

Japan Tax Bulletin

Revenue recognition for licence transactions and technical service transactions

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Taxable revenue (“*Ekikin*”) is revenue from selling assets, the transfer of assets or provision of services either for consideration or for free, the receipt of assets for free or revenue from transactions other than those of capital nature (Article 22(2) of the Corporation Tax Law (“*CTL*”). As revenue is recognized for transactions that have no consideration, the Arm’s Length Principle is applied under the general revenue recognition rules. Where a corporate taxpayer sells an asset whose fair value and tax basis are 100 and 80 respectively, the taxable revenue and deductible cost are 100 and 80. 20 is a cost subject to restriction on deduction (Donation: *Kifukin*) for tax purposes.

As a result of the new Accounting Standard 29 on revenue from consumer contracts, which was released by the Accounting Standard Board of Japan (“*ASBJ*”), and in line with IFRS 15, Article 22-2 on revenue recognition from the transfer of assets or provision of services was incorporated into *CTL* as part of the 2018 Tax Reform. Article 22-2 of *CTL* provides the following:

- Revenue is in principle recognized in the business year which contains the day of shipment of goods or the provision of services.
- If a contract contains provisions that change the timing of revenue recognition, GAAP allows for revenue to be recognized in the accounts of a corporate taxpayer in the business year that contains the “day close to the day of the shipment of goods or the provision of services”.
- Where the revenue is recognized in business years other than the business years indicated above, a tax adjustment is allowed to recognize the revenue in the business year which contains the “day close to the day of the shipments of goods or the provision of services”.
- The amount of revenue to recognize is the arm’s length price of goods or services when shipped or provided.
- The possibility of return of goods or bad debt loss is not considered when determining the arm’s length price.
- Subsequent changes in the arm’s length price for discounts or rebates are recognized in the business year when the adjustments are made in accounts. The detailed rules are left to the Enforcement Ordinance.

The detailed rules for different types of transaction on revenue recognition are provided in the Corporation Tax Law Basic Circular (“*CTLBC*”). *CTLBC* provides a uniform approach for recognizing revenue and takes account of the fact that the new Accounting Standard 29 does not apply to Small or Medium-sized Enterprises.

1. *Licence transactions*

1.1 Timing of revenue recognition from a licence transaction of intellectual property¹

Revenue from licensing intellectual property is recognized depending on the nature of the licence.

- (i) Rights to access to the intellectual property during the licence period
Revenue is recognized over the licence period, as the performance of licensor’s obligations is fulfilled over the licence period.
- (ii) Rights to exploit the intellectual property rights when the licence is provided
Revenue is recognized when the licence is provided, as the performance of licensor’s obligations is fulfilled at the time when the licence is provided.

1.2 Timing of revenue recognition from granting rights to exploit industrial property rights (excluding royalties)²

The following day is treated as the “day close to the day of provision of service” under Article 22-2 of *CTL*.

- (i) The day when the contract granting rights takes effect.
- (ii) The day when the registration of rights where the grant of the rights takes effect by registration.

1.3 Timing of revenue recognition of a lump-sum receipt from disclosing know-how³

A lump-sum receipt of consideration for disclosing know-how, is recognized as revenue in the business year which includes the day of completion of disclosing the know-how.

Where the know-how is disclosed two or more times and the consideration is paid in instalments, the revenue for each disclosure is recognized in the business year which includes the day of disclosure.

¹ *CTLBC* 2-1-30

² *CTLBC* 2-1-30(2)

³ *CTLBC* 2-1-30(3)

1.4 Timing of revenue recognition for royalties on licences of intellectual property where the royalty is calculated based on sales etc.⁴

Where royalties that are calculated based on sales or usage are related only to licensing intellectual properties, or royalties are received mainly for licensing intellectual properties, revenue is recognized in the business year when the later of the following days is included:

- (i) The day when the licensee records sales or utilizes the intellectual property.
- (ii) The day when all or part of the services related to royalties are completed.

1.5 Timing of revenue recognition of royalties

Where a company recognizes royalty revenues consistently on the day when the royalties are receivable, the day when royalties are receivable is treated as the “day close to the day of provision of services”.⁵

2. *Technical service transactions*

Revenue from providing services where the performance of obligations is fulfilled over a period is recognized over the period. Each day in the period from the commencement to the completion of the services is treated as the “day close to the day of provision of services”.⁶

Revenue from providing services where the performance of obligations is fulfilled when the service is completed is recognized in the business year that includes the day of completion of the services.⁷

Revenue from technical services such as design, supervision of works and technical instruction is recognized principally in the business year which includes the day the service is completed, unless the performance of obligations is fulfilled over a period.⁸

If the following facts occur, revenue from technical services is recognized as unit of services divided by the period of work:⁹

- (i) The amount of service fee is calculated based on the number technical staff assigned to the local site and the number of days of their stay, and is determined and becomes receivable in a certain period.
- (ii) The service fee is split based on work stages such as basic design and detailed design, and is determined and becomes receivable once each stage is completed.

⁴ CTLBC 2-1-30(4)

⁵ CTLBC 20-1-30(5)

⁶ CTLBC 2-1-21(2)

⁷ CTLBC 2-1-21(3)

⁸ CTLBC 2-1-21(10)

⁹ CTLBC 2-1-1(5)

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