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Japan tax alert

Ernst & Young Shinnihon Tax

Update on Japanese consumption tax rate increase

On 10 August 2012 the Japanese Diet passed bills for reform of social security and other taxes, including "Consumption Tax Reform." The Consumption Tax Reform will become effective on or after 1 April 2014 unless otherwise specified.

Outline of the Consumption Tax Reform

Key features of the Consumption Tax Reform are as follows:

1. Two-phase tax increase

   The consumption tax rate will be increased pursuant to the following two-phase schedule:

   - Phase One - From 5% to 8% on 1 April 2014
   - Phase Two - From 8% to 10% on 1 October 2015

   Temporary measures

   The 5% tax rate is still applied to the transfer of assets after 1 April 2014 if such transfer is pursuant to a construction contract that was concluded before 1 October 2013.

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2. **Consumption taxpayer status for newly established companies**

   Under the current consumption tax regime, a newly established company would generally be exempt from consumption tax for the first two fiscal years[1] if the company's registered capital is less than JPY 10 million (USD 128,000). Under the Consumption Tax Reform, a newly established company will be subject to consumption tax for the first two fiscal years, regardless of its registered capital to the extent that a controlling person (e.g., a company holding more than 50% of equity interest of the newly established company) or a related company has taxable sales in Japan exceeding JPY 500 million (USD 6.4 million). This treatment becomes applicable to companies established on or after 1 April 2014.

3. **Measures against regressive taxation**

   In order to mitigate the economic burden on low-income households of the rate increase, the Diet may introduce a tax credit system providing for a refund or reduced consumption tax rates for the "necessities." Also, "a simple cash benefit" would be provided at the time of tax rate increase as a temporal measure.

4. **Flexible clause**

   The Consumption Tax Reform includes a vague flexible clause that states that the expected consumption tax rate increase may be suspended if the comprehensive economic condition is not appropriate for the tax hike. The bill does not define when a "comprehensive economic condition" is not appropriate for the consumption tax increase.

Implications

The expected increase in consumption tax rate would require proper adjustments to reflect the rate change in a company's accounting and other systems, which may be rather costly and time consuming. In addition, persons who plan to establish a new company after the Consumption Tax Reform should take into account the potential inapplicability of exemption in advance. For these reasons, it is critical for business entities to monitor developments and take necessary actions for the Consumption Tax Reform.

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1 According to the 2011 tax reform, for the fiscal years beginning on or after 1 January 2013, the exemption period may be shortened from two years to one year, only applicable to the first year, if a newly established company generates more than JPY 10 million taxable sales during the first 6 months of the inception year.

Comments or general inquiries regarding this tax alert may be directed to our Corporate Communications team at tax.marketing@jp.ey.com.

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