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Japan: New Japanese invoicing requirements for consumption tax (JCT)

In brief

The Japanese value added tax is referred to as JCT. As all taxes around the world have connections with the history of the tax mechanism of each country, the explanation below also covers the history of the discussions regarding introducing value added tax in Japan.

Contact Information

Edwin Whatley
Principal
Tokyo

Shinichi Kobayashi
Local Partner
Tokyo

[Name]
[Position]
[Location]

1. Overview of the history of introducing value added tax in Japan

As a historical background to understand the JCT mechanism, it may be worthwhile mentioning the history of value added tax in Japan. In the early 70s, to tackle the budget deficit at that time, the ruling party (the Liberal and Democratic Party (LDP)) and the government were contemplating introducing value added tax in Japan.

However, the LDP and the government twice failed to introduce valued added taxes in the late 70s (1979) and late 80s (1987), respectively. In these proposals, it appears that the introduction of the EU-type value added tax was contemplated, including the invoice method. In the 70s and 80s, tax revenue was mainly corrected by means of income taxes, such as individual income tax and corporate income tax. The marginal progressive rate of individual income tax was 88% (including local tax), and the standard effective tax rate of corporate income tax was approximately 55%. In other words, the majority of the tax revenue was collected from wealthy people and large corporations at that time. However, tax revenue that mainly relies on income taxes is destined to fluctuate with economic conditions, and any tax revenue mainly sourced by income taxes is not necessarily stable. Indeed, in the 70s, Japan was suffering from a shortage of tax revenue due to the economic downturn, including the oil crisis, and an increase in expenditures, especially medical expenditures corresponding to the aging population. Under the circumstances, the LDP and the government were contemplating introducing value added tax as a stable source of tax revenue. However, in 1979 and 1987, the introduction of value added tax was not supported in the election and failed. There was strong opposition from the majority of middle-class voters potentially targeted by the value added tax. As a result of the defeats in election, the ruling party withdrew the proposal.

2. History of the JCT

In 1989, after around 20 years of discussions regarding the introduction of value added tax, the JCT was introduced. It replaced the commodity tax, which was only imposed on listed luxury goods whose purchasers were mainly wealthy people.

Traditionally, no invoice method has been applied for the input JCT credit for the purpose of simplifying the JCT-related procedures. This was practically possible as the JCT rate was a single rate until 30 September 2019.

In addition, under the JCT system, in relation to small/medium-sized enterprises, exemption measures are also provided. It can be said that having no invoice system is a part of such measures. Namely, to protect small/medium-sized enterprises as parties in transactions with JCT taxpayers (i.e., so as not to be excluded from transactions with the JCT taxpayer solely because they are not JCT taxpayers), no invoice system has been introduced under which only JCT taxpayers can claim the input credit. Instead, as all business enterprises retain and maintain the invoices and other records, and the books of account recognizing commercial transactions, a so-called books and record method has been adopted in recognizing the JCT-taxable transactions. Namely, the input JCT creditability is determined based on the nature of the transaction supported by the books and record requirements (i.e., it is required to maintain accurate records in the books of account, retaining traceable records of the transactions).

The items to be stated in the books of account and the records (invoices, etc.) are summarized in Table 1 below. Due to the introduction of multiple JCT rates, this has been changed slightly, as shown in the columns on the right.

Table 1 - Requirements for the books and records

	Requirements until 30 September 2019	Requirements from 1 October 2019 to 30 September 2023 (bold parts)
Books	(1) identification of the transaction party (2) transaction date (3) nature of the transaction (4) amount of the consideration	(1) identification of the transaction party (2) transaction date (3) nature of the transaction **(with separate statements for the transactions to which the lower rate is applicable)** (4) amount of the consideration
Records	(1) identification of the person who prepares the document (2) transaction date (3) nature of the transaction (4) amount of the consideration (5) identification of the person who receive the document	(1) identification of the person who prepares the document (2) transaction date (3) nature of the transaction **(with separate statements for the transactions to which the lower rate is applicable)** (4) amount of the consideration (5) identification of the person who receive the document

These are mostly overlapping and there have been some critical comments from practitioners that both the books and records requirements are redundant and too burdensome.

On the other hand, such measures considering the small/medium-sized enterprises also create a problem — non-JCT taxpayers can also receive the output JCTs even if they are not needed to pay the JCT liability to the government. This is called "Ekizei" meaning the part of the JCT legally retained by business enterprises. In theory, at the non-JCT taxpayer level, Ekizei constitutes a part of the consideration for the transaction and is subject to corporate income taxes as a taxable revenue; it is not completely tax-free. However, focusing on the JCT mechanism, it is a loophole and the legislative history of the JCT summarized in Table 2 below shows that the legislations are mainly aimed at closing this loophole.

Table 2 - Summary of the JCT's legislative history

	Year	Major legislation for the scope of JCT taxpayers	JCT rate
I	1989	If the taxable sales in the "base period" (the second preceding year) are JPY 30 million or less, a JCT exemption is available for the current year (the "two-year exemption" treatment). Thus, a newly established company is not a mandatory JCT taxpayer for the initial two years of operations at least.	3%
II	1997	A newly established company with JPY 10 million or more in capital became ineligible for the two-year exemption treatment.	5%
III	2004	The taxable sales threshold in the base period for the exemption was lowered from JPY 30 million to JPY 10 million.	
IV	2013	A shorter exemption period (one-year exemption) was introduced, subject to certain conditions.	

		If the taxable sales in the "specified period" (the first six months of the preceding year, e.g., 2018 for 2019) are JPY 10 million or less, a JCT exemption is available for the current year. For the JPY 10 million threshold for the specified period, a company may use the payroll amount paid to Japanese residents instead of taxable sales for the threshold (the payroll amount paid to Japanese non-residents does not need to be counted, at least under the existing JCT law).	
V	1 April 2014	Newly established companies in which a large corporate group (i.e., a corporate group with over JPY 500 million in annual JCT taxable sales) owns more than 50% of the shares became ineligible for the two-year exemption treatment.	8% Total JCT rate | National JCT rate | Local JCT rate 8% | 6.3% | 1.7%
VI	1 October 2023 (predetermined future change)	The input JCT credit will only be available for statutory invoices issued by the JCT taxpayer who is a registered invoice issuer.	8% or 10% from October 2019 (lower 8% rate applies for foods and newspapers) Total JCT rate | National JCT rate | Local JCT rate 8% | 6.24% | 1.76% 10% | 7.8% | 2.2%

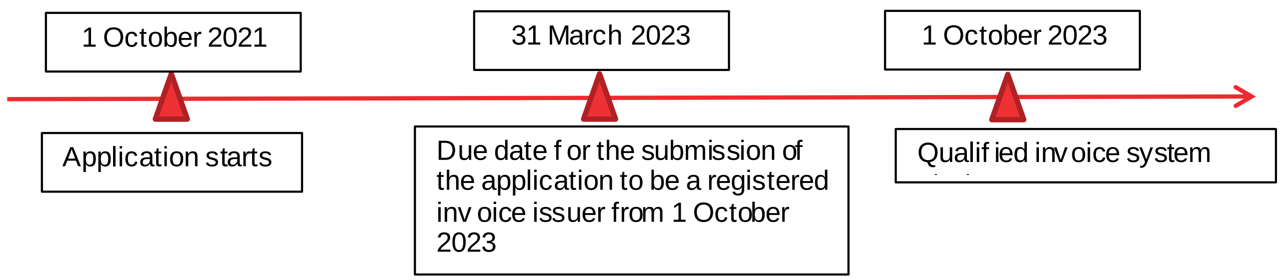
3. Introduction of the qualified invoice system on or after 1 October 2023

As shown in Table 2 above, on or after 1 October 2023, a JCT taxpayer is required to maintain qualified invoices issued by registered invoice issuers to be eligible for the input JCT credit. The necessity of the qualified invoice method is generally supported by the multiple JCT rates such as 8% or 10%, introduced on or after 1 October 2019. In other words, after the introduction, a JCT taxpayer cannot recognize the input tax credit for transactions with non-registered invoice issuers who are mainly non-JCT taxpayers (please see the special measures for the transit period mentioned in (4) below).

(1) Procedures and time schedule

The application for the registration will be made to the appropriate national tax office from 1 October 2021. When the registration is made, the name of the registered invoice issuers and their registration numbers can be confirmed through the website of the National Tax Agency of Japan. To be a registered invoice issuer on or after 1 October 2023, the application must be submitted on or before 31 March 2023. The registration number would be either "T + the My Corporate Number" or "T + the newly allocated 13-digit number" (for non-corporate enterprises or other persons/entities that have no My Corporate Number, per se).

The time schedule can be visualized as follows.



(2) Requirements for registered invoice issuers

A registered invoice issuer is required to (a) provide the qualified invoices to the transaction parties and (b) retain copies of the registered invoices (subject to the separate books retention rule, under which the retention period is generally seven years). Once the registration for the registered invoice issuer is made, it cannot become a non-JCT taxpayer even if the JCT taxable sales amount in the base period becomes JPY 10 million or less. Non-registered persons cannot issue qualified invoices, and making false statements in qualified invoices is prohibited. These actions are subject to a penalty.

The items that must be stated in the qualified invoice are described in Table 3.

Table 3 - Items to be stated in the qualified invoice (with bold for the new requirements)

1	Identification of the qualified invoice issuer (e.g., name) and **the registered number**
2	Transaction date
3	Nature of the transaction (with separate statements for the transactions to which the lower rate is applicable)
4	Amount of the consideration (**exclusive or inclusive basis) per applicable JCT rates (and applicable JCT rates)**
5	**Amount of the applied JCT**
6	Identification of the person who receive the document (e.g., name)

Certain business enterprises that provide JCT taxable transactions to numerous and unspecified counterparties (e.g., retail businesses, restaurants and catering establishments, etc.) can provide simplified qualified invoices. These must contain broadly the same information as a qualified invoice, except the names of the recipients do not need to be included. In addition, the issuance of qualified invoices can be omitted for transportation fairs less than JPY 30,000 and other de minimis transactions.

In the case of intermediary transactions, such as consignment sales, if both the consignor and the consignee are registered invoice issuers, the consignee can issue the qualified invoices to the counterparty of the transaction (such as the customers) in the name of the consignee, subject to certain conditions (e.g., retention requirements regarding the copies of the qualified invoices for both the consigner and the consignee, etc.).

A comparative sample of invoices under the existing method and under the qualified invoice method can be visualized as follows.

Table 4 - Comparative sample invoices

Under the existing invoice requirements	Under the qualified invoice requirements (with bold for the new requirements)
(Invoice) (Issuance date) To: Company A From: Company B Transaction date: D/M/Y Transactions: - Purchase of stationaries: JPY 11,000 - Purchase of beef (*): JPY 21,600 Total: JPY 32,600 (Subject to 10% rate: JPY 10,000) (Subject to 8% rate: JPY 20,000) (*) = subject to the reduced JCT rate	(Invoice) (Issuance date) To: Company A From: Company B **(Registration Number: T1234567890123)** Transaction date: D/M/Y Transactions: - Purchase of stationaries: JPY 11,000 - Purchase of beef (*): JPY 21,600 Total: JPY 32,600 (Subject to 10% rate, **JPY 11,000, JCT = 1,000**) (Subject to 8% rate, **JPY 21,600, JCT = 1,600**) (*) = subject to the reduced JCT rate

(3) Requirements for counterparties

The counterparty of transactions with registered invoice issuers must (a) maintain the books of account in the same manner as the existing requirements (please see Table 1 above), and (b) retain the qualified invoices prepared in accordance with Table 3 above (except for where the de minimis rule mentioned in (2) above applies).

(4) Special measures for the transit period

As mentioned above, on or after 1 October 2023, a JCT taxpayer cannot recognize the input tax credit for transactions with non-registered invoice issuers who are mainly non-JCT taxpayers. On the other hand, as an exception, if the current record requirements are satisfied (please see Table 1) — and also stating that the transit measure applies in the books of account — a partial input JCT credit is available as follows.

Table 5 - Transit measures

Period	Percentage of the input JCT credit available
From 1 October 2023 to 30 September 2026 (three years)	80% of the input credit amount equivalent
From 1 October 2026 to 30 September 2029 (three years)	50% of the input credit amount equivalent

(5) Registration as a registered invoice issuer by a non-JCT taxpayer

It is also possible for non-JCT taxpayers to register as registered invoice issuers. However, in this case the non-JCT taxpayer status is forfeited and it must become a JCT taxpayer (and, at the same time as the registration, an election report to become a voluntary JCT taxpayer must be filed). Although a strict due date to become a voluntary JCT taxpayer has been promulgated, as an exception, where a non-JCT taxpayer becomes a registered invoice issuer during the taxable year in which 1 October 2023 is covered, it can become a voluntary JCT taxpayer from the registration date. As mentioned above, to become a registered invoice issuer from 1 October 2023, the application must be submitted by 31 March 2023, and if a non-JCT taxpayer files the application by 31 March 2023 and the registration is made, it can become a voluntary JCT taxpayer from 1 October 2023.

(6) Registration on or after 1 January 2024

Where a non-JCT taxpayer wants to become a registered invoice issuer from the next taxable year following the year in which 1 October 2023 is covered (for example, where a calendar-year-type fiscal year is applied), the application for the registered invoice issuer is made at least one month before the beginning of the fiscal year from which the registered invoice issuer treatment applies (as well as the election as a voluntary JCT taxpayer in due course).

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As mentioned above, the due date for the application to become a registered invoice issuer from 1 October 2023 is 31 March 2023. Although no details have been announced for the registration procedures at this stage, understanding the new JCT invoicing system is necessary to be ready to take necessary action.