APOutsourcing

APO Newsletter

December 2024 Vol.58

Consumption Tax for Foreign Entities

To take effect from a taxable period beginning October 1, 2024

This article outlines the consumption tax (VAT equivalent) issues that foreign entities are facing for cross-border transactions with Japan. Cross-border transactions can be conducted by creating a Permanent Establishment (PE), such as branches and local entities, or without. It is quite difficult and complex to determine which transactions would create a PE, and we do not mention it in this article.

Generally speaking, cross-border transactions without a PE are not subject to corporate income tax under Japanese tax laws. However, even if there is no PE in Japan, consumption tax will be levied when foreign entities conduct a domestic sales transaction. A domestic transaction is a transaction in which assets located in Japan are transferred or services are provided in Japan. For example, a transaction where a foreign corporation (“FC”) sells goods to Japanese Corporation in Japan is a domestic transaction.

If the FC, which amount of share capital (capital injection not classified as capital surplus/reserve) as of the beginning of its fiscal year is JPY 10 million or more, sells goods in Japan for the first time after October 1, 2024, it becomes subject to consumption tax filing in Japan. In other words, if the FC’s share capital is less than JPY10 million (“FC-Small”), it is exempted from consumption tax filing. However, there are so many exceptions to that exemption rule.

1. FC-Small under influential entities

If FC-Small is under the influence of other entities, such as 50% or more owned by others directly or indirectly, it would be subject to consumption tax filing, when the amount of the influential entities’ sales transaction satisfies either of following:

① The amount of domestic taxable sales was more than JPY 500 million during the corresponding “base period”, which is defined as the fiscal year two fiscal years prior to the fiscal year.

② The amount of all revenue, domestic/foreign sales and other income, was more than JPY5 billion during the corresponding base period.

2. FC-Small under no influential entities

① The first fiscal year
As there is no “base period” for FC-Small, it is exempt from consumption tax filing unless it intentionally elects the consumption tax taxable status.
② Second fiscal year
There is still no “base period” for FC-Small, but it becomes subject to consumption tax filing, if the taxable sales during the period of the first half of the previous fiscal year (“specified period”) exceed JPY 10 million.
③ Third fiscal year or after
As there is a “base period” for FC-Small, it is subject to consumption tax filing if its domestic sales in the “base period” were more than JPY10 million. Even if the domestic sales in the “base period” were JPY10 million or less, FC-Small becomes subject to consumption tax filing, if the taxable sales during the “specified period” exceeded JPY 10 million.
As mentioned above, the consumption tax rules are very complex, particularly for foreign entities. Making a voluntary election as a consumption taxable status from the first year sometimes would work more beneficially. Please consult with our tax expert in any case.

AP Outsourcing Ltd. | APO-Tax Corporation
1-18 Ageba-cho, Shinjuku-ku, Tokyo 162-0824, Japan
https://apo-tax.jp/ | https://www.apoutsourcing.jp/en/
Tel:+81-3-5228-1820 | e-mail: toiawase@apol.jp