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CHAPTER VIII

CONSUMPTION TAX

8/1 General

Consumption tax is an indirect tax fairly and widely imposed on general consumption. In domestic transactions, taxpayers are business enterprises offering asset transfers, loans and services for consumption and these who receive foreign goods from bonded areas. Consumption tax is added on (shifted) to the price of goods and services offered by enterprises and ultimately borne by consumers. Since this tax is assessed on transactions by enterprises at each manufacturing, wholesale, and retail stage, it contains a scheme for avoiding tax accumulation by way of deducting taxes on purchases, thus making it neutral to industry and the economy in general.

The tax period for the calculation of tax payable on domestic transactions is for individual proprietors, the calendar year which overlaps with the tax period for their income tax returns, and for corporations, the accounting period which overlaps with their corporate tax returns. Calculation of the deductible consumption tax on purchases is based on both book entries and invoices or delivery statements currently in use instead of invoices. For small and medium-sized business enterprises, a simplified taxation system is utilised to alleviate the administrative burden on tax payers, thereby enabling calculation of the tax amount from the sales amount. The rate of tax is a flat 4% (together with the 1% local consumption tax, a local tax, the tax rate reaches 5%). Various amendments were rendered in 1991 notably on the scope of exemption and on the simplified taxation system, which was followed by amendments in 1997 for the introduction of the current flat rate of 4% and abolition of the special deduction system for small and medium-sized enterprises. The reduction of the special measure for small & medium-size enterprises introduced in the FY 2003 reform will be applied from FY2004.

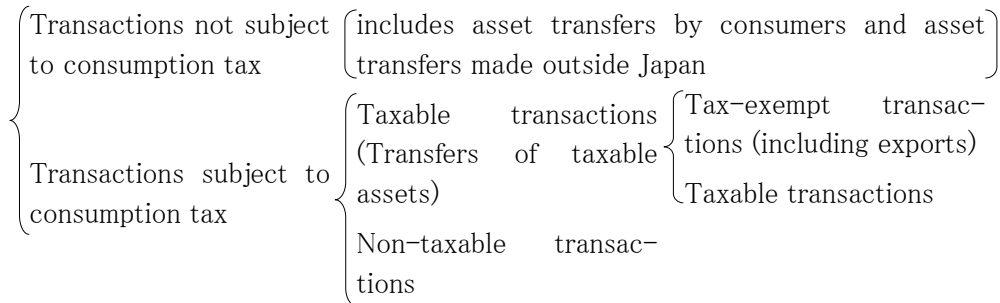
8/2 Taxable Items

1. General

Consumption Tax Law (hereafter called the “Law”) applies to asset transfers by enterprises in Japan and foreign goods received from bonded areas.

“Asset transfers” mean sales and leasing of assets and provision of services effected for compensation as a business activity. For such asset transfers, taxable items are those effected by enterprises in Japan.

Even among asset transfers by enterprises in Japan, there are categories not subject to taxation, the so-called nontaxable transactions. Among taxable transactions, moreover, certain items including export transactions are exempted from consumption tax.



2. Transactions subject to Consumption Tax

Transactions fall within the scope of the law if they are (1) domestic transactions, (2) a business activity, (3) effected for compensation, and (4) categorized as sales and leasing of assets or provision of services.

(1) Domestic transactions

The consumption tax is levied only on transactions made in Japan. Therefore, in cases where enterprises have transferred assets purchased in foreign countries to third parties without bringing them into Japan, such transactions are not subject to taxation.

The criteria for judging whether or not a transaction has been made in Japan are shown elsewhere in this section.

(2) Business activity

Consumption tax is levied only on transactions made as a business activity. This leaves sales of household assets by an individual entrepreneur free from taxation.

In addition, taxable asset transfers shall include the sales and leasing of assets and the provision of services effected for compensation in conjunction with business activities.

(3) Effected for compensation

Consumption tax is, in principle, levied only on transactions made for compensation. The activities shown below are regarded as asset transfers effected for compensation as a business activity.

- (a) Consumption or use, for household purposes by an individual entrepreneur, of inventory or other assets that have been used for business purposes and;
- (b) Gift assets by a corporation to its directors.

As explained above, taxable items only include transactions made for

compensation. Therefore, excluded from taxation are activities such as the use and consumption of merchandise or raw materials for purposes including advertisement, other publicity, and research and development conducted directly by the enterprise.

Insurance proceeds received, dividends received (limited to those related to capital contributions), and compensation for damages inflicted on persons or assets do not fall under compensation related to asset transfers.

The taxability of membership dues or annual fees charged by trade groups or associations shall depend on whether or not such payments clearly constitute compensation for asset transfers provided by the respective trade group or association. When such a correlation is not clear, payments shall not be taxable if the trade group or association concerned does not consistently treat such payments as compensation for asset transfers and if the enterprises that are members of the organisation do not recognise such payments as taxable purchases.

The transactions listed below are treated as transactions made for compensation.

- (a) Asset transfers made as payment in substitute;
 - (b) Asset transfers made as a substantial gift;
 - (c) Capital contribution of assets other than cash;
 - (d) Successions of loans and other monetary claims (excluding general successions); and
 - (e) Transmission of wireless communications for the purpose of direct reception by a number of unspecified persons per a law requiring the receiving persons to enter into a uniform contract for such reception and charging fees as prescribed in the contract.
- (4) Sales and leasing of assets or provision of services
- (a) Sales of assets

Sales of assets means transfers to third parties of assets without modifying their identity and without regard to the mode of these transfers. As such, they also include transfers of assets made for the fulfillment of guarantee obligations owed on behalf of third parties or the realisation of assets made per procedures for compulsory conversions. Similarly, transfers of ownership or other rights on land made per the procedures prescribed in the Land Expropriation Law or other laws with compensation for the loss of rights paid by the parties acquiring such rights are included in the sales of assets effected for compensation.

- (b) Leasing of assets

Leasing of assets includes any and all acts made for the creation of rights pertaining to assets and permitting their use by other parties.

“Creation of rights pertaining to assets” means the creation of surface rights or easements pertaining to land, granting the right of expropriation, or a licence for industrial property rights (including patent rights, utility model patents, design rights and the right of trademark) and the creation of copyrights pertaining to authors’ works.

“Any and all acts permitting the use of assets by other parties” include, for example, the following:

- ① Use or deposit of industrial property rights;
 - ② Reproduction, performance, and broadcasting of authors’ works or any other acts permitting their exploitation and;
 - ③ Provision of know-how.
- (c) Provision of services

Provision of services means the rendering of services such as civil engineering and construction work, repair, transportation, safe custody, printing, advertisement, brokerage, entertainment, technical assistance, provision of information, stage performance, and writing. It also includes services rendered by lawyers, certified public accountants, certified tax accountants, writers, athletes, movie directors, and professional *go* or *shogi* players, drawing on their professional knowledge or skills.

3. Criteria for Classification of Domestic and Overseas Transactions

a. Sales or leasing of assets

The classification of domestic and overseas transactions is based on whether the assets sold or leased are physically located in Japan at the time of the transaction.

As for the following asset categories, however, classification is based on whether the relevant entities or places are located in Japan at the time of sale or lease.

(1) Ships (limited to registered vessels)

Classification depends on the location of the official agency which registers the ship. In cases where non-Japanese ships are leased by residents to other residents and where Japanese ships are leased by nonresidents, the residence, main office, or principal place of business of the lessor determines classification.

(2) Ships other than those covered by (1) above

Classification depends on the location of the office, place of business, or similar facility of the seller or the lessor where the business of the sale or leasing is conducted.

(3) Aircraft

VIII Consumption Tax

Classification depends on the location of the official agency which registers the aircraft. In cases where the aircraft is not registered, the office of the seller or the lessor where the business of sale or leasing is conducted determines classification.

- (4) Mining rights or mine lease rights, stone-quarrying rights, and other rights for the quarrying or excavation of earth and rocks, mining concession areas, mine lease areas, or stone quarrying areas covered by quarrying or excavation rights determine the classification.
- (5) Patent rights, utility model rights, design rights, rights of trademark, rights of circuit layings and use rights (including rights for exploitation); the location of the official agency that registers these rights determines classification. In cases where there are registrations of the same right in two or more countries, the place of the seller's residence determines classification.
- (6) Copyrights (including publishing rights, quasi-copyrights, and other rights of a similar nature) or production formulas using special technology or others of similar nature (know-how); the place of abode of the seller or lessor.
- (7) Goodwill, fishing rights, or right of entry into a fishing ground; the place of abode of business entities doing business in connection with those rights.
- (8) Assets shown in (a) through (f) below; the place shown correspondingly for each item.
 - (a) Securities (securities provided for in Clause 1, Article 2 of the Securities Transaction Law (excluding shares of golf club memberships)); the place where the securities are situated.
 - (b) Registered national government bonds and other bonds (national government bonds, local government bonds, and corporate bonds (including bonds issued under special laws by juridical persons other than corporations) registered under the provision of the Law Concerning National Government Bonds and the Corporate Bond Registration Law and foreign bonds of a similar nature) and foreign bonds of a similar nature); the place where the official agency that registers these bonds is situated.
 - (c) Equity interest of investors in corporations; the place where the main office or the principal place of business of the corporation concerned is situated.
 - (d) Mortgage securities; the place where the mortgage securities are situated.
 - (e) Loans, deposits, accounts receivable and other monetary claims (excluding those shown in (f) below and including monetary claims pertaining to negotiable certificates of deposit and commercial papers); the

place where the office of the creditor concerned conducting the sale is situated.

- (f) Shares of golf club memberships and monetary claims pertaining to deposits with golf clubs or other sports clubs; the place where the golf club or other sports club is situated.
- (9) Assets other than those listed in (1) through (8) above without any clear indication where they are situated; the office where the entity engaging in the sale or leasing of these assets conducts such business.

b. Provision of Services

Classification of domestic and foreign transactions is based on whether or not the service in question is provided in Japan.

As for the following service categories, however, classification is based on whether or not the places shown below are situated in Japan at the time the service is provided.

- (1) Transportation of passengers or cargoes conducted within and outside Japan; the place of departure, shipment, destinations of the passengers, or cargoes.
- (2) Communications conducted within Japan and internationally; the place of dispatch or reception.
- (3) Mail services conducted within Japan and internationally, etc.; Place of forwarding or delivery.
- (4) Insurance; Place where the office of the entity (engaged in the business of insurance excluding those who act as agents in the conclusion of insurance contracts) concluding insurance contracts is situated.
- (5) Provision or design of data; the place where the office of the entity engaged in the provision or design of data conducts such business is situated.
- (6) Provision of services pertaining to research, planning, projection, consultation, supervision, or examination requiring professional knowledge in specialised fields of science and technology made in connection with the construction or production of manufacturing facilities; the place where most of the materials needed for the construction or production of the manufacturing facilities are procured.

In this context, manufacturing facilities shall mean the following items:

- (a) Buildings (including attached facilities) or structures;
- (b) Facilities for mining and manufacturing production, electric power generation and transmission, railways, roads, port facilities, and other transportation services or fishery production;
- (c) Facilities for the transformation and distribution of electrical current, the storage and supply of gas, the storage of oil, communications and broadcasting, water service for industrial use, water supply and sewerage

VIII Consumption Tax

systems, waste water disposal stations (including facilities of a similar nature), agricultural productions and forestry production and;

(d) Ships, railway vehicles and aircrafts.

(7) Provision of services other than those listed in (1) through (6) above, conducted within Japan and internationally without any clear indication as to where they have been provided; the place where the office of those entities engaged in the provision of such services is situated.

c. Financial transactions

For the lending of money with interest as compensation (including the acquisition of national government bonds and other bonds for interest as compensation and the holding for special drawing rights provided for in the Agreement of the International Monetary Fund) and other acts stated below, classification of domestic and foreign transactions shall be based on whether or not the office of the entity concluding these acts is situated in Japan.

(1) Placing of deposits or savings;

(2) Placing of money in trust for collective management, including jointly managed trusts and investment trusts that aim dividends from revenue as compensation;

(3) Payment of mutual installments as compensation or installments of fixedperiod savings;

(4) Payment of installments to mutual aid credit contracts;

(5) Obtaining mortgage securities for interest as compensation;

(6) Acquisition of national government bonds and other bonds for profits from redemption as compensation;

(7) Discounting of notes and;

(8) Receipt of, or other succession to, monetary claims (not including cases of general succession).

4. Non-taxable Transactions

The following transactions are exempt from taxation:

a. Sales and leasing of land

Sales and leasing of land (including establishment, sales, and leasing of rights relating to land); the rights relating to land including superficialities, easements, perpetual tenancy rights, and other rights relating to the use of and benefiting from land, except for mining rights and hot springs usage rights.

Land leased for a period shorter than one month and used in conjunction with buildings, parking lots, and other facilities are taxable.

b. Sales of securities and means of payment

Sales of securities such as national government bonds, corporate bonds, and

stocks (excluding shares of golf club memberships); sales of registered bonds, ownership, or membership shares of partnership and cooperative associations and monetary claims certificates of deposits.

Sales of means of payment (excluding those for collection or sale) and provision of money-changing services.

c. Money lending and other financial transactions

The lending of money for interest as compensation, provision of such services as guarantees, provision of services effected, as compensation, for trustee remuneration from jointly managed money trusts or bond investment trusts, insurance premiums (excluding fees received separately as administrative expenses), and other similar services (such as sales of assets for compensation for specified interest, and insurance premiums for financial leasing, installment sales fees, and mutual-aid installments).

d. Sales of postal and other stamps

Sales of postal and other stamps (provided sales are made at designated places) and similar items.

e. Sales of certificates for the provision of goods and services

Sales of certificates for the provision of goods and services (such as “telephone cards”).

f. Registration and licencing fees by the national government and local public bodies

Provision by the national government and local public bodies of services related to registration, licensing, passport control, resident and family certification, and certain other similar services.

g. Services such as international postal money transfers

h. Services for foreign currency transactions

i. Medical services, etc. in the public medical care systems

Medical services (including payment of medical benefits) made under medical insurance laws, such as the Health Insurance Act, the Elderly’s Health Protection Act, the Livelihood Protection Law, the Law Concerning Compensation for Ill Health caused by Environmental Pollution, the Workers Accident Compensation Act, and other similar medical services, and medical treatment given to the victim related to indemnity under the Automobile Accident Compensation Security Act (up to a certain limit with respect to payment for special hospital rooms).

j. Nursing Care Services specified services provided under the Nursing Care Insurance Law

k. Social Welfare Services

Social Welfare Services defined under the Social Welfare Services Act (including relevant rehabilitation and relief services defined under the Rehabili-

VIII Consumption Tax

tation and Emergency Relief Act; excluding sales and leasing of assets or provision of services by industrial training institutes).

- l.** Transfer of assets, etc., conducted by businesses similar to social welfare services, such as meal delivery services for the elderly, etc.
- m.** Delivery of babies (including delivery not covered by medical insurance laws under medical insurance laws)
- n.** Burial and crematory services
- o.** Transfer or lease of equipment with special properties, structures, or functions for the physically handicapped
- p.** Educational services
Services effected as compensation for tuition, entrance fees, entrance examination fees, facility charges, and certification fees for schools defined under Article 1 of the School Education Act, special schools under Article 82 (2) of the same law, vocational schools under Article 83 of the same law (provided that the course of study lasts more than a year), and other schools defined under other laws specified in Articles 82 (2) and 83 (1) of the same law.
- q.** Transfers of textbooks defined in the School Education Act
- r.** Housing rent

Note: Transactions mentioned at above l, m, o, n, g, r, and in some parts of k and p have been exempt from taxation since 1 October 1991.

5. Tax Exemption for Exports, etc.

In principle, consumption tax seeks to impose tax on goods and services in the country where they are consumed (principle of taxation at consumption places). Therefore, transfer of taxable assets that taxable business operators engage in trades, similar to export trading and international transportation, is exempt from consumption taxation.

In addition, according to international practice, transfer of taxable assets to embassies and other diplomatic missions of foreign governments are exempt from consumption tax taxation.

Tax exemptions are differentiated from non-taxable transactions in that the consumption tax levied on purchases made for tax-exempt transactions is deductible.

a. Tax exemption for exports

(1) Scope of exemption

Export transactions qualifying for exemption are taxable asset transfers effected within Japan and specified as follows:

(a) Sales or leasing of assets effected as exports from Japan

This category applies exclusively to enterprises directly involved in

export transactions. It does not apply to enterprises subcontracted for the processing of goods manufactured for export and those selling export items to enterprises engaged in export transactions.

(b) Sales and leasing of foreign cargoes

Foreign cargoes are those for which export licences have been obtained and cargoes arriving from foreign countries (including marine products collected or caught by foreign ships operating on the high seas) for which import licences have not been obtained.

(c) Transportation of passengers or cargoes, communications and mail services conducted within Japan and internationally

International transportation, communications and mail services are regarded as export transactions.

(d) Repair work on ocean liners done at the request of ship operators or leasers.

(e) Sales or leasing of aircraft for the transportation of passengers or cargoes exclusively between destinations within and outside Japan, or between destinations outside Japan (aircraft operating in international routes) for air transportation enterprises provided for in the Aviation Act.

(f) Repair work on aircraft operating in international routes done at the request of air transportation enterprises.

(g) Sales or leasing of containers used for the transportation of cargoes between destinations within and outside Japan or between destinations outside Japan, to ship operators leaseeship or air transporters (ship operation business enterprises, etc.), or repair work on containers done at the request of ship operation enterprises, etc.

(h) Services to ship operation enterprises, etc., such as pilotage and other assistance in the entry or landing and departure of ocean liners or aircraft operating in international routes, or facilities for the entry or landing and departure, anchorage or parking of ocean liners, etc., and other similar services.

(i) Services related to foreign cargoes such as stevedoring, transportation, custody, tallying, surveying, and other similar services.

These services further include those related to cargoes kept in designated bonded areas, bonded warehouse, bonded exhibiting areas, and bonded comprehensive areas for the purpose of export, and cargoes kept in these places for which import licences have been obtained. Furthermore, “other similar services” related to foreign cargoes include, for example, tallies on foreign cargoes, services related to harbor transportation customs clearance of imported cargoes, and fumigation of vegetables and fruits.

VIII Consumption Tax

- (j) Sales and leasing to nonresidents of mining rights, mine lease rights, stone-quarrying rights, and other rights for the quarrying and excavation of earth and rocks, industrial property rights (patent rights, utility model patents, design rights, and trademark rights) or circuit laying and use rights (including right to the use of these rights), copyrights (including publishing rights, quasi-copyrights, and similar rights), production formulas using special technology and others of a similar nature (knowhow), franchise rights, fishery rights, or right of entry into fishing grounds.
- (k) In addition, the provision of services to nonresidents, except for:
 - (a) Transportation or custody of assets situated in Japan;
 - (b) Services related to food, drinking, and lodging in Japan; and
 - (c) Services similar to (a) and (b) above and directly provided in Japan.

b. Tax exemption for sales of export goods at export goods sales facilities

Sales of goods (exports for daily life) by enterprises operating export goods sales facilities for nonresidents, such as foreign travelers and U.S. military personnel stationed in Japan, are exempt from consumption tax by fulfilling certain procedures.

c. Tax exemption for sales of goods loaded on ocean liners, etc.

The tax exemption for export transactions in (1) above applies to the loading of Japanese goods on ships or aircraft registered in foreign countries (domestic registered ships, etc.) while the tax exemption for the loading of goods for use aboard ships or aircraft applies to the receipt of delivery from bonded areas of goods for use aboard ships or aircraft for loading in foreign-registered ships, etc. For an equitable balance, the same exemption is afforded to the loading of goods for use aboard Japanese ships or aircraft.

d. Tax exemption for sales of taxable assets to foreign embassies and other diplomatic missions

Sales of taxable assets by enterprises designated by the Director General of the National Tax Agency to foreign embassies, legations, consulates, or other similar diplomatic missions or to foreign ambassadors, ministers, consuls, or other similar diplomatic representatives are exempt from consumption tax, provided that such sales have been effected with the embassies, etc., or the ambassadors, etc., by presenting documents in prescribed form certifying that the taxable assets in question are necessary for the performance of their diplomatic, consulate, and other missions, with attached papers showing the particulars of the purchases in prescribed form.

As part of the principle of reciprocity, however, this exemption shall be restricted for embassies, or ambassadors, etc., representing countries that restrict exemption from taxes similar in nature to consumption tax for Japanese embassies, etc., in these countries, or Japanese ambassadors, etc., ac-

credited in these countries.

To qualify for this exemption, the designated enterprises are required to keep papers presented by the embassies, etc., or the ambassadors, etc., in good order and maintain their files at the place of tax payment or at their offices that conducted the asset transfers in question for seven years after the time limit for filing final tax returns.

With the exception of unavoidable circumstances, the embassies, or ambassadors, etc., may not use the assets in question for purposes other than the performance of their missions for two years after the application of this tax exemption.

- e. Tax exemption for the sale of goods to shopping facilities operated by the U.S. Navy.

Sales by enterprises to shopping facilities operated by the U.S. Navy or PXes, of goods purchased by members or civilian employees of the U.S. armed forces or their families (members of the U.S. armed forces) for the purpose of export and that follow prescribed procedures are exempt from consumption tax.

The prescribed procedure mentioned above requires that U.S. armed forces members, at the time of purchase, submit papers to the shopping facilities (operated by the U.S. Navy or PX) with entries noting that the purchase in question is for the purpose of export in exchange for delivery of the purchased items.

The scope of goods eligible for this tax exemption is the same as that for goods eligible for tax-exempt sales at export goods sales facilities in b. above.

6. Import Transactions

- a. Taxable Foreign Cargoes

- (1) Transfers of cargoes without compensation

Foreign cargoes received from bonded areas are subject to taxation even if their receipt involves no payment of compensation. In domestic transactions, however, transfers of cargoes effected without compensation are not subject to taxation. Imports are, in effect purchases for consumption in Japan, and taxation on the receipt of cargoes without compensation is necessary to keep the tax burden balanced between domestic and foreign products.

- (2) Receipt of delivery from bonded areas

Cargoes such as mail received from bonded areas are regarded as having been received from bonded areas and, as such, are subject to taxation.

- (3) Consumption or use inside bonded areas

Consumption or use of foreign cargoes inside bonded areas (designated

bonded areas, bonded storehouses, bonded factories, bonded exhibiting areas, and comprehensive bonded areas) is also regarded as receipt of delivery from bonded areas and, as such, is subject to taxation. In cases where foreign cargoes are consumed or used as raw materials for the manufacture of taxable goods, such consumption or use is not subject to taxation.

In cases where goods are received from bonded areas for domestic consumption or use instead of being re-exported to foreign countries, such products are subject to taxation based on their delivery price at the time of the import declaration.

Consumption or use of sample tests of foreign cargoes extracted by customs officials under the Customs Act, or those taken into custody by authorized officials of public agencies under the provisions of other relevant laws and regulations are excluded from taxation.

b. Tax-Free Foreign Cargoes

Foreign cargoes excluded or exempt from taxation are: Securities, postage stamps, revenue stamps, certificate stamps, and commodity stamps, certain kinds of equipment for the physically handicapped, and certain kinds of textbooks are exempt from taxation;

c. Tax-Exempt Foreign Cargoes

Excluded or exempt from taxation are accorded foreign cargoes such as:

- (1) Foreign cargoes amounting to less than ¥10,000 in total taxable value are, in principle, exempt from taxation;
- (2) Ocean liners imported by enterprises engaged in ship operations are exempt from taxation and;
- (3) Cargoes for use by diplomats are exempt from taxation.

8/3 Taxpayers

1. General

Taxpayers are defined as enterprises and those who receive foreign goods from bonded areas.

In other words, taxpayers in domestic transactions are limited to enterprises, including individual proprietors. In contrast, consumers can become taxpayers when they receive taxable cargoes from bonded areas.

Enterprises include individual proprietors and corporations. In this context, however, organisations without juridical personality, such as unincorporated associations and foundations with officers designated as representatives or administrators, are regarded as corporations and, as such, are subject to the provisions of the consumption tax. Small enterprises with taxable sales during the

base period of less than ¥10 million are exempt from tax liability on sales of taxable assets during a tax period. However, this does not apply if there is no tax base for the taxation period, and an exception is established for a corporation whose capital is ¥10 million or more at the time of commencing its taxation period. With regard to the level of the tax exemption system, taxable sales had been set at ¥30 million since the introduction of consumption tax. However, this exemption level was reduced to ¥10 million at the time of the revision in 2003, applicable to the taxation period beginning on April 1, 2004.

2. Base Period

a. Definition of “base period”

The “base period” is the period that determines the existence or absence of tax liability. For individual proprietors, it is the calendar year two years before the current tax year. For corporations with an accounting period of one year, it is the period two years before the current accounting period.

b. Taxable sales during the base period

The taxable sales during the base period is the amount obtained by deducting the total sum of refunded sale prices, not including tax, (amounts for returned goods unsold, deductions, or rebates) from the total sum of prices (not including the consumption tax) received as compensation for the transfer of taxable assets effected within Japan during the base period.

In cases where a corporation’s base period is not one year, the taxable sales during the base period is the amount obtained by prorating the balance after deducting the total sum of refunded sales prices, not including tax, from the total sum of prices received as compensation for the transfer, etc. of taxable assets during the above-mentioned base period. The proration is made by first dividing the above balance by the total number of months in the accounting period included in the base period and multiplying the result by 12.

These calculations are to include sales in export transactions exempted from the consumption tax and the amount returned from the compensation received in export transactions.

3. Election of Non-Exemption from Tax Liability

Under consumption tax law, deductions of various kinds, including deductions for amounts paid as a consumption tax on purchases are, as detailed later applicable only to taxpayers. Therefore, enterprises primarily engaged in export transactions, with taxable sales amounting to less than ¥10 million for the base period, can elect to forego tax liability exemption to qualify, as taxpayers, for deduction or refund of the amount paid as consumption tax on their purchases.

4. Special Rules in Cases of Inheritance, Corporate Mergers, and Corporate Division, etc.

a. Inheritance

- (1) In cases where an inheritance takes place during the current year, and the successor's taxable sales amount to less than ¥10 million for the corresponding base period, if the business of the ancestor has total taxable sales of ¥10 million or more for the said base period, there is no tax liability exemption for the transfer of taxable assets by the successor during the period from the day after the inheritance to 31 December of the same year.
- (2) In cases where the successor of an inheritance that took place two years before the current year has taxable sales amounting to less than ¥10 million for the base period corresponding to the current year and the total of these taxable sales by the successor in question for said base period and the taxable sales by the ancestor for the same base period exceed ¥10 million, there is no tax liability exemption for the transfers, etc. of taxable assets by the successor during the year.

In the case of an inheritance by two or more successors of business establishments operated by the ancestor at two or more places of business, and where each place of business has been apportioned to one of the successors, the taxable sales by the ancestor for the base period are to be calculated as amounts generated at each succeeded place of business.

In cases where the inheritance of the ancestor's business establishment has taken place during the three years preceding the current year, tax liability is determined by the total taxable sales by the ancestor in question during the base period and the taxable sales by the successors during the same base period.

b. Corporate mergers

- (1) Mergers
 - (a) Determination of tax liability for the accounting period during which mergers took place

In cases where mergers took place during the current accounting period and the transferee corporations with taxable sales amounted to less than ¥10 million for the base period corresponding to the current accounting period succeeded to the business of the amalgamated corporations with taxable sales exceeding ¥10 million for the base period, there shall be no tax liability exemption relating to the transfer, etc. of the taxable asset during the period from the day of the said merger to the end of the current accounting period.
 - (b) Determination of tax liability in case where mergers took place after

the start of the base period

If mergers took place during the period from the second day of the base period corresponding to the current accounting period to the day prior to the current accounting period and if the sum of taxable sales by transferee corporations for the base period and of taxable sales by the amalgamated corporations for the period corresponding to the said base period exceed ¥10 million, there shall be no tax liability exemption during the current accounting period (limited to cases where taxable sales for the base period are lower than ¥10 million).

(2) Incorporation by merger

(a) Determination of tax liability for the accounting period during which an incorporation by merger took place

In case where a corporation was established by merger and one of the amalgamated corporations has taxable sales exceeding ¥10 million for the base period corresponding to the accounting period in which the day of the said merger fell, there shall be no liability exemption for transfer, etc. of taxable assets by the corporation established by the merger during the accounting period in which the day of the said merger fell.

(b) Determination of tax liability in cases where incorporation by merger took place after the start of the base period

If mergers took place during a period from the day two years before the first day of the current accounting period to the day before the first day of the current accounting period and if the sum of taxable sales by transferee corporations during the said period and of taxable sales by amalgamated corporations for the period corresponding to the base period of transferee corporations exceed ¥10 million, there shall be no tax liability exemption for transfers of taxable assets by the transferee corporations for the accounting period (limited to cases where taxable sales of transferee corporations for base period lower ¥10 million).

c. Corporate divisions, etc.

(1) Scope of divisions, etc.

The scope of divisions covers corporations established through investment in kind and so-called irregular investment in kind (postmortem incorporation) in addition to divisions under the Commercial Code (division for incorporation, division for absorption). We define that “division” is a reorganization form where a new corporation succeeds to the existing business while “division for absorption” is a reorganization form where the existing corporation succeeds to the business.

(a) Divisions, etc.

1. Division for incorporation

Corporations stipulated in the Commercial Code or the Private Limited Company Law

2. Incorporation in certain investment in kind

This is a corporation whose total of outstanding shares is owned by the investing company or whose total of capital is subscribed by the investing company.

3. Postmortem incorporation

When a corporation incorporates a new corporation with money contributed to set up another corporation and when the founding corporation transfers the assets of the corporation incorporated to a third party after the incorporation based on a “postmortem incorporation” contract stipulated in the Commercial Code or the Private Limited Company Law, the founded corporation that meets the requirements stated below falls into postmortem incorporation.

a) The total of outstanding shares of or the total of capital of the founded corporation is owned by the investing company (the equity is wholly owned) at the time of incorporation

b) Transfer of the assets of the founded corporation is scheduled at the time of incorporation and when the transfer is executed within the six months after the incorporation

(b) Division for absorption

Divisions stipulated in the Commercial Code or the Private Limited Company Law

(2) Method for concrete determination of tax liability

(a) Case of divisions

1. Determination of tax liability of divided subsidiary corporations (corporations formed through division)

a) Accounting period that includes the day of the division (first accounting period)

When taxable sales of the parent corporation within the period corresponding to the base period of the accounting period of a divided and newly established subsidiary corporation (any of the parent corporations if they are two or more) exceeds ¥10 million, there shall be no tax liability exemption.

b) When a division takes place within the period one day before the year prior to the start day of the accounting period until one day prior to the start day of the accounting period (second accounting period of one-year settlement corporation)

When taxable sales of the parent corporation (any one of the parent corporations if the parent companies are two or more) for the

period corresponding to the base period of the accounting period of the divided subsidiary company exceed ¥10 million, there shall be no tax exemption.

- c) When divisions took place before at least one year and two days prior to the start day of the accounting period (not including the case where there are two or more parent corporations) (third accounting period or later of one-year settlement corporations)

If taxable sales of the corporation for the base period of the accounting period is lower than ¥10 million and if the divided subsidiary satisfies specific requirements at the last day of the base period concerned with the accounting period and if the sum of taxable sales of the subsidiary for the base period of the accounting period and of taxable sales of the parent corporation exceeds ¥10 million, there shall be no tax liability.

✕The specific requirements are as follows:

The total of outstanding shares of a subsidiary or more than 50/100 of capital of a subsidiary is owned by the parent corporation and a person who has special relationship with the parent corporation.

2. Determination of tax liability of a dividing parent corporation (corporation who had divisions)
- a) Accounting period that divisions took place and the following accounting period

Tax liability shall be determined by taxable sales of the parent corporation for the base period.

- b) When divisions took place at least one year and two days prior to the start day of the accounting period (third accounting period or later of one-year settlement corporations after divisions)

If taxable sales of the parent corporation for the base period of the accounting period is lower than ¥10 million and if the divided subsidiary satisfies specific requirements at the last day of the base period concerned of the accounting period and if the sum of taxable sales of the parent corporation for the base period of the accounting period and of taxable sales of the subsidiary for the period corresponding to the base period exceeds ¥10 million, there shall be no tax exemption.

- (b) Case of division for absorption
1. Determination of tax liability of a divided and succeeding corporation (corporation that succeeds to the business of the divided corporation)
- a) Accounting period within which a division took place for absorption (accounting period that the division took place)

VIII Consumption Tax

If taxable sales of a succeeding corporation for the base period of the accounting period within which the division took place for absorption is lower than ¥10 million and if taxable sales of the divided corporation (taxable sales of any one of the divided corporations if they are two or more) for the period corresponding to the base period exceed ¥10 million, there shall be no tax exemption.

- b) When a division took place for absorption within the period from one year and one day prior to the start day of the accounting period until one day prior to the start day of the accounting period (accounting period following the accounting period that the division took place)

If taxable sales of the dividing corporation is lower than ¥10 million for the base period of the accounting period and if taxable sales of the divided corporation (taxable sales of any one of the divided corporations if they are two or more) exceed ¥10 million, there shall be no tax exemption.

- c) When a division took place within the period of at least one year and two days prior to the start day of the accounting period (third accounting period or later of one-year settlement corporations)

Determination of tax liability depends on taxable sales of the divided and succeeding corporation for the base period.

2. Determination of tax liability of the dividing corporation (corporation that divided itself)

Determination of tax liability depends on the taxable sales of the dividing corporation for the base period.

8/4 Place of Tax Payment

a. Place of tax payment for domestic transactions

- (1) Individual proprietors - ① if they have domiciles in Japan, the place of payment is the location of the domicile; ② in cases where they have dwellings instead of domiciles, the location of the dwellings; and ③ in cases where they have neither domiciles nor dwellings but have offices in Japan, the location of the office.
- (2) Corporations - ① for domestic corporations, the location of their main office or principal place of business; and ② for foreign corporations with offices in Japan, the location of the office.

b. Place of tax payment for import transactions

The place of payment for foreign cargoes received from bonded areas is the location of the bonded area.

8/5 Attribution of Asset Transfers, etc.

- a. In asset transfers, etc. those who substantially enjoy compensation are regarded as entities who have effected asset transfers, etc.
- b. In the case of assets belonging to trust properties, their transfers are regarded, in principle, as having been effected by the beneficiaries.

8/6 Time of Asset Transfers, etc.

1. General Rules

The realisation of tax liability for domestic transactions is at the time of transfer of taxable assets, etc.

a. Time of inventory sales

Sales of inventory are regarded as having been effected on the day of delivery. The day of delivery is the day that an enterprise concerned has consistently chosen for sales out of all days that can be reasonably regarded for delivery, based on the type and quality of the inventory as well as the contents of the sales agreement, such as the day of shipment; day of receipt upon inspection by the counterparty; the day on which the inventory sold becomes available for beneficial use by the counterparty; and the day on which the volume of sales has been confirmed by methods such as a meter check.

If forests or wilderness areas constitute the inventory and the day of delivery is not clear, delivery is regarded as having been made either on the day on which payment of approximately more than 50 percent of the sales price has been received or on the day on which an application has been submitted for registration of the transfer of ownership, whichever is earlier.

b. Time of asset transfers by contract

The time of asset transfers by contract is, in principle, for a contract requiring delivery of goods by the day on which all of the objects of the contract have been completed and, when delivered to the counterparty for a contract not requiring delivery of goods, the day on which contracted services have been fully provided.

c. Time of transfer of fixed assets

The time of transfer of fixed assets is, in principle, the day of delivery. In cases where the fixed assets consist of land, buildings, or other similar assets, the time of their sale can be the day the sales agreement takes effect.

d. Time of asset transfers, etc. in return for rent payments as compensation

The time of asset transfers, etc. in return for the payment of rent as compensation (excluding amounts received in advance) based on lease agreements

VIII Consumption Tax

is the day on which rent comes due in accordance with the agreement or business customs.

2. Exceptions for Time of Asset Transfers for Installment Sales

a. Tax period during which installment sales took place

In cases where assets (inventory in the case of individual proprietors) have been sold or transferred on a deferred payment basis, or where asset transfers have been effected in construction work (including manufacture and excluding long-term, large-scale construction work) or other supplies of services contracted on a deferred payment basis and where the amount of compensation for such sales or transfers are to be recognised by way of a deferred payment basis, portions of such assets or the objects of such contracts for which installments have not yet come due during the tax period that includes the day of such sales (excluding amounts received during that tax period) are regarded as not having been sold or transferred during that tax period and the amount of compensation for the portions for which installments have not yet come due may be deducted from the amount of compensation for such assets or the object of the contract.

b. Tax periods after the tax period during which sales on a deferred payment basis took place

During the next tax period and each subsequent tax period following the period during which installment sales took place, asset transfers are regarded as having taken place during the respective tax period corresponding to installments coming due (excluding amounts received as installments before the first day of that tax period and including amounts coming due after the last day but received during that tax period).

3. Exception for Time of Asset Transfers for Construction Work

a. Long-term, large-scale construction work

In cases where asset transfers are effected based on long-term contracts for construction work on a large-scale and where the amount of compensation is calculated by the percentage of completion method, asset transfers for the portions corresponding to compensation calculated in a tax period can be treated as having been effected during that tax period.

b. Construction Work

In cases where asset transfers are effected on contracts for construction work (excluding long-term, large-scale construction projects of great size) and the amount of compensation for such transfers (excluding those showing losses) are to be recognised by the percentage of completion method, assets

transferred for the portion corresponding to compensation calculated in a tax period can be treated as having been effected during that tax period.

c. Tax period during which the delivery was made

In cases where construction work (including long-term, large-scale construction work of great size) was completed and delivered, the amount of compensation for the portion for asset transfers deemed effected before the period during which the delivery was made may be deducted from the amount of compensation for such asset transfers.

8/7 Tax Base and Tax Rate

1. Tax Base

a. Tax base for domestic transactions

The tax base for domestic transactions is the amount of compensation for the transfer, etc. of taxable assets, etc.

The amount of compensation for the transfer of taxable assets is the amount of all money, goods other than money, rights, or other economic benefits received or to be received as compensation for the transfer of taxable assets, not including amounts equal to those paid as consumption tax and local consumption tax.

In this context, the term “amounts to be received” does not, in principle, mean the market value of the transferred assets, but rather such amounts that have been agreed upon between the parties.

In addition, goods other than money, rights, or other economic benefits include arrangements that substantially produce the same economic results as the receipt of consideration for transfer of assets, such as the delivery of goods other than money or rights, or the lending of money free of charge or at rates lower than current market rates as essentially compensation for the transfer of taxable assets, etc.

(1) Amount of compensation for special forms of transfer of taxable assets, etc.

(a) Payment in substitute

The amount of compensation for asset transfers, etc. made as payment in substitute is the amount equal to liabilities eliminated by the payment in substitute.

(b) Substantial gift

The amount of compensation for asset transfers, etc. made as substantial gift is the amount equal to the value of the accompanying liabilities.

VIII Consumption Tax

(c) Investment in kind

The amount of compensation for asset transfers, etc. made as investment in kind is the amount equal to the value of the shares (including investment certificates) acquired in return for investment at the time of acquisition.

(d) Exchange

The amount of compensation for asset transfers, etc. made in the form of exchange is the amount equal to the value of the assets acquired in exchange at the time of acquisition.

In case where margins of exchange are paid and received, the receiving party shall add amounts received as margin to the value of the assets acquired by exchange, while the paying party shall deduct amounts paid as margin from the value of the assets acquired by exchange.

(2) Calculation of compensation amount

(a) Division of the amount of compensation for co-mingled sales of taxable and non-taxable assets

In cases where taxable assets and non-taxable assets have been sold together for one price without respectively marking the amounts of their compensation, the price must be divided into components in a reasonable way. If no reasonable method is available, the division is to be made in proportion to the respective market values of the taxable and non-taxable assets.

(b) Money or other valuables received for the payment of stamp tax, etc.

In cases where money, etc. received by enterprises as compensation for the transfer of taxable assets, etc. include amounts equal to the value of stamp duties and other charges owed, in principle, by the enterprises to the national government or local public bodies, such amounts for the payment of stamp duties and other charges may not be deducted from the amount of compensation for the transfer of taxable assets.

Meanwhile, registration and license tax, automobile tonnage tax, automobile acquisition tax, other transaction taxes, and public charges owed, in principle, by entities who receive transfers, etc. of taxable assets shall not be included in the amounts of transfers of taxable assets for compensation so far as that effect is clearly stated in bills, etc.

(c) Treatment of specific indirect taxes

Amounts of compensation for the transfer of taxable assets, etc. should include the liquor tax, tobacco tax, gasoline tax, and LPG tax, etc. However, since the taxpayers for the light oil delivery tax, golf course utilisation tax, and bathing tax are consumers, these taxes should not be included in the amount of compensation in cases where such amounts are

clearly marked.

- (d) Treatment of returned unsold goods and discounts, etc.

In cases where returned unsold goods, discounts, or rebates take place in connection with the transfer of taxable assets, etc. exclusion of the amount of returned or unsold goods, discounts, or rebates from the sales figures and recognition of the balance as the amount of compensation is permitted on condition of consistent application of the same principle.

- (e) Value of self-consumption

In cases where individual proprietors use their assets for self-consumption or corporations transfer their assets to their directors as gifts, or at extraordinarily low prices, the amount of compensation is determined on the basis of the market value of the assets so used or transferred.

However, in cases where individual proprietors use their inventories for self-consumption or corporations transfer their inventories to their directors as gifts and they declare in their final tax returns amounts larger than the compensation actually paid for the taxable purchases of such inventories as the amounts of compensation for assets used for self-consumption, and larger than approximately 50 percent of the normal sales price of those inventories the declared amounts are acceptable.

- b.** Tax base of consumption tax for import transactions

The tax base for import transactions is the delivery price (including customs duties and other selective consumption taxes) of imported goods.

2. Tax Rate

The current tax rate is 4% (a 1% Local Consumption Tax, a local tax, was also introduced with the current rate for a total of 5%).

The tax rate was raised from 3% on 1 April 1997.

8/8 Tax Credit for Consumption Tax on Purchases, etc.

1. Tax Credit for Consumption Tax on Purchases

Concerning taxable purchases made by enterprises in their country or taxable cargoes received from bonded areas, the consumption tax arising on taxable purchases in the said taxable period and the consumption tax imposed or to be imposed on taxable cargoes that are received from bonded areas may be deducted from the consumption tax to the taxation standard value (amount of consumption tax on sales) for the taxable period that include the days when the said taxable purchases are made or the days when the deliveries of taxable

VIII Consumption Tax

cargoes from bonded areas are received (which include the period of the days when the special returns are filed for the said taxable cargoes)

a. Qualifying enterprises

- (1) This deduction is only afforded to enterprises with tax liability and not to those exempt from payment.
- (2) This deduction is applicable to the period which includes the days of taxable purchases or receipts for deliveries of taxable cargoes from bonded areas in Japan (in case special returns are filed for taxable cargoes, the period that includes the days when the special returns concerned are filed)

b. Definition of taxable purchases

Taxable purchases means receipt of transfers or the borrowing of assets from other entities or receipt of services provided by other entities, each made as a business activity by business enterprises. Provision of services made in return for the payment of salaries and transfers of non-taxable assets and tax-exempt transfers of assets do not fall under this definition.

Taxable purchases also include, however, purchases by enterprises of taxable assets from tax-exempt enterprises or consumers.

c. Purchases excluded from taxable purchases

Taxable purchases are those made for business purposes. Therefore, those made by individual proprietors for self-consumption do not fall under this category.

Since the provision of services in return for the payment of salaries is not included in this category, directors' compensation, personnel expenses, labour costs, and retirement deductions are not taxable purchases. However, business trip expenses, hotel charges, and other daily deductions that are considered necessary for such trips under normal circumstances, as well as commuting deductions to pay for transportation, all of which are considered necessary for such trips under normal circumstances, are treated as compensation paid in conjunction with taxable purchases.

Furthermore, purchases involving transfers of non-taxable assets or taxable assets accorded tax exemption, etc. are not taxable purchases. Therefore, interest paid, ground rent paid, employees' overseas business trip expenses, and international telephone charges do not represent compensation paid in conjunction with taxable purchases.

In addition, since transactions that do not fall under "asset transfers" are, by definition, not included in this category, dividends paid and proceeds from insurance paid are not taxable purchases. Tax credit is only allowed for taxable purchases made in Japan, taxable purchases made outside Japan are not included in this category.

Similarly, of cargoes received from bonded areas, tax credit is not allowed

for those afforded tax exemption under other laws or treaties.

d. Calculation of the tax credit amount

(1) Calculation of the tax credit amount

In principle, the entire amount of consumption tax paid on taxable purchases is deductible. However, in order to limit the deduction accorded to purchases involving non-taxable transactions, if the amount of non-taxable sales exceeds 5 percent of total sales during a tax period, the amount deductible as a tax credit on taxable purchases can be calculated either by the itemised method or the proportional method.

Enterprises have the option of choosing either method. In cases where the proportional method is selected, however, it must be used for at least two years.

(a) Itemised method

The amount of tax on taxable purchases during a tax period is divided into tax attributable to taxable sales, etc. tax attributable to the sale of other assets, etc. and tax common to both taxable and other sales. The deductible amount of tax is equal to the sum of ① taxes attributable to taxable sales only and ② taxes common to both taxable and other sales multiplied by the proportion of taxable sales to total sales.

However, the amount of tax common to both taxable and other sales can be allocated between the two by using the predetermined proportion (based on the number of employees, floor space, and similar considerations) approved in advance by directors of the tax offices in lieu of the actual proportion of taxable sales to total sales.

Note:

$$\text{Proportion of taxable sales} = \frac{\text{Amount of compensation for taxable assets sold in the country}}{\text{Total amount of compensation for assets sold in the country}}$$

“Tax attributable only to taxable sales” in (a) above includes, for example, taxable assets sold to third parties without any processing, costs of raw materials, containers, wrapping papers, machinery and equipment, machine tools, other tools, fixtures consumed or used only for the manufacture of taxable assets, and other costs relative to taxable assets such as warehouse charges, freight, advertising expenses, and processing fees. In cases where trial articles and testing products are distributed to customers and other entities concerned as a sales promotion for taxable assets, the amount of tax on taxable purchases of such trial articles and testing products is treated as tax attributable only to the transfer, etc. of taxable assets. Moreover tax attributable only to the

VIII Consumption Tax

transfer, etc. of taxable assets and that qualify for export exemption are included in this category.

In addition, amounts of compensation for the transfer of non-taxable assets made within Japan that constitute export transactions (including interest on loans to nonresidents and foreign bonds) are treated as the amount of compensation for export transactions. And exports of assets for sale outside Japan or self-consumption or use in foreign countries are treated as export transactions.

Note: This treatment does not apply to the export of loans and securities as principal.

“Tax attributable only to the transfer, etc. of other assets” includes, for example, costs for the development of land for sale and purchases of medicine, etc. necessary for medical tests and treatment made under the provisions of the Health Insurance Act.

(b) Proportional method

The amount of deduction is calculated by multiplying the amount of tax on taxable purchases, etc. by the percentage of taxable sales to total sales.

(2) Calculation method for the percentage of taxable sales

Percentage of taxable sales means the weight of the amount of compensation for taxable assets sold within Japan during a tax period in respect to the total amount of compensation for assets transferred within Japan during the tax period.

In the above definition, both the total amount of compensation for assets sold and the total amount of compensation for taxable assets sold do not include the amount of consumption tax. These figures also show the net after deducting the amount of refunded sales prices (due to returned goods unsold, discounts, and rebates). This definition naturally includes amounts of compensation in export transactions but excludes amounts of compensation in foreign transactions.

In calculating the percentage of taxable sales, the amount of compensation for transfer of assets, etc. and the amount for transfer of taxable assets, etc. are to include:

- ① Amount of compensation for the sales of non-taxable assets made within Japan constituting export transactions (including interest on loans to nonresidents and foreign bonds) and;
- ② The value of assets (FOB price) exported for sale and selfconsumption or use outside Japan.

e. Qualifications

To qualify for tax credit on purchases, it is necessary to keep both books

and documents as follows for seven years at the place of tax payment or the taxpayers' office:

- (1) Books that record the particulars of taxable purchases and prices and;
- (2) Statements of delivery, bills, etc., or papers issued by customs superintendents that show the particulars of taxable purchases and prices.

2. Adjustment of Tax Deductions on Purchases

a. Adjustment of deduction for refunds of compensation for purchases

(1) Adjustment for refunds of compensation for purchases

In cases where, in conjunction with taxable purchases made within Japan, enterprises receive partial or total return of the compensation paid for such purchases, or have their accounts payable or other liabilities for compensation reduced by returning purchased goods unsold, received discounts, or rebates (refund of purchase prices, etc.), adjustment must be made in the amount of tax on purchases used as the basis for calculation of the deduction for the consumption tax on purchases for a tax period, which includes the day of the refund of purchase prices, etc.

(2) Methods of adjustment

In the case of return of compensation for purchases, etc., the amount of consumption tax on the amounts received as a refund of the purchase price during the tax period (an amount equivalent to 4/105 of the amount received as a refund of the purchase prices), is deducted from the amount of tax on taxable purchases during the tax period. The methods of calculation are as follows:

(a) In cases where the percentage of taxable sales is 95% or more:

The amount of consumption tax on the amounts received as a refund of purchase prices during the tax period is deducted from the total amount of taxes on the taxable purchases.

(b) In cases where the percentage of taxable sales is less than 95% and the amount of deduction for consumption tax on purchases is calculated by the itemised method:

① The amount of consumption tax on the amounts received as a refund of the purchase price during a tax period in conjunction with taxable purchases required only for transfers of taxable assets is deducted from the total amount of taxes on taxable purchases required only for transfers of taxable assets during the tax period.

② The amount calculated by multiplying the total amount of the consumption tax on the amounts received as a refund of the purchase price during a tax period in conjunction with taxable purchases required only

VIII Consumption Tax

for the transfer, etc. of both taxable and other assets by the percentage of taxable sales, is deducted from the amount calculated by multiplying the total amount of tax on taxable purchases required for the transfer of both taxable and other assets by the percentage of taxable sales (including percentages similar in nature to the percentage of taxable sales).

- (c) In cases where the percentage of taxable sales is less than 95% and the amount of deduction for the consumption tax is calculated by the proportional method:

Amounts calculated by multiplying the amount of consumption tax on amounts received as return of compensation during a tax period by the percentage of taxable sales are deducted from amounts calculated by multiplying the total amount of taxes on taxable purchases during the tax period by the percentage of taxable sales.

- b.** Adjustment of deduction for the consumption tax on purchases in other circumstances

- (1) In the case of fixed assets subject to adjustment, the deduction for consumption tax on purchases is adjusted in the following circumstances:

- (a) When calculation of the deduction for consumption tax on purchases by the proportional method has resulted in a material change in the percentage of taxable sales and;
- (b) When the use of fixed assets subject to adjustment has been changed from exclusive use for non-taxable business to exclusive use for taxable business, or vice versa.

- (2) With respect to the amount of tax on taxable purchases of inventories, adjustment is made in the following circumstances:

- (a) When a tax-exempt enterprise has become a taxable enterprise and;
- (b) When a taxable enterprise has become a non-taxable enterprise.

3. Simplified System

Taking the administrative burden of small and medium-sized enterprises into account, a simplified tax system has been designed to help them easily calculate deductible tax on purchases based on the amount of consumption tax on sales.

Through a revision in 2003, the upper limit to the application was reduced from taxable sales of ¥200 million to ¥50 million, to be effective from the taxation period beginning on April 1, 2004 onward.

- a.** Simplified tax system

Enterprises whose taxable sales during the base period are less than ¥50 million, can choose to regard the amount calculated by multiplying their taxes

on purchases by the deemed rate of purchases defined according to their type of business of their taxes on sales (less the amount of taxes on refunded sales) as tax on taxable purchases. Once this simplified tax system is chosen, it cannot be changed for two years.

b. Applicable tax period

This simplified tax system is applicable for the tax period following the period when notification is submitted and in each tax period thereafter with taxable sales amounting to less than ¥50 million for the corresponding base period.

Although advance notification is required, notification submitted during the tax periods below makes this system applicable from that tax period:

- (1) Tax period during which the enterprise concerned started its business in Japan;
- (2) Tax period during which the enterprise concerned inherited the business of an ancestor who also used this system;
- (3) Tax period during which the enterprise concerned merged with the business of an amalgamated corporation which also used this system and;
- (4) Tax period during which the enterprise concerned divided for absorption with the business of a divided corporation which also used this system.

With respect to the determination of taxable sales of a subsidiary formed through divisions or of the dividing parent corporation for the base period, taxable sales of the parent corporation or of the subsidiary for the base period are taken into accounts. However, taxable sales of a merger corporation or of a divided and succeeding corporation, or of a dividing corporation are determined based on their taxable sales for the base period.

c. Deemed rates of purchases

- Type 1 businesses: 90%

Type 1 businesses corresponding to wholesalers

- Type 2 businesses: 80%

Type 2 businesses corresponding to retailers

- Type 3 businesses: 70%

Type 3 businesses corresponding to those listed below.

- Agriculture
- Forestry
- Fishery
- Mining
- Construction
- Manufacturing (including manufacturing retailers)
- Electricity, gas, heat, or water supply

- Type 4 businesses: 60%

- Type 5 businesses: 50%

Type 5 businesses corresponding to those listed below.

- Real estate

- Transport and communication
- Service industry (except restaurants)

Type 4 businesses corresponding to those other than Type 1, 2, 3, or 5.

The rates should be applied to all sales of an enterprise.

d. Relationship to other deductions

This system provides an exception for calculating the consumption tax deduction on purchases. Therefore, other schemes of deduction (such as the deduction for the consumption tax on the amounts of refunded sales, the deduction for the consumption tax on losses from bad debts) are applicable as separately determined.

During the tax period in which this system is applicable, no adjustment is to be made on the consumption tax deduction amount on purchases of fixed assets subject to adjustment and the deduction for the consumption tax on inventories in conjunction with the shift of status from non-taxable business enterprises to taxable business enterprises.

8/9 Other Deductions

1. Tax Deduction for Refunds of Sale Prices

This deduction is conditional on the maintenance of books or other documents recording the particulars of refunds of sale prices.

In cases where prices of taxable sales are refunded due to the return of goods unsold, discounts, or rebates, the refund of sale prices can be deducted from the amount of consumption tax for the tax period during which such refunds are made.

2. Tax Deduction for Losses from Bad Debts

When, due to circumstances in accounts receivable and other claims on the buyers, all or part of the compensation for transfers of taxable assets including tax have become unrecoverable, the amount of consumption tax included in the unrecoverable amounts of sales are deductible from the amount of consumption tax during the tax period in which the bad debt takes place.

The application of this deduction is conditional on the maintaining of supporting documents.

8/10 Self Assessment and Payment

1. Domestic Transactions

a. Tax period

(1) General

Tax period is the time frame for which payable amounts of the consumption tax are calculated. Taking into account the taxpayer's burden for tax collection and returns, the tax period is the calendar year for individual proprietors and the accounting period for corporations.

An arrangement has also been made to shorten the tax period, taking into account the interest payment burden from the payment of the consumption tax on purchases by enterprises primarily engaged in export transactions or those who are regular recipients of consumption tax refunds.

(2) Shorter tax periods

When taxpayers so elect, each of the quarters from January to March, April to June, July to September, and October to December becomes the tax period for individual proprietors, while each of the quarters starting from the first month of an accounting period becomes the tax period for corporations.

b. Final return and payment of taxes

Enterprises must file their final return and pay taxes (with the local consumption tax) due within two months of the day following the last day of the tax period. In addition, individual proprietors must file their final return and pay taxes by the end of March of the following year.

c. Interim tax declaration and payment

Businesses (excluding those which selected the period of tax payment as stated in the above a (2)) shall submit their interim tax declaration and pay the tax as indicated in the items stated below unless the annual tax amount paid in the last period for tax payment is less than ¥480,000.

① In the case of a business which paid more than ¥480,000 and ¥4 million or less as the annual tax amount during the last period for tax payment:

An interim declaration shall be submitted within two months from the day following the end of the period of six months from the day of commencement of the period for tax payment, and the tax in the amount of half as much as the annual tax amount shall be paid as decided by the end of the relevant period.

② In the case of a business which paid more than ¥4 million and less than ¥48 million:

An interim declaration shall be submitted within two months from the date

VIII Consumption Tax

following the end of each three-month period from the day of commencement of the last period for tax payment, and the tax shall be paid in the amount of a quarter as much as the annual tax amount as decided by the end of the relevant period.

- ③ In the case of a business which paid more than ¥48 million as the annual tax amount during the last period for tax payment:

An interim declaration shall be submitted within two months from the day following the end of the period of one month from the day of commencement of the period for tax payment (for a month from the day of commencement of the period for tax payment, after passage of two months from the date of commencement of the period for tax payment) and the tax shall be paid in the amount of a twelfth as much as the annual tax amount as decided by the end of the relevant period.

- d. Attachment of certain details to a final return, etc.

Taxpayers are obliged to attach the details of the prices of assets transferred in the tax period, etc., and of the tax amount of taxable purchases, etc., in the tax period to a final return, an interim return, or a return of claim for a refund.

2. Import Transactions

- a. General

- ① Self-assessment system

In the case of goods subject to the self-assessment system under customs law, business enterprises must file tax returns and pay (with the local consumption tax) taxes to the Director of Customs Offices at the time of receipt of taxable goods from bonded areas.

However, when a business enterprise files a special return on tariff with the Custom-House, the enterprise shall pay the taxes to the Custom-House by the end of the following month of the day that the enterprise files a return and takes goods out of the bonded area.

- ② Official assessment system

In the case of goods subject to the official assessment system, business enterprises must file assessment case returns to the Director of Customs Offices and the director must collect the consumption tax (with the local consumption tax).

- b. Deferment of payment (in the case of ①)

- ① Deferment on a one-time basis

Payment can be deferred for a period up to three months each time the goods are delivered if collateral is offered.

② Deferment on a one-month basis

Payment of tax for a specific month can be deferred for a period up to three months from the end of that month if collateral is offered.

③ Deferment of special returns

When a guarantee is submitted to the Custom-House, payment can be deferred up to two months from the end of the month when the enterprise is supposed to take goods out of the bonded area.

8/11 Special Provisions Concerning Government and Entities

1. Special Provisions Concerning National and Local Governments

a. Unit of calculation

The national government and local public bodies are regarded as one corporation for each of their general accounts and special accounts.

b. Time of asset transfers, etc.

Asset transfers, etc. and taxable purchases by the national government or local public bodies can be regarded as being made on the last day of the accounting year during which receipt or payment of compensation is made.

2. Special Provisions Concerning Deductions on Purchases

With respect to the national government, local public bodies, corporations listed in Schedule 3 of the Corporation Tax Law, and public organisations and associations without juridical personality, the amount of tax on purchases corresponding to specific revenue (such as taxes, subsidies, and donations) is excluded from deduction.

With respect to the general accounts of the national government and local public bodies, the amount of consumption tax on sales and the aggregate amount of various deductions are regarded as identical and the bodies are therefore exempt from filing tax returns.

3. Special Provisions Concerning Due Date for Tax Returns

With respect to the national government and local public bodies, exceptions are provided concerning the due date for tax returns.

The due dates are the following months after the settlement of the accounting period:

National government	5 months
Local government	6 months
Local public corporation	3 months

8/12 Obligation to Show Net Price

When a taxable business in order to transfer a taxable asset to a consumer indicates the price of the asset in advance by means of a tag or advertisement, the undertaker shall indicate the total amount paid including the relevant consumption tax and local consumption tax. This provision initially established in the revision of FY 2003 will be applicable from April 1, 2004 onward.

(reference) Local Consumption Tax

a. General

The Local Consumption Tax (Prefectural Tax) was established on, 1 April 1997 to replace the Consumption Transfer Tax in order to build strong finances or local finances to promote decentralisation and to enhance local welfare.

b. Taxpayer

The business and the person to receive foreign cargoes from the bonded area (consumption tax payer)

c. Tax Base

- (1) As for domestic transactions, the tax base is the amount of the Consumption Tax.
- (2) As for import transaction, the tax base is the amount of the Consumption Tax levied on the receipt of taxable cargoes from bonded areas.

d. Tax Rate

The tax rate is 25% of the amount of consumption tax (equivalent to a consumption tax rate of 1%)

e. The assessment and Payment

- (1) The enterprises that are required to file a final return must file a final return with that of Consumption Tax and pay the declared Local Consumption Tax amount with the Consumption Tax amount by the deadline for declaration of Consumption Tax.
- (2) Those who receive taxable cargoes from bonded areas must file a fixed return with that of Consumption Tax to the Director-General of Customs and pay the declared Local Consumption Tax amount with the Consumption Tax amount.

[Note 1] The enterprises declare and pay Local Consumption Tax with the same return and receive a tax payment slip including the Consumption Tax.

[Note 2] While Local Consumption Tax is a Prefectural Tax, the State is executing this tax with Consumption Tax for the time being considering the burden of taxpayers, etc.