Japan

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Japan Introduced Full VAT Liability Regime to Digital Platforms

In this article, the author discusses a new Japanese tax reform named the "Platform Taxation" regime, which is, in effect, the long-awaited Japanese adoption of the full VAT/GST liability regime that is recommended in the OECD's 2019 report.

1. Introduction

The Japanese Cabinet submitted the 2024 tax reform package bill to the National Diet of Japan on 2 February 2024. The bill passed the parliament without changes on 28 March 2024 and was promulgated on 30 March 2024.[1] It will apply from 1 April 2025. The bill includes an amendment to the Consumption Tax[2] Act[3] to insert a new article 15-2 to implement what they call a "Platform Taxation" regime. Under this Platform Taxation regime, the platform operators, rather than the suppliers, are solely and fully liable for consumption tax (Japanese VAT) due on certain types of supplies made through digital platforms. Accordingly, the Platform Taxation regime will be the Japanese version of the full VAT/GST liability regime recommended by the OECD in its 2019 report "The Role of Digital Platforms in the Collection of VAT/GST on Online Sales" (Report on Platforms).[4]

In this article the author analyses the Japanese Platform Taxation regime. Section 2. provides the tax policy background of the Platform Taxation regime to be finally introduced in Japan five years after the OECD hinted at the full VAT/GST liability regime. Section 3. outlines the Platform Taxation regime in Japan and describes its main features. Conclusions are offered in Section 4.

2. Background

2.1. 2015 amendment to the place-of-supply rule for cross-border electronic services

The Japanese consumption tax is imposed on transactions whose place of supply is located in Japan. The Consumption Tax Act of Japan establishes different place-of-supply rules depending on the category of supply. For digital content and services provided from abroad through the Internet (such as the distribution of e-books, music and advertising), the place of supply used to be the place of the supplier's office. As a result, domestic supplies were subject to Japanese consumption tax while supplies made by foreign suppliers were not, even if they provided the same services to Japanese consumers.

Japan amended its place-of-supply rules in 2015.[5] After this amendment, the Consumption Tax Act defined "electronic services" to generally include supplies of digital content and services, and the place of supply of electronic services became the location of the person receiving the services. Furthermore, the reverse charge method would apply to business-to-business electronic services.[6] For business-to-consumer electronic services, a specific registration procedure was introduced, even though Japan did not have any formal tax invoice system with business registration procedures at that time. Any foreign suppliers who supplied business-to-consumer electronic services exceeding the exemption threshold of JPY 10 million (approximately USD 66,000) were requested to register specifically as a "registered foreign business" in Japan. In short, the 2015 amendment ensured that electronic services consumed in Japan would always be subject to Japanese consumption tax, regardless of the location of the supplier. Therefore, in theory, the Consumption Tax Act began to ensure a level playing field between domestic and foreign suppliers.

Japan was apparently satisfied with the 2015 amendment and did not prioritize the issue of electronic services for many years afterwards. Even when the OECD released the Report on Platforms in 2019, Japan did not seem interested and did not move to amend its laws for whatever reasons. Perhaps Japan was too busy with other things at the time to consider the report. From the late 2010s to the early 2020s, the Japanese consumption tax experienced a turning point in other significant issues, such as the introduction of the multiple tax rate structure, the transition from a credit system without invoices (which was fairly unique to Japan) to a typical credit system with invoices.[7] After these significant changes were made, Japan has

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1. JP: National Diet of Japan – Tax Reform, 2024, available at https://kanpou.npb.go.jp/20240330/20240330t00028/20240330t000280073f.html (accessed 5 Apr. 2024).
2. The Japanese consumption tax is a VAT type of tax.
3. JP: Consumption Tax Act [hereinafter Consumption Tax Act], 108, 1988.
4. OECD, *The Role of Digital Platforms in the Collection of VAT/GST on Online Sales*, Ch. 2. (June 2019) [hereinafter Report on Platforms], available at https://www.oecd-ilibrary.org/docserver/e0e2dd2d-en.pdf?expires=1708382953&id=id&accname=ocid177428&checksum=C2B1878233AA7AD2940AFE7EFDF0F76A (accessed 4 Apr. 2024).
5. For the 2015 amendment, *see* generally, Y. Nishida, *Japan Consumption Tax on Cross-Border Supplies of Services*, 26 Intl. VAT Monitor 4 (2015), Journal Articles & Opinion Pieces IBFD (accessed 5 Apr. 2024).
6. For more information about the Japanese consumption tax treatment of electronic services, *see* the website of National Tax Agency of Japan, available at https://www.nta.go.jp/english/taxes/consumption_tax/04.htm (accessed 4 Apr. 2024).
7. *See* generally, Y. Masui, *Japan's Consumption Tax Experiment: Operating a VAT Without Tax Invoice*, in *Virtues and Fallacies of VAT: An Evalu-*

finally reengaged with the issue of cross-border electronic services.

2.2. Need to address non-compliant foreign suppliers

Returning to the issue of cross-border electronic services, Japan has become aware that the 2015 amendments raised an enforceability issue. This was particularly highlighted in an expert report posted by the Japanese Ministry of Finance in November 2023 (the Expert Report).[8]

According to the Expert Report, the Japanese consumption tax on cross-border business-to-consumer electronic services was initially not much of an issue. Indeed, those transactions are not subject to the reverse charge method, and the foreign businesses themselves are liable for the Japanese consumption tax. At the time, electronic services were dominated by the e-book, music, video and other content distribution business. Specifically, the typical business model was the so-called Buy-Sell type transaction, in which a major distribution platform operator purchased content from a content developer and distributed it to Japanese consumers. As a result, foreign suppliers typically consisted only of a limited number of major platform operators, who were liable for Japanese consumption tax with respect to cross-border electronic services. These tax liabilities were relatively enforceable and, thus, did not present a significant problem.[9]

However, the situation has changed rapidly in recent years. The Expert Report noted that the mobile app market for consumers, especially online games, is expanding sharply.[10] Furthermore, using intermediary services for contracts, deliveries and payments through digital platforms has made it easier for even smaller overseas digital content suppliers to enter the Japanese market. Nowadays, mobile apps are typically sold through the so-called sales agent scheme, with digital platforms acting as mere intermediaries. In these cases, it is the respective foreign businesses that supply digital content to the Japanese consumer. Accordingly, each supplier behind the platform is liable for Japanese consumption tax. However, these suppliers are usually small foreign businesses with no enforceable presence in Japan.[11] Japanese consumption tax is not always fully enforced against such foreign suppliers, as the tax audit and collection mechanisms are ineffective against them.[12]

Consequently, the Expert Report noted that this would result in virtually unequal tax treatment between domestic and foreign businesses, and seriously undermine the business environment with regards to neutrality between domestic and foreign suppliers.[13] In addition, the Expert Report pointed out that many other jurisdictions had already addressed this issue by introducing the full VAT/GST liability regime (or what the report called the Platform Taxation regime), in which the platform operator is liable for VAT on the supplies made through the platform, utilizing the role of the platform in collecting transaction information and the financial flow.[14] In summary, the Expert Report suggested that it was time for Japan to consider this Platform Taxation regime, referring to other jurisdictions as precedents.

Ultimately, the issue was followed up politically, resulting in the proposal for a Platform Taxation regime whereby intermediate digital platform operators, rather than overseas suppliers, would become liable for Japanese consumption tax on cross-border business-to-consumer electronic services. Japan's governing coalition released an outline of its 2024 tax reform package on 14 December 2023, making the same argument as the Expert Report. In their view, for example, the new regime aims to improve Japanese consumption tax enforcement regarding cross-border electronic services supplied to Japanese consumers, ensuring a level playing field between domestic and foreign suppliers.[15] According to government estimates, this new regime will eliminate Japanese consumption tax leakage of JPY 23.1 billion per year.[16]

3. Overview of the Japanese Platform Taxation Regime

3.1. Scope of the regime

The Platform Taxation regime is a mechanism for enhanced consumption tax enforcement whereby the platform operator, rather than the foreign supplier, is solely and fully liable for Japanese consumption tax on cross-border electronic services supplied through a platform to final consumers. Paragraph 1 of article 15-2 of the Consumption Tax Act establishes the scope of this regime. There are four requirements. If all of them are met, a platform operator will be deemed to be a supplier of the electronic services, and will be solely and fully liable for Japanese consumption tax on those electronic services.

Firstly, foreign businesses must supply electronic services to Japanese consumers (the definition of "electronic services" remains unchanged from the 2015 amendments). Importantly, this requirement takes domestic businesses out of the scope of this regime. Accordingly, if domestic businesses supply electronic services to Japanese consumers through digital platforms, these domestic businesses,

ation after 50 Years, pp. 515-528 (R.F. van Brederode ed., Kluwer Law International 2021).

8. The ministry had invited leading tax scholars and practitioners to organize a study group on consumption taxation on cross-border digitalized transactions from April to June 2023. The outcome is the Study Group on Consumption Taxation on Cross Border Digital Services, *Kokkyo wo koeta digital service ni taisuru syouhizei no kazei no arikata ni tsuite* [*Report on the Consumption Taxation on Cross Border Digital Services*] (November 2023) [hereinafter Expert Report], available at https://www.mof.go.jp/tax_policy/summary/consumption/PF_honnbunn.pdf (accessed 4 Apr. 2024).
9. Id., at p. 4.
10. Id., at p. 3.
11. Id., at p. 4.
12. Id., at p. 5.
13. Id.
14. Additionally, the Expert Report contains a summary of the full VAT/GST liability regime in the selected countries; id., at pp. 6-10.
15. Japan's governing coalition, *Reiwa 6 nendo zeisei kaisei taikou* [*Outline of the 2024 tax reform package*], p. 17 (Dec. 2023), available at https://storage2.jimin.jp/pdf/news/policy/207233_1.pdf (accessed 8 Apr. 2024).
16. Japanese Ministry of Finance, *Estimated increase or decrease in revenue due to tax reform (domestic tax) in FY2020* (2024), available at https://www.mof.go.jp/tax_policy/tax_reform/outline/fy2024/06taikou_08.htm#san01 (accessed 4 Apr. 2024).

as suppliers, will remain liable for consumption tax by themselves (*see* section 3.2.).

Secondly, foreign businesses must provide their electronic services through a digital platform. The term "digital platform" is defined in the Consumption Tax Act,[17] but considering the fourth requirement below, this definition may be less practically important.

Thirdly, foreign businesses must receive consideration for their electronic services *through* the digital platform operator. This requirement appropriately excludes cases where the platform operators would have difficulty in passing on the consumption tax burden effectively to the supplier because the platform is not an intermediary in the payment flow from the consumer to the supplier. Accordingly, the Platform Taxation regime does not apply when the supplier receives consideration directly from the consumer rather than through a digital platform operator. In other words, even if the transactions are carried out through the platform, they would not fall within the scope if the platform only showcases the content or services of those transactions and has no authority to be engaged in billing or settlement processes.[18]

Lastly, the scope is limited to cases where the operator of a digital platform is the "specified digital platform operator" designated by the Japanese tax authority under the process described in section 3.4. Thus, in practice, suppliers do not need to consider whether the platform they use falls within the definition of "digital platform" on a case-by-case basis. Instead, they only need to confirm whether or not the platform operator is designated. As such, this requirement would ensure the certainty of this regime.[19]

3.2. Not applicable when the suppliers are domestic businesses

As mentioned above, this regime applies to the supply of cross-border electronic services by foreign businesses[20] to Japanese consumers. In contrast, it does not apply to the supply of domestic electronic services by domestic businesses to Japanese consumers. The Expert Report points out that, when looking at full VAT/GST regimes worldwide, some jurisdictions apply their regime only when the suppliers are foreign businesses (for example, some Asian countries and Australia), and others may apply their regime even when the suppliers are domestic businesses (for example, European countries).[21] Japan has chosen the former. In essence, the Japanese Platform Taxation regime is designed primarily to target non-compliant foreign suppliers and has nothing to do with domestic suppliers.

According to the Expert Report, this asymmetric treatment between domestic and foreign suppliers is justifiable for four reasons.[22] Firstly, there is an urgent need to develop effective measures to address non-compliant foreign businesses outside of the enforcement jurisdiction and to provide a level playing field. Secondly, domestic businesses are more likely to comply with tax liability due to income tax filings, tax audits and other tax administrative pressures. Thirdly, based on hearings from platform operators, they are already keeping track of the suppliers' locations. Lastly, there is concern that if domestic suppliers were subject to this regime, they would suffer from the unnecessary compliance burden of distinguishing sales based on whether they are made through digital platforms. For these reasons, the Expert Report recommended limiting the scope to cross-border transactions performed by foreign suppliers to Japanese consumers. Subsequently, the tax reform follows this recommendation.

3.3. Even small businesses to be captured

The Platform Taxation regime applies regardless of the size of sales of foreign suppliers behind the platform, even to cross-border electronic services supplied by businesses that are so small that they could qualify for the small business exception. For example, a foreign app developer sells its game apps through an online app store operated by a specified digital platform operator but receives only JPY 100,000 of consideration in each taxable period. In this case, no Japanese consumption tax was previously imposed on such sales since the developer would meet the small business exception threshold. Now, given that the Platform Taxation regime applies, the sales will be subject to the Japanese consumption tax at the hands of the specified digital platform operator. The specified digital platform operator would only hand over the remaining amount to the foreign app developer after deducting Japanese consumption tax from the consideration for the game apps. Ultimately, the economic result would be the same as if the foreign app developer had paid the Japanese consumption tax.[23]

17. The second bracket of para. 1 of art. 15-2 of the Consumption Tax Act sets forth a lengthy definition of a digital platform as "a place constructed by computer data processing with the intention of being used by an unspecified and large number of people, where information regarding the supply of electronic services is regularly displayed to an unspecified and large number of people through an electric communication network in order for a person other than the person operating such place to supply such electronic services through such place." [Author's translation.]
18. Expert Report, *supra* n. 8, at p. 13. One Japanese tax scholar pointed out that it is necessary to make sure that the consumer's relationship with the digital platform is sufficiently close to justify the tax liability of the platform (*see* K. Fuchi, *Digital Platforms and Their Role in Collection of VAT/GST and RST*, 64 Japanese Yearbook of International Law, pp. 173-201 (2021)), while it is unclear whether this point was taken into account in designing the Platform Taxation regime.
19. Expert Report, *supra* n. 8, at p. 11.
20. In practice, the National Tax Agency suggests that platform operators may determine whether a supplier is a foreign business by the head office location provided by the supplier in the agreement for using the platform, according to Japanese National Tax Agency, Consumption Tax Act Basic Notification 5-8-8, available at https://www.nta.go.jp/law/tsutatsu/kihon/shohi/kaisei/240401/pdf/01.pdf (accessed 4 Apr. 2024).
21. Expert Report, *supra* n. 8, at p. 9. Taking the so-called "deemed supplier" rule in the European Union as an example, the rule may apply when the supply of goods in consignments of an intrinsic value not exceeding EUR 150 supplied to a customer in the European Union and imported in the European Union, irrespective of whether the underlying supplier is established in the European Union or outside the European Union.
22. Expert Report, *supra* n. 8, at p. 12.
23. However, the foreign app developer in this example would be denied the right for an input tax credit against the Japanese consumption tax under the small business exception while this developer effectively pays the Japanese consumption tax.

Consequently, the Platform Taxation regime may serve as a Japanese consumption tax hike on foreign small businesses. Nevertheless, the Expert Report concluded that this result is acceptable, considering that the objective and purpose of the small business exception is to save wasting tax administration resources to collect a tiny amount of taxes from small businesses with low compliance capacity.[24] The Expert Report also implied that the platform operators should not bear the burden of verifying the size of each supplier's sales.[25]

3.4. Designation process regarding a "specified digital platform operator" and other procedural rules

As discussed above, the Platform Taxation regime applies only in cases where a "specified digital platform operator" is involved. Paragraph 2 of article 15-2 of the Consumption Tax Act sets forth that the Commissioner of the National Tax Agency will designate an operator of a digital platform as a specified digital platform operator, provided that the total amount of consideration[26] paid for electronic services supplied by foreign businesses to Japanese consumers through that digital platform and received through the operator in its taxable period[27] exceeds JPY 5 billion (approximately USD 33 million). Paragraph 3 of article 15-2 of the Consumption Tax Act requires platform operators satisfying this threshold to notify the tax authorities. Nevertheless, even if a platform operator fails to notify the tax authorities, the Commissioner can still designate the platform operator as a specified digital platform operator as long as the platform operator meets the threshold.

The reasoning behind the figure of JPY 5 billion is unclear. Given that the regime aims to strengthen the enforcement of consumption tax, it should be designed to apply to a few major digital platforms with reliable tax compliance and administrative capabilities. However, if only a few platforms are covered, suppliers could easily migrate to platforms that are not covered. The Expert Report called for a balance between these two perspectives,[28] and the government appears to have determined that JPY 5 billion is appropriate.

For the sake of tax certainty,[29] paragraph 4 of article 15-2 of the Consumption Tax Act requires the Commissioner of the National Tax Agency to publish the name of each specified digital platform operator on the National Tax Agency's website. Paragraph 6 of article 15-2 of the Consumption Tax Act would ensure that any subsequent changes to the published information would also be made public on the National Tax Agency's website. Moreover, paragraph 5 of article 15-2 of the Consumption Tax Act requires specified digital platform operators to notify foreign suppliers that they would be affected by the Platform Taxation regime.

Once designated as a specified digital platform operator, there are only two ways to lift the designation. One possibility is provided in paragraphs 7-9 of article 15-2 of the Consumption Tax Act, which would allow a specified digital platform operator to apply for lifting the designation if, in principle, the specified digital platform operator goes below the JPY 5 billion threshold for three years in a row. The other possibility is provided in paragraphs 10-11 of article 15-2 of the Consumption Tax Act, whereby the Commissioner may discretionarily lift the designation, taking into account any circumstances where the specified digital platform operator is no longer capable of collecting and paying consumption tax (e.g. the abolition of its digital platform business, non-filing of its tax return without any valid reason or severe tax delinquency). As the Expert Report appropriately noted, limiting the possibility of lifting the designation would stabilize the Platform Taxation regime.[30] Once the designation is lifted, paragraph 12 of article 15-2 of the Consumption Tax Act requires the Commissioner to publish it on the National Tax Agency's website. Paragraph 13 of article 15-2 of the Consumption Tax Act also requires the platform operator to notify the foreign supplier.

Finally, there are some miscellaneous rules. Paragraph 14 of article 15-2 of the Consumption Tax Act clarifies that specified digital platform operators are not eligible to apply for the small business exception. Paragraph 15 of article 15-2 of the Consumption Tax Act requires the specified platform operators to attach an additional document regarding electronic services governed by the Platform Taxation regime to their tax returns, as determined by the Ministry of Finance.[31] The National Tax Agency has released Form 27 - (4)[32] for this additional document, which requires platform operators to list: (i) the total amount of consideration for electronic services subject to Platform Taxation regime; and (ii) the name, location and amount of consideration with respect to the top 50 foreign suppliers in terms of the amount of consideration subject to platform taxation. Paragraph 16 of article 15-2 of the Consumption Tax Act gives the Cabinet the authority to enact regulations that prescribe detailed operating rules.[33]

24. Expert Report, *supra* n. 8, at p. 12.
25. Id., at p. 13.
26. The first bracket of para. 2 of art. 15-2 Consumption Tax Act clarifies that this is the amount of consideration on a tax-inclusive price basis.
27. If the taxable period is less than 12 months, the amount equal to the monthly average multiplied by 12 shall be used instead (*see* the second bracket of para. 2 of art. 15-2 Consumption Tax Act).
28. Expert Report, *supra* n. 8, at p. 11.
29. Id., at p. 12.
30. Id.
31. The Ministry of Finance amended the Regulation for the Enforcement of the Consumption Tax Act (Ministry of Finance Order 53 of 1988) as of 30 Mar. 2024, introducing art. 11-5 that specifies reporting items. *See* Japanese Ministry of Finance, Amendment of the Regulation for the Enforcement of the Consumption Tax Act, 30 Mar. 2024, available at https://kanpou.npb.go.jp/20240330/20240330t00028/20240330t000280283f.html (accessed 4 Apr. 2024).
32. The form is available at https://www.nta.go.jp/law/tsutatsu/kihon/shohi/kaisei/240401/pdf/02.pdf (only available in Japanese) (accessed 4 Apr. 2024).
33. The Cabinet amended the Enforcement Order to the Consumption Tax Act (Cabinet Order 360 of 1988) as of 30 Mar. 2024, introducing art. 29 that provides the operating rules. The amendment is available at Japanese Cabinet, Amendment of the Enforcement Order to the Consumption Tax Act, 30 Mar. 2024, available at https://kanpou.npb.go.jp/20240330/20240330t00028/20240330t000280160f.html (accessed 4 Apr. 2024).

3.5. Non-recognition of transactions between suppliers and platforms

Looking at full VAT/GST regimes worldwide, some jurisdictions recognize deemed transactions between supplies and platform operators (e.g. European countries) and others do not (e.g. Australia). Japan has chosen the latter option. The Expert Report explains the reasons for this as follows.[34] Assuming that the platform operator must recognize deemed purchases from foreign suppliers, the reverse charge method would apply to the deemed transaction if the platform operator is a domestic business. If the platform operator is a foreign business, the place of supply for the deemed transaction would be outside Japan. In any case, the tax amount imposed on the platform operator would be the same as if the purchase were not recognized. If so, the non-recognition approach makes more sense because it is simpler and requires fewer compliance costs.

3.6. Effective date

Paragraph 6 of article 13 in the supplementary provisions of the Consumption Tax Act specifies that the Platform Taxation regime will apply to electronic services supplied in Japan on or after 1 April 2025. This effectively provided a one-year preparation period. This preparation period will allow the initial designation process regarding specified digital platform operators to take place during 2024. In particular, paragraph 7 of article 13 in the supplementary provisions of the Consumption Tax Act requires any platform operators that satisfy the JPY 5 billion threshold to notify the tax authorities by 30 September 2024. Paragraph 8 of article 13 in the supplementary provisions of the Consumption Tax Act clarifies that if the designation is made by 31 December 2024, it will take effect upon the regime's launch on 1 April 2025.

34. Expert Report, *supra* n. 8, at p. 14.

4. Conclusion

Since 2015 all cross-border electronic services supplied to Japanese consumers are subject to tax in Japan. Foreign suppliers of cross-border electronic services are currently liable for Japanese consumption tax, but this is not always enforced. Although the OECD's Report on Platforms indicated a full VAT/GST liability regime in 2019, proposals to address the enforceability issue did not gain momentum in Japan until 2023. With the adoption of the Platform Taxation regime introduced by the 2024 tax reform package, which is the Japanese version of the full VAT/GST liability regime, Japan has finally caught up with this global trend.

The Platform Taxation regime has some key design features, such as only covering electronic services supplied by foreign businesses, applying even if foreign suppliers behind the platform are small businesses and not recognizing the deemed purchase of the digital platforms from suppliers. In addition, to ensure certainty and smooth implementation, Japan's Platform Taxation regime will establish a designation procedure for specific platform operators and provide a preparation period. It remains to be seen whether the Platform Taxation regime will work successfully in Japan.