

Japan Inbound Tax & Legal Alert

Japanese tax authorities intensify audits of foreign digital service providers

November 2019, No. 47

In Brief

More than four years have passed since foreign digital service providers (FDSPs) became subject to Japanese consumption tax (JCT) on 1 October 2015. Recently, the Japanese tax authorities (NTA) have intensified their audits of FDSPs to maximize collection of JCT due. The NTA initially sends a questionnaire to the FDSP requesting basic information, such as the amount of the FDSP's paid-in capital, registered address, amount of sales to Japanese consumers, etc. According to media reports, if an FDSP that is determined to be a JCT taxpayer does not respond to the questionnaire or does not pay the JCT due as established by a subsequent audit, the NTA is requesting the attachment of certain assets of the FDSP (such as receivables from the Japanese customer debtors) in settlement of the JCT due.

1. Determination of JCT status and obligations of JCT taxpayers

There is no registration system for JCT purposes and an enterprise must self-assess its JCT status (JCT taxpayer or JCT-exempt enterprise) by applying various tests. A foreign company assessed as a JCT taxpayer is required to file a JCT return and pay the JCT due (broadly calculated as output JCT less input JCT) to the NTA within two months of the end of the taxable period (generally coinciding with the fiscal year). A foreign company may be a JCT payer even if it has no physical presence, office, branch, etc. in Japan.

2. Digital services subject to JCT

As from 1 October 2015, the place of supply of digital services for JCT purposes changed from the office location of the supplier to the domicile or head office of the recipient. As a result, the supply of digital services from foreign enterprises to Japanese customers, which previously was outside the scope of JCT, became subject to JCT at the standard rate. The current rate is 10%, increased from 8% as from 1 October 2019.

Digital services are defined as services provided via a telecommunications network, and include:

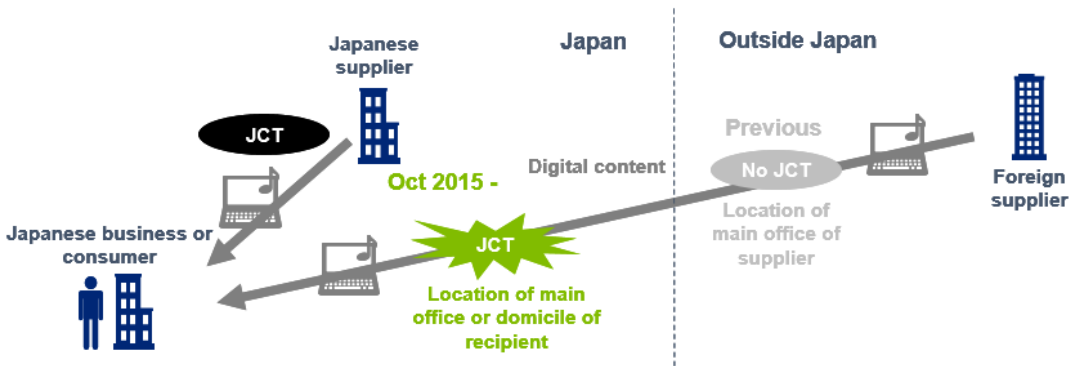
- Distribution of e-games, e-books, e-newspapers, e-journals, music, videos, software (including various applications) via the internet;
- Services allowing customers to use software or database on the internet cloud;
- Online advertising services; and
- Consulting services provided for certain periods via telecommunications networks.

3. Classification as B2B or B2C services

Under the JCT rules applicable to digital services, different JCT implications arise depending on whether a service provided by a foreign enterprise is a B2B (business-to-business) or B2C (business-to-consumer) service.

The reverse charge applies to B2B digital services, under which the recipient (rather than the supplier) is required to account for both input and output JCT. Where a digital service is classified as a B2C service, the foreign supplier must treat the amount charged to Japanese customers as inclusive of JCT and account for output JCT if the foreign supplier is a JCT taxpayer in the relevant fiscal year.

Therefore, where the services rendered by an FDSP are classified as B2B services, the FDSP is not required to pay JCT; the obligation lies with the recipient of the services provided by the FDSP. On the other hand, where the services provided by an FDSP are classified as B2C services, the FDSP is required to pay JCT even if it does not have a physical presence, office, branch, etc. in Japan.



4. Audits

The questionnaires are issued to FDSPs by the NTA after the deadline to self-assess as a JCT payer has passed. If the information provided in the NTA questionnaire indicates that the FDSP may be subject to JCT, the NTA will launch a tax audit.

Audits of foreign entities that do not have a physical presence, office, branch, etc. in Japan generally are conducted via the foreign entity’s designated tax agent in Japan, who will respond on behalf of the foreign entity to NTA information and documentation requests. Towards the completion of the audit, the FDSP generally may choose to either file a JCT return or wait for the NTA to issue an assessment (both options will incur interest and penalties). Where a JCT assessment is issued, the FDSP may appeal to the tax tribunals and ultimately the courts.

According to recent media reports, where the JCT due is not paid, the NTA is requesting attachment of certain assets of the FDSP. This may have a significant negative impact on an FDSP’s financial position and reputation and demonstrates the NTA’s increasingly uncompromising approach to FDSPs that do not comply with JCT legislation.

Deloitte’s View

FDSPs providing games, e-books, etc. to Japanese consumers through platforms may be considered JCT taxpayers and, therefore, should seek to confirm their JCT status and potential JCT liability as soon as possible.

Although the official text of the NTA questionnaire is in Japanese, an English translation is provided and non-Japanese speaking staff of foreign entities should appreciate the significance of the request, ensuring that an appropriate and timely response is provided and any JCT due paid, where necessary designating a tax agent in Japan. Filing even a late JCT return in advance of a tax audit may reduce penalties.

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