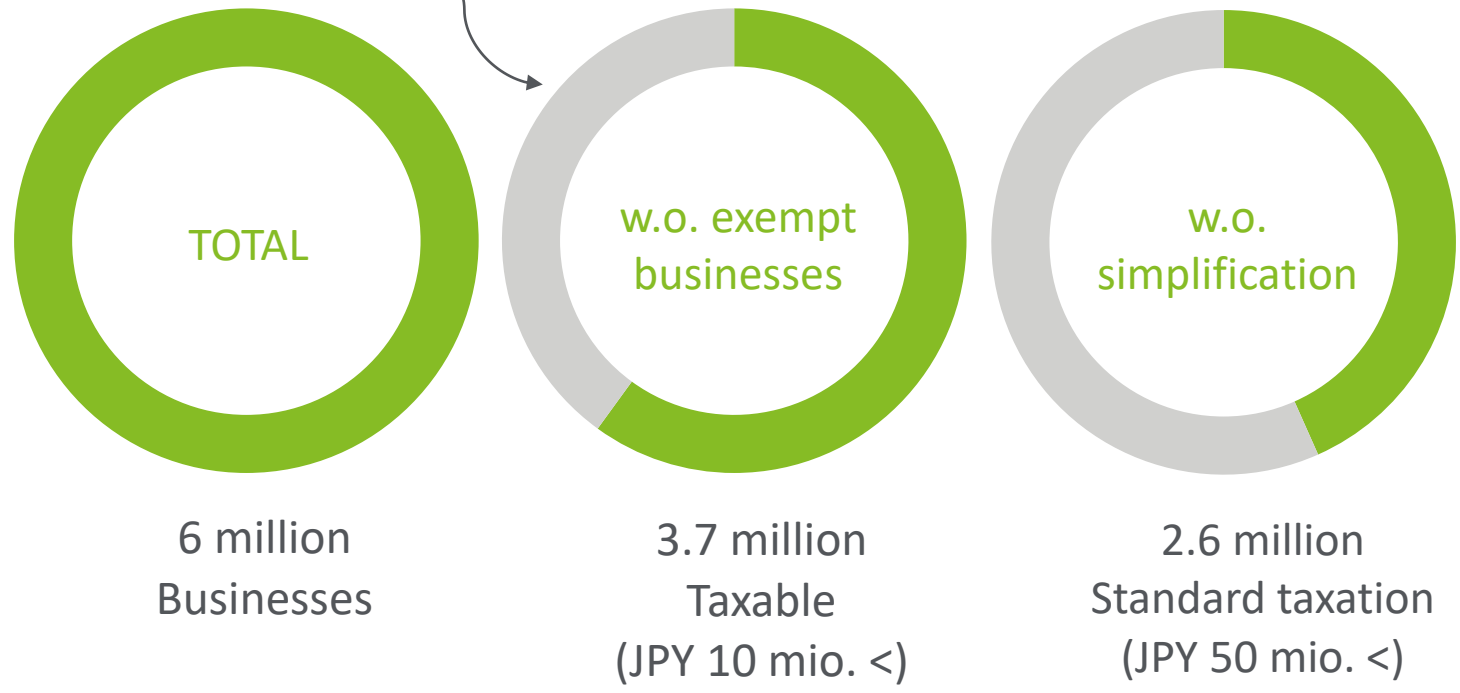
1. Public transportation of passengers (ships, buses, railways) with tax-inclusive value < 30,000 yen
2. Vending machine sales with tax-inclusive value < 30,000 yen
3. Mail and cargo services in exchange only for postage stamps, etc. (limited to those dropped to mailboxes)
4. Sale of fresh foods by farmers etc. at wholesale markets [Note]
5. Transfer of certain agricultural, forestry and fisheries products by producers entrusted to agricultural cooperatives, fisheries cooperatives or forestry cooperatives, etc. [Note]

[Note] Certain documents prepared by intermediary should be preserved.

Buyer perspectives

Impact of tax-exempt businesses

Around 40% of businesses in Japan (2.3 million) are tax exempt businesses.



Source: created by Deloitte based on the information on the website provided by Japanese Ministry of Finance

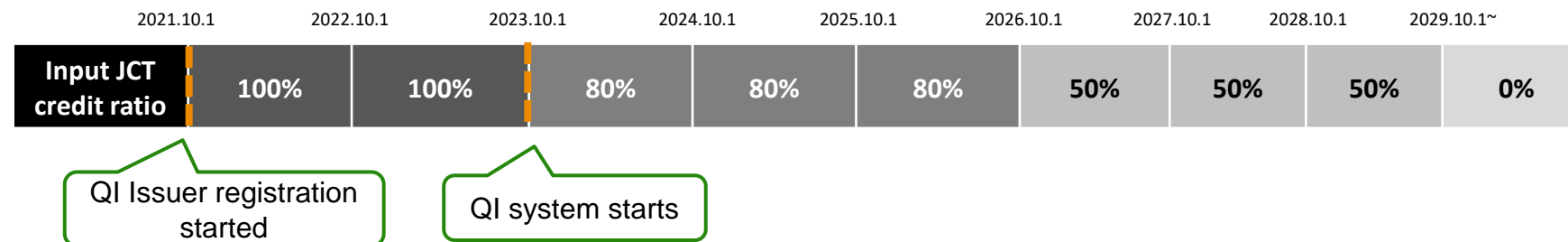
Impact of JCT exempt businesses in your supply chain

2.3 million tax exempt businesses would keep charging JCT?

Tax exempt business supply to JCT taxpayers (B2B)	Tax exempt businesses supply to consumers (B2C)
<p><u>JCT taxable businesses with standard taxation</u></p> <p>Oct 2023 – Oct 2029</p> <ul style="list-style-type: none">• Transitional measure (80%/50% deductible) <p>After Oct 2029</p> <ul style="list-style-type: none">• No deduction of input JCT	<p>No need to issue QI</p>

Transitional measures for deduction of input JCT on purchases from tax exempt businesses

Transitional measures will allow (for 6 years after 1 Oct 2023) deduction of certain % of input JCT on purchases from tax exempt businesses



Key exceptions from the requirement to receive Qualified Invoices

Input JCT deduction is permitted without Qualified Invoices for the following

1. Public transportation of passengers (ships, buses, railways) with tax-inclusive value < 30,000 yen
2. Purchases from vending machines with tax-inclusive value < 30,000 yen
3. Mail and cargo services in exchange for postage stamps etc. (limited to those dropped to mailboxes)
4. Transactions for which admission tickets, etc., with the required items in a Qualified Simplified Invoice (excluding transaction date) are issued and collected after the usage
5. Purchase of certain antiquities from person who is not a QI Issuer
6. Acquisition of goods pledged by a person who operates a pawnshop from a person who is not a QI issuer
7. Purchase of certain buildings from a person other than a QI Issuer engaged in Real Estate Brokerage
8. Purchase of recyclable resources/parts from person who is not a QI issuer
9. Travel expenses, etc. that are deemed to be normally payable to employees, etc. (travel expenses, accommodation expenses, daily allowance, commuting allowance)

How to identify if QI is genuine?



Identification of QI Issuers is necessary, especially as tax exempt businesses still allowed to state JCT in “invoices”!
Effectiveness of technology solutions is limited by quality of vendor master data

QI Issuer’s registration number is the only indication that invoice issuer is a JCT taxpayer

	Qualified Invoice Issuer’s Registration Number	Information to be published in connection with the registration number
Taxpayer with a corporation number	T + Corporate Number (13 digits)	<ul style="list-style-type: none"> ➤ Name and registration number ➤ Date of registration ➤ Date of cancellation/ expiration of registration ➤ For corporate entity, the location of its head office ➤ Address of an individual shall not be disclosed. Location of main office shall be disclosed, if agreed. ➤ In the case of a foreign business, the location of the office, etc. pertaining to the taxable supplies in Japan
Other taxpayers (Individual businesses, etc.)	T + 13 digits (Does not overlap with a corporate number, different from personal number (“My Number”))	

- Qualified Invoice issuers will be announced on National Tax Agency (NTA) website from November 1, 2021 (<https://www.invoice-kohyo.nta.go.jp/>)
- NTA "publication site" (of information on QI Issuers), will provide "search function," "Web-API function," and "data download function," to provide a user-friendly interface for checking "registration number."
- Data formats provided by Web-API function and data download function correspond to CSV format, XML format, & JSON format

QI system readiness response should respect competition law

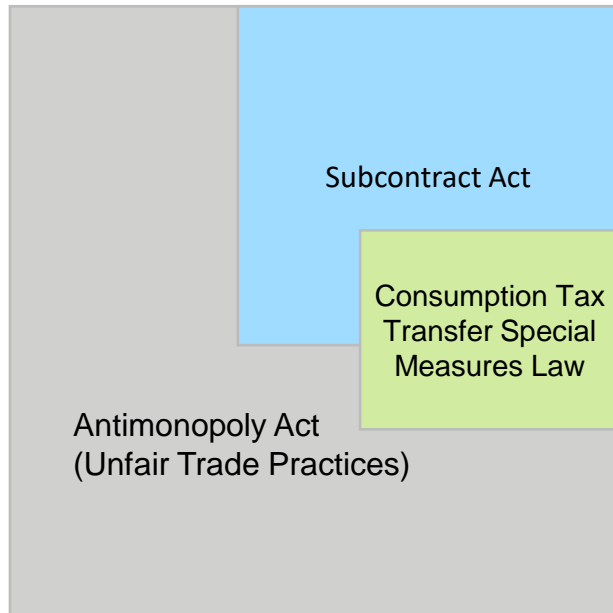
Points in this slide should be confirmed with appropriate legal counsel

Small businesses are protected by competition laws



- Change in price and other conditions of goods at time of changes to JCT system may be subject to competition law regulation
- The Fair-Trade Commission enforces the Consumption Tax Transfer Special Measures Law (which expired on 31 March 2021), the Anti-Monopoly Act and the Subcontract Act to control acts that violate competition laws

Application of each law



Examples of <u>inappropriate</u> responses	Possible issues under competition law
<ul style="list-style-type: none"> ● To obtain input JCT deduction incurred on purchases, pressure supplier to be a QI Issuer 	<ul style="list-style-type: none"> ● Restrictive Transactions (Antimonopoly Act) ● Abuse of Superior Bargaining Position (Antimonopoly Act)
<ul style="list-style-type: none"> ● Cease business with supplier who does not apply for QI registration 	<ul style="list-style-type: none"> ● Rejection of Transactions (Antimonopoly Act)
<ul style="list-style-type: none"> ● To vendors not registering as QI Issuer, request discount equivalent to amount of non-deductible JCT related to the purchase 	<ul style="list-style-type: none"> ● Abuse of Superior Bargaining Position (Antimonopoly Act) ● Unfair Purchase (Subcontract Act)
<ul style="list-style-type: none"> ● For those suppliers that do not apply for Qualified Invoice issuer's registration, request changes in the contents of the transactions (increased volume, etc. for the same price) 	<ul style="list-style-type: none"> ● Abuse of Superior Bargaining Position (Antimonopoly Act) ● Unfair Purchase (Subcontract Act)

Record retention

Electronic transaction records required to be saved digitally from 1 January 2022
 However transitional measures introduced in 2022 tax reform

Scope and Requirements of Japan's ERRL

Document Type	Books	Records		
	Accounting books used for tax purposes	Internally generated documents / copies of transaction records	Paper documents received and scanned	Electronic transaction records
Examples	<ul style="list-style-type: none"> • General ledger • Journal • Fixed asset ledger 	<ul style="list-style-type: none"> • Balance sheet • P&L statement • Inventory list • Invoices (copies) 	<ul style="list-style-type: none"> • Contracts • Invoices • Receipts 	<ul style="list-style-type: none"> • EDI data • Contracts (PDF) • Invoices (PDF)
Requirements to maintain electronically	<p>Integrity</p> <ul style="list-style-type: none"> • Correction/deletion history • Cross-referencing System documentation <p>Visibility</p> <ul style="list-style-type: none"> • Readability • Search function 	<p>Integrity</p> <ul style="list-style-type: none"> • System documentation <p>Visibility</p> <ul style="list-style-type: none"> • Readability • Search function 	<p>Integrity</p> <ul style="list-style-type: none"> • Data entry deadline / Timestamp • Correction/deletion history • Proper processing <p>Visibility</p> <ul style="list-style-type: none"> • Cross-referencing • Readability • System documentation • Search function 	<p>Integrity</p> <ul style="list-style-type: none"> • Timestamp • System prohibits / tracks corrections & deletions • Internal policies <p>Visibility</p> <ul style="list-style-type: none"> • Readability • System documentation • Search function

Illustrative case study

Transacting with a JCT exempt business

Illustrative case study

Manufacturer purchases from JCT exempt supplier

Situation:

- A manufacturer has in its supply chain a JCT exempt supplier from whom it purchases product for use in its manufacturing activities
- Upon completion of the final product, the manufacturer sells its goods to customers in Japan
- Based on its volume of taxable sales (e.g. in excess of JPY 10 million in its Base Period), the manufacturer is a JCT taxpayer and collects 10% JCT on its sales to customers

Complication:

- The introduction of the qualified invoicing system for JCT requires a qualified invoice issued by a registered JCT taxpayer in order to credit input JCT

Question:

- What is the financial impact for the manufacturer of transacting with a JCT exempt business?



Case Study: Financial impact of transacting with JCT exempt businesses (Current)

Example 1: Current rules **allow recovery of input JCT** on transactions with JCT exempt businesses

	Purchases			Sales			Profit (5) - (2)	JCT due (6) - (3)
	Total paid (1)	Unit price (2)	JCT (3)	Total received (4)	Unit price (5)	JCT (6)		
Supplier (JCT exempt)	8,800	8,800		11,000	11,000		2,200	0
Manufacturer (JCT taxpayer)	11,000	10,000	1,000	13,200	12,000	1,200	2,000	200

- 10% of total paid can be deducted as input JCT incurred by manufacturer
- No restrictions under current rules for claiming 10% input JCT incurred until 1 October 2023

Case Study: Financial impact of transacting with JCT exempt businesses (Future)

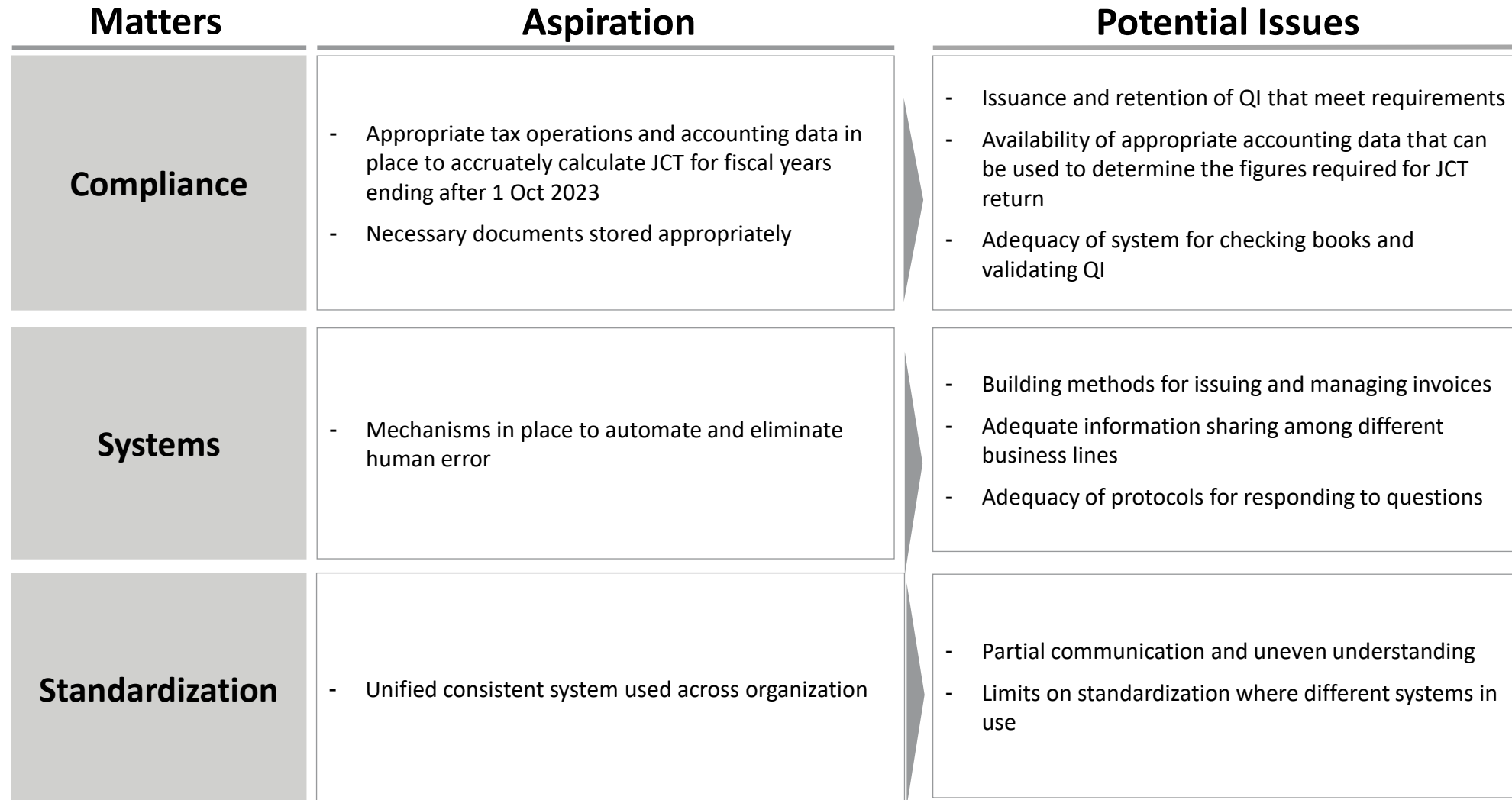
Example 2: From October 2029 **no recoverable input JCT** on transactions with tax exempt businesses

	Purchases			Sales			Profit (5) – (2)	JCT due (6) – (3)
	Total paid (1)	Unit price (2)	JCT (3)	Total received (4)	Unit price (5)	JCT (6)		
Supplier (JCT exempt)	8,800	8,800		11,000	11,000		2,200	0
Manufacturer (JCT taxpayer)	11,000	11,000	0	13,200	12,000	1,200	1,000	1,200

- A JCT exempt supplier is not able to issue a QI and there is no creditable input JCT for manufacturer
- Transitional measures allow 80% recovery of input JCT incurred from transactions with JCT exempt businesses until October 2026, and 50% recovery until October 2029

QI readiness

QI readiness



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