Grant Thornton

Japan Tax Bulletin

Tax Reform on Determining Taxable Enterprise Under Consumption Tax Law

September 2024

This article explains the impact of the reform of determining a taxable enterprise for consumption tax purposes on foreign owned domestic enterprise and a foreign enterprise for taxable periods beginning after October 2024, based on the amendments.

1. *General rules on determining taxable enterprise*

(1) *Base period rule*

A taxable enterprise is required to file a consumption tax return for output taxes collected and input taxes paid and pay the difference of them to a tax office. A taxable enterprise is an enterprise of which taxable sales amount in a base period was more than JPY10 million. A base period is the tax period 2 years prior to the current tax period.

(2) *Specified period rule*

Even where taxable sales for the base period of the taxable period are JPY10 million or less, if the taxable sales amount for the specified period exceeds JPY10 million, or if certain other circumstances apply, an enterprise will be a taxable enterprise for the taxable period. In addition, instead of the amount of taxable sales, the total amount of salaries and wages paid may be used to determine the amount of JPY10 million for the specified period.

The specified period is, in the case of a company, the period of six months after the beginning of the fiscal year preceding the current fiscal year.

(3) *Rule for company without base period*

A company when newly incorporated is usually a non-taxable enterprise for the first 2 years as there is no base period for the years. However, where the amount of the stated capital at the beginning of the taxable period is JPY10 million or more, a company falls under a taxable enterprise.

(4) *Specified newly incorporated company rule*

Further, even where a company of which stated capital is less than JPY10 million is set up, the company is a taxable enterprise if it is controlled by another person.

2. *Amendment to Specified newly incorporated company rule*

Specified newly incorporated company rule, whether or not a newly incorporated company is controlled by another person, is determined with reference to the following two conditions:

(1) More than 50% of the number of shares or capital amount is owned directly or indirectly by another person, and

(2) Taxable sales amount of another person in (1) in a period corresponding to the base period of newly incorporated company exceeds JPY500 million.

In 2024 tax reform, for taxable periods beginning after October 1, 2024, JPY500 million taxable sales amount in (2) is replaced by JPY500 million taxable sales amount <u>or gross revenue (worldwide revenue) exceeds JPY5 billion</u>. Therefore, a large foreign company sets up a Japanese subsidiary with small sated capital, the subsidiary is a taxable enterprise where the parent's global revenue in a period corresponding to the base period of the subsidiary exceeds JPY5 billion.

Please note that the taxable period for consumption tax purposes coincides with the fiscal year, unless the company chooses to shorten the taxable period. However, when a foreign company establishes a branch or other PE in Japan, the fiscal year is deemed to begin at the time of establishment for purposes of the Corporation Tax Law, and the taxable period for consumption tax purposes also begins at that time. Therefore, the above amendment will be applied when determining consumption tax liability if the PE is established in Japan after October 2024.

3. *Amendment to base period and specified period of foreign enterprise*

The base period of an existing foreign company originally exists even where it has conducted no business in Japan and the rule for company without base period and the specified newly incorporated company rule were not applicable.

In the 2024 tax reform, for taxable periods beginning after October 1, 2024, where a foreign company with a base period for a fiscal year has started a business in Japan on or after the day following the last day of the base period, the said fiscal year shall be deemed as if it had no base period. Therefore, the rule for company without base period and the specified newly incorporated company rule become applicable.

In addition, for foreign enterprise, the determination of JPY10 million for the specified period rule may not be based on the total amount of salaries and wages.

4. Determination process for taxable enterprise

Where a foreign company sets up its subsidiary or branch in Japan, the applicability of taxable enterprise determination rules discussed above can be summarized as below and has become consistent between subsidiary and branch:

	(Applicable rules)	Japan subsidiary	Japan branch
First year	Base period rule	No	No
	Specified period rule	No	No
	Rule for company without base period	Yes	Yes
	Specified newly incorporated company rule	Yes	Yes
Second year	Base period rule	No	No
	Specified period rule	Yes	Yes*
	Rule for company without base period	Yes	Yes
	Specified newly incorporated company rule	Yes	Yes
Third year and thereafter	Base period rule	Yes	Yes
	Specified period rule	Yes	Yes*
	Rule for company without base period	No	No
	Specified newly incorporated company rule	No	No

* Taxable sales amount can not be replaced by wage, salary amount.

Please note that a non-taxable enterprise based on the above determination may elect to be a taxable enterprise in any tax period by submitting a notification to the tax office by a specified due date.

5. Other notes

In addition to the above, there is a special exception whereby if an enterprise acquires inventories or fixed assets over a certain amount during a taxable period in which it is a taxable business, it is considered taxable compulsorily for two years after the following taxable period.

There are also special provisions for tax liability in the event of a merger or split.