

# 2024 Tax Reform Proposals: Introduction of consumption tax remittance obligation for B2C-type digital service platforms

December 2023

## In brief

On 14 December 2023, the ruling parties in Japan published their 2024 Tax Reform Proposals (“Proposals”).

The Proposals include some significant changes in the method to impose Japanese consumption tax on inbound cross-border digital service provided to consumers in Japan through certain platforms. Under the proposed rules, platform operators will be liable to pay consumption tax on behalf of foreign service providers. In addition, the proposal also includes changes in the tax exemption rules.

The government would like to introduce the new rules as soon as possible in order to reduce unreported consumption tax from foreign providers of digital services, to ensure a level playing field with domestic providers of digital services, and to align with global tax trends in this area. Having said that, the burden on platform operators to establish systems that can collect and remit consumption tax is significant, so the Proposals have suggested that the new rules would come into force on 1 April 2025.

It is expected that most of the items contained in the Proposals will be passed into law in March 2024. However, it would take a little longer for all the details of the new rules to become clear, as details may be stipulated in Cabinet Orders and/or Ministerial Ordinance (“Regulations”) to be enacted at a later stage.

This newsletter provides an overview of the major revisions in the consumption tax rules contained in the Proposals, which would be relevant to both foreign digital service providers and platform operators. We have also included background information obtained from a report published by the Ministry of Finance in November 2023 (“MOF Report”).

## In detail

### 1. Introduction of the platform-level taxation on B2C-type digital services

A summary of the key points from the Proposals is as follows.

B2C-type digital services provided by a foreign enterprise via a digital platform, for which the consideration is received via a qualified platform operator, shall be deemed to have been provided by that qualified platform operator.

The Commissioner of the National Tax Agency shall designate a platform operator as a qualified platform operator if the total amount of the above-mentioned consideration exceeds JPY 5 billion in a tax period of such platform operator.

A platform operator who meets the above requirements must notify the Commissioner by the due date for filing the consumption tax return.

When a qualified platform operator has been designated, the Commissioner shall immediately publish on the Internet the name of the digital platform and other information concerning that qualified platform operator. In addition, the designated qualified platform operator shall notify foreign providers to that effect.

## **Observations**

### **(1) Scope of platform operators**

The MOF Report suggested that it would be necessary to clearly define which platform operators would be subject to the proposed rules and it would be important to consider the balance between tax compliance, administrative capabilities of platform operators, and fairness among industry players. The MOF Report recommended that the total sales by all foreign providers of digital services through a particular platform into Japan could be used as an indicator to define the scope. Platform operators would be required to notify the Japanese tax authorities when they reached the specified sales threshold, which would trigger the relevant consumption tax obligations. Subsequently the tax authorities would make a list of such platform operators available to the public. The designation would remain for a certain period of time, to remove volatility for platform operators being in or out of scope. The proposed rules would apply to both foreign and domestic platform operators. The Proposals provide the threshold of JPY5 billion, however further details on scope will likely be provided in Regulations.

The MOF Report as well as the Proposals did not address in detail more complex scope issues, such as differentiating between platform operators and other kinds of intermediaries, e.g., payment processors. However, it suggests that platform operators subject to the proposed rules should be those that have the authority to charge fees and receive cash from customers.

### **(2) Scope of suppliers and covered transactions**

The MOF Report recommended that platform operators would only be required to remit consumption tax on sales of foreign providers of B2C-type digital services, given that the Japanese tax authorities have other ways to identify and ensure appropriate consumption tax reporting by domestic service providers. However, this will put the obligation on platform operators to distinguish between foreign and domestic service providers.

At the same time the MOF Report recommended that all inbound B2C-type digital services through a platform should be covered, following the existing Consumption Tax Law, which removes the obligation on platform operators to distinguish between different kinds of digital services.

Both of these recommendations are contained in the Proposals.

### **(3) Taxation method**

The MOF Report recognises that the imposition of a liability to collect and remit indirect taxes for digital services on platform operators is common in many jurisdictions. However, there are various ways in which this liability has been implemented. For example, in some jurisdictions, the platform operator recognises purchases from service providers while in others it does not. The MOF Report considered that whichever approach makes the system simpler and less administratively burdensome should be adopted in Japan.

It is likely that there will be no provision to deem the purchase of services as having been made by a qualified platform operator, although the Proposals make no specific reference to this point.

## **2. Revisions of tax-exempt enterprise rules**

The Proposals contain important amendments to the tax-exempt enterprise rules, which were originally established to ease the practical burden on small-sized enterprises, but were often criticised as lacking in fairness.

The MOF Report suggested reviewing the criteria that are used to determine eligibility for exemption from consumption tax reporting and remittance obligations. To clarify, under the Consumption Tax Law, a company's consumption tax filing and remittance obligation is determined, in general, based on whether the company's taxable sales in the base period (two years prior to the current year) or the specified period (the first half of the previous year) were more than JPY 10 million. In addition, there is a second threshold for the specified period that looks at the total amount of salaries paid to Japanese residents as well as taxable sales.

If the platform-level taxation regime is implemented as the Proposals suggest, and if a foreign service provider sells B2C-type digital services to customers in Japan only through platform operators subject to those proposed rules, that foreign service provider will have no obligations related to Japanese consumption tax (i.e. only the qualified platform operators will be required to report and remit consumption tax on the sales of the foreign service provider). Moreover, consumption tax would be reported and remitted by the platform operator on all the sales of the foreign service provider, regardless of whether those sales are more than JPY 10 million or not.

On the other hand, if the foreign service provider sells B2C-type digital services to customers in Japan through any other route (e.g. direct sale to customers), whether or not the foreign service provider is eligible for consumption tax exemption status would still need to be considered based on the criteria described above. However, for foreign service providers not having any local employees, the second threshold in terms of salaries is practically meaningless. Following a suggestion by the MOF Report, the Proposals provides that the salary-based criteria will not apply to foreign enterprises.

There are additional rules to determine the tax-exempt status for newly-established corporations which do not have a base period. Under the current rules, the tax-exempt status shall not be granted for such newly-established entities, regardless of being established in Japan or outside Japan, if the amount of statutory capital at the beginning of the current business year is JPY 10 million or more. According to the Proposals, for a foreign entity, the capital-based threshold will be applied at the time when it commences a business in Japan.

The Proposals also include an amendment to strengthen the anti-avoidance rules for newly-established corporations. Under the current law, corporations established by another corporation with domestic taxable turnover in excess of JPY 500 million, even if the statutory capital is less than JPY 10 million, are not granted tax-exempt status for tax periods for which the base period does not exist. The Proposals propose to extend the scope of this anti-avoidance rule to cases where a corporation with global sales of more than JPY 5 billion directly or indirectly establishes a corporation with a statutory capital of less than JPY 10 million.

According to the Proposals, these amendments related to the tax-exempt enterprise rules will come into effect for tax periods commencing on or after 1 October 2024.

### **3. Restriction on the application of the simplified input tax credit method for foreign enterprises**

It is also proposed that for tax periods commencing on or after 1 October 2024, the simplified input tax credit method, by which allows the input tax credit to be calculated by applying a certain flat rate to taxable sales, does not apply to foreign enterprises having no PE for corporate income tax or personal income tax purposes on the first day of the tax period.

The Proposals imply that further amendments may be introduced.

## The takeaway

If the Consumption Tax Law is revised in line with the Proposals, platform operators will need to start work on systems that can properly:

1. Identify foreign service providers engaged in B2C-type sales of digital services to Japanese residents
2. Track the amount of B2C-type sales of those foreign service providers through their platforms
3. Submit the required notifications to the Japanese tax authorities if the threshold is exceeded
4. Collect the correct amount of consumption tax from the foreign service providers
5. Report and remit that consumption tax to the Japanese tax authorities

For foreign providers of digital services, assuming the Proposals are implemented, Japanese consumption tax will be deducted from payments made for services provided via qualified platform operators. On the other hand, for digital services provided through platforms or other channels that are not subject to the Proposals, or for digital services sold directly by the foreign service providers themselves, the foreign service providers will need to determine their own consumption tax compliance obligations, including the impact of any new tax exemption rules, and take the necessary actions to report and remit any consumption tax owing.

Finally, platform operators and foreign service providers will both need to monitor developments in this area carefully, particularly as a number of points are left for further discussion. For example, how to distinguish platform operators from other intermediaries, the treatment of multiple platform operators in a transaction, and the relationship with Japan's new qualified invoicing system (in place from 1 October 2023); to highlight a few.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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