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Re: Application of VAT to Foreign-Based Supplies of Electronic Services

Dear Abe san:

The Japanese National Tax Authority (“NTA”) amended the Japanese Consumption Tax Act (“JCTA”) to change the taxation of cross-border supplies of services effective 1 October 2015. Tax Executives Institute, Inc. (“TEI”) appreciates the invitation from the Ministry of Finance (“MOF”) to submit stakeholder comments on the proposed changes, and sent a letter addressing the proposed changes on 29 October 2014. This letter supplements TEI’s initial submission and addresses TEI’s concerns with the additional proposed changes outlined in the Revision of Consumption Taxation on Cross-Border Supplies of Services guidelines issued in May 2015 (“May 2015 Guidelines” or “Guidelines”).

Background

Founded in 1944 to serve the professional needs of business tax professionals, TEI is the preeminent association of in-house tax professionals worldwide. TEI’s approximately 7,000 professionals manage the tax affairs of over 2,800 of the companies across all industry sectors around the world. TEI’s members are accountants, lawyers, and other corporate and business employees responsible for the tax affairs of their employers in an executive, administrative, or managerial capacity.

Many of these companies are involved in the sale, distribution, and purchase of digital products and services globally, including Japan. TEI members working for these companies continually monitor consumption tax developments around the world. TEI espouses organizational values and goals that include integrity, effectiveness, efficiency, and dedication to improving the tax system for the benefit of taxpayers and tax administrators.

TEI believes it is critical to maintain a dialogue between businesses and revenue authorities when developing new rules for consumption taxes to ensure they are workable and not overly burdensome on businesses or tax authorities. In relation to cross-border transactions, it is also critical to protect the neutrality of the consumption tax system by ensuring that supplies are not subject to double taxation.

Comments on the May 2015 Guidelines

1. The “Provision of Electronic Services”

The May 2015 Guidelines first address what constitutes the “provision of electronic services.” The Guidelines state “services provided via electronic and telecommunication networks (e.g., internet) such as the provision of e-books, music, and advertisements” constitute electronic services. The Guidelines also state the “[u]se of telecommunication networks and transactions where services via the telecommunication networks are ancillary to the transfer of other assets do not fall under the provision of electronic services.”

The Guidelines then set forth a list of services constituting the “provision of electronic services.” According to the list, such services include “advertising on the internet,” “consulting business via telephone and email,” “[s]ervices that allow customers to access shopping and auction sites on the internet (e.g., charges on posting goods for sale),” “services that allow customers to access the place to sell game software and other products,” “[p]rovision via internet reservation website for accommodations and restaurants (those who charge posting for the website from the businesses that operate accommodation and restaurants),” and “English lessons provided via internet.”

TEI commends the NTA for recognizing that services provided via electronic and telecommunication networks should not be classified as electronic services if using such networks is merely “ancillary” to the transfer of other assets. However, the adopted standard creates confusion. TEI maintains that whether a service is an electronic service should be determined by the true object of the service provided rather than how the service is provided. For example, the true object of consulting services, advertising services, and English lessons is the provision of professional or personal services that may be delivered electronically or by

other means. These professional and personal services should not be deemed electronic services simply because they are delivered to a customer over an electronic platform.

A clear rule focusing the true object of service will avoid confusion. First, it is impossible to identify and address whether every current and future service involving telecommunications or the internet will constitute an electronic service. A rule focusing on the fundamental nature of the service will enable businesses to more easily determine whether services, particularly new services, constitute an electronic service. Second, services not inherently electronic may be delivered via multiple means for a single price. For example, advertising services might be disseminated through many media, including print, radio, internet, and social media. Under the May 2015 Guidelines, only a portion of such advertising services would constitute electronic services. Similarly, consultants might report their observations and recommendations to their customers by voice, email, or mail. The Guidelines do not address how such services should be classified, or address whether or how they should be apportioned.

Further, to determine whether a service is an electronic service, it is essential to understand the nature of the service, the charges, the parties charged, and how such charges are passed through to consumers. For example, many customers making a hotel reservation online will pay for the room via an online intermediary but actually purchase the hotel room or airline ticket from the hotel or airline. The intermediary generally charges the hotel or airline rather than the traveler for this service. Customers reserving a table at a restaurant, however, simply make a reservation through an intermediary; they do not pay for their meal over the internet. The restaurant might pay the intermediary a flat fee for listing the reservation on the intermediary's website, a fee based on each reservation booked, or a combination thereof. TEI welcomes the opportunity to identify individuals working in various e-commerce industries who can explain the nature of their business and how their services are billed. These insights would aid the MOF in determining which services constitute electronic services for the JCT.

2. The Classification of B2B and B2B Electronic Services

The amendments address how Japanese Consumption Tax ("JCT") will be imposed and remitted upon services and intangibles supplied from outside Japan to Japanese customers. Under the May 2015 Guidelines, electronic services will be classified as business-to-business ("B2B") electronic services or business-to-consumer ("B2C") electronic services. B2B electronic services are defined as the "provision of services that normally are limited to businesses, considering the nature of the services, or the terms and conditions relating to the provision of the services." All other services, including services intended for business use but that cannot be restricted to those not in business, are classified as B2C electronic services.

As discussed in TEI's 29 October 2014 letter, although certain services and intangibles are normally purchased by businesses only, there is a broad range of "cross-over" services and

intangibles purchased by businesses and consumers. For example, books, periodicals, legal services, and computer software are routinely purchased by businesses and end consumers. The administrative costs placed on foreign businesses to determine whether a service constitutes a B2B or B2C electronic service, and upon NTA to audit those determinations, can be substantial.

TEI recommends adopting a rule defining B2B services and B2C services based upon whether the purchaser is a business or end consumer. Such a rule would be easier to apply than the proposed rule. Indeed, because many other consumption tax regimes use this approach, adopting such a rule is likely to increase compliance and result in fewer errors.

Moreover, expanding the scope of B2B services would likely increase the amount of JCT remitted. For B2B services, the Guidelines require Japanese businesses whose taxable revenue ratio is less than 95 percent to account for all such purchases using the reverse charge mechanism. In contrast, for B2C services, the Guidelines require foreign businesses to register and remit tax on such sales. Many foreign businesses may not know or fully understand their obligation to collect and remit JCT on supplies of B2C services and thus compliance will not be complete. However, most Japanese businesses will be familiar with the reverse charge mechanism, which ensures that Japan receives the JCT due. Therefore, expanding the pool of B2B services is likely to increase the amount of JCT collected.

3. Reverse Charge Mechanism – Notification Requirement

The May 2015 Guidelines require foreign businesses supplying B2B electronic services to Japanese businesses to “indicate beforehand that the service recipient will be liable to file and pay consumption tax (that the transaction tax is subject to tax filing under the reverse charge mechanism) when providing the services.”

TEI commends the NTA for adopting a reverse charge mechanism for B2B electronic services supplied by foreign businesses and maintains this mechanism should apply to all purchases of electronic services made by Japanese businesses with a restricted right to recover JCT. However, requiring foreign businesses to notify Japanese businesses regarding their collection and remittance obligations is not reasonable or necessary. Japanese businesses are more likely to be familiar with their filing and payment requirements than foreign businesses not registered to file and pay JCT. TEI thus recommends eliminating the notification requirement and clarifying to Japanese businesses when the reverse charge mechanism applies.

4. B2C 10 Million Yen Exemption

The May 2015 Guidelines require foreign businesses selling B2C electronic services to register and pay JCT. Businesses with B2C sales of less than 10 million yen in the base period are

exempt from this obligation. TEI maintains that it will be difficult for foreign businesses supplying electronic services to businesses and consumers to determine whether the 10 million yen threshold has been exceeded because foreign businesses are unlikely to separately track B2C sales, as defined in the May 2015 Guidelines, to Japanese customers to the implementation date.

TEI recommends adopting a threshold that is easier to measure. For example, the threshold could measure supplies of B2C services made from the date the new rules come into effect. Foreign businesses that know the value of their B2C sales will exceed the threshold could register and account for JCT on such sales beginning on 1 October 2015. Foreign businesses for whom the answer is less clear could measure such sales from 1 October 2015 and register to remit JCT once it becomes clear they will exceed the 10 million yen threshold.

5. Eligibility for a Purchase Tax Credit

The May 2015 Guidelines impose different requirements upon Japanese businesses purchasing B2B electronic services from foreign businesses, depending upon whether the Japanese business is exempt, has a taxable sales ratio of 95 percent or greater, or has a taxable sales ratio of less than 95 percent. Japanese businesses with taxable sales ratios of less than 95 percent must implement a reverse charge mechanism with respect to B2B purchases. The reverse charge mechanism does not apply to Japanese businesses with taxable sales ratios of 95 percent or greater or to JCT-exempt businesses.

The proposed rule could distort competition because foreign suppliers making B2B sales will not charge JCT on supplies sold to Japanese businesses, meaning JCT-exempt Japanese businesses will not incur JCT on supplies purchased from outside Japan. This could encourage some JCT-exempt Japanese businesses to purchase their supplies from foreign suppliers rather than locally, which would give those businesses an unfair advantage over competitors that purchase from Japanese suppliers and pay JCT.

TEI recommends requiring JCT-exempt Japanese businesses to apply the reverse charge mechanism with respect to B2B electronic services purchased from foreign suppliers. This would increase JCT revenues and ensure Japanese businesses selling B2B services to JCT-exempt businesses are not at a competitive disadvantage.

6. Portals and App Stores

Since 1 July 2015, South Korea has introduced rules requiring foreign open market portals and app stores providing electronic services to consumers in South Korea to register and account for VAT on those sales. A simplified VAT registration process enables sellers to account for VAT through these platforms. Similarly, the European Union permits portals and app stores

supplying electronic services to register and account for VAT/GST on sales made through such platforms. Australia has announced similar plans for rules it proposes to introduce in 2017.

This process has several benefits: it reduces the number of foreign business registrations, increases overall tax collection, reduces the need to contact smaller businesses in different countries to ensure they are aware of and are complying with Japanese law, and allows smaller businesses to develop and grow without being crippled by complex regulations and requirements. TEI recommends requiring portals and app stores to similarly register and account for JCT.

7. Translations of Rules, Forms, and Other Guidance

TEI encourages the NTA to publish all rules, forms, and other guidance pertaining to the JCTA and its amendments in all major international languages (at a minimum, Chinese, English, Spanish, French, and German). This action will ensure a standard interpretation of the rules and will be more effective than requiring foreign businesses to rely upon translations made by their fiscal agents.

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TEI welcomes the opportunity to meet with MOF and NTA representatives to discuss these comments and other issues relating to the administration of the JCT. This dialogue would ensure the system ultimately adopted would operate in the most practical, effective, and efficient manner to the benefit of both the government and the business community.

TEI's comments were prepared by TEI's European Indirect Tax Committee, whose chair is Paula Regales, in consultation with TEI's Asia Tax Committee and its Canadian Commodity Tax Committee. If you have questions about TEI's comments, please contact Ms. Regales at +34 (91) 426 35 57 or paula.regales@jci.com, or Pilar Mata of TEI's legal staff at +1 202 464 8346 or pmata@tei.org.

Respectfully submitted,
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