

Countdown Commenced

Is your business prepared for the
consumption tax hike?



December 2013

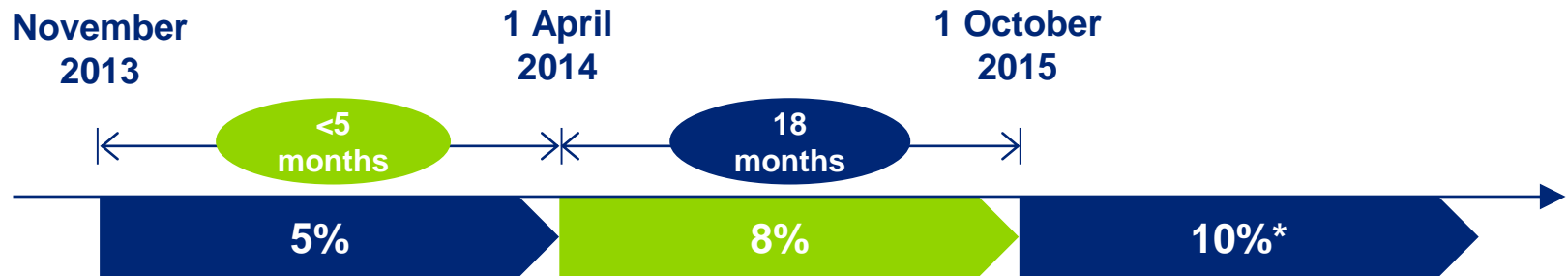
Today's Agenda

- 1. Introduction**
- 2. Business Considerations**
- 3. Tax Considerations**
 - Transitional Rules
 - Creditable Input Tax
- 4. System Considerations**
- 5. A Strategic Approach**

Introduction

JCT hike: to 8% and then to 10%

Less than 5 months remain to prepare for the JCT rate hike



	Through 31 March 2014	From 1 April 2014 to 30 September 2015	From 1 October 2015
National JCT	4%	6.3%	7.8%
Local JCT	1%	1.7%	2.2%
Total	5%	8%	10%

*The increased 10% JCT rate remains subject to fulfillment of certain economic conditions

Key considerations

Considerations:

- Addressing issues with suppliers and customers
- Internal controls
- Legal compliance

Business

Considerations:

- Minimizing JCT cost
- Understand the transition rules
- JCT compliance issues

Tax

Considerations:

- Identify systems that will be impacted
- Addressing transitional complexities
- Time and cost for updating systems

System

Managing consumption tax - objectives

JCT rate hike will impact on JCT tax cost and the ability to ensure compliance with filing obligations – careful planning is required

Minimizing
JCT Cost

Invoicing of
output JCT

Recoverability
of input JCT

Ensuring
Compliance

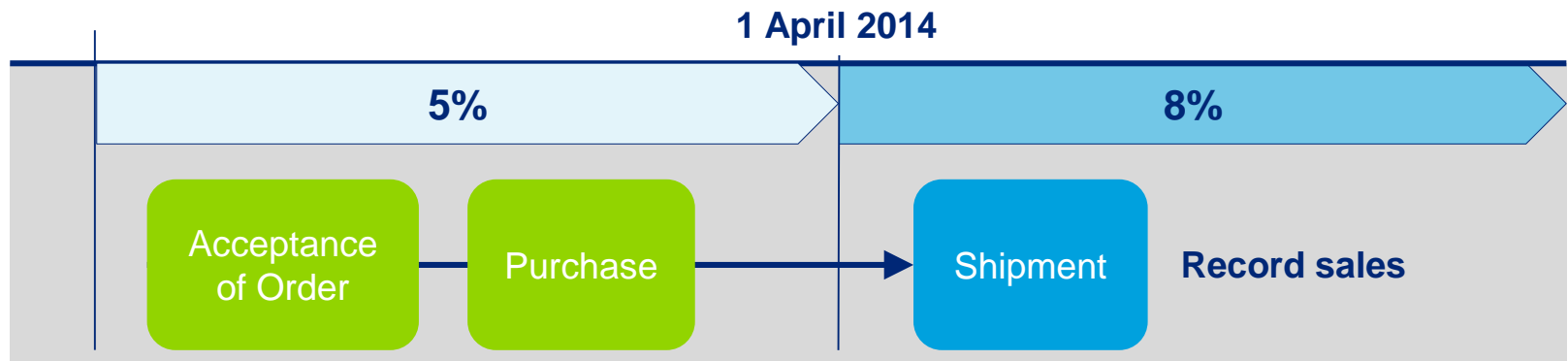
Capturing
accurate data

Timely filing of
correct return

Business Considerations

Un-invoiced output JCT

Transactions straddling date of rate increase can result in uncollected output JCT, increasing JCT tax cost



Case Study

- Purchase and shipment scheduled to be completed before 1 April 2014
- 5% JCT rate effective at time purchase order accepted
- Shipment delayed until on or after 1 April 2014, such that 8% rate applies

Risk

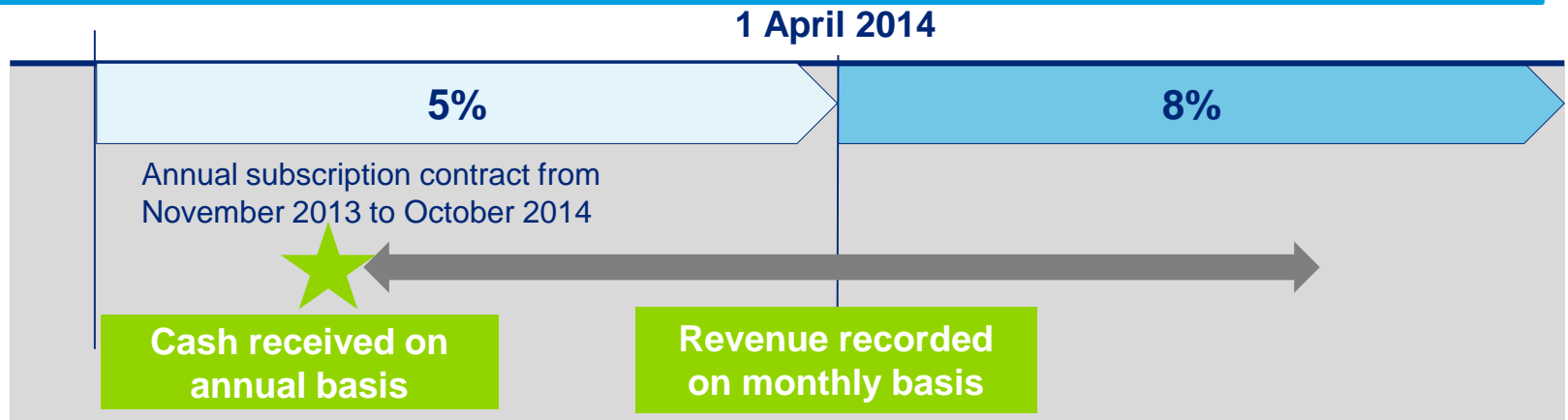
- Since the agreed price included 5% JCT, the company risks a 3% loss on the sale if it is not able to collect the applicable 8% output JCT from its customer

Potential Fix

- Accept order without stating the applicable JCT rate (JCT exclusive price)
- Stipulate in contracts, etc. and agree with customers that in case the shipment is made on or after 1 April 2014, the new JCT rate will be applied

Un-invoiced output JCT

Transactions straddling date of rate increase can result in uncollected output JCT, increasing JCT tax cost



Case Example

- Annual subscription services from November 2013 to October 2014
- Since the beginning date of contract is during 5% period, annual fee collection is on 5% JCT inclusive basis
- Revenue is recorded on monthly basis for accounting/tax purposes

Risk

- Since the revenue recognized on or after April 2014 is subject to 8% JCT, there will be 3% uncollected output JCT. Unless 3% output JCT is collected from customers, the company will incur a loss of 3% of the sales

Potential Fix

- Adjust fee quote to customers in advance
- Appropriate fee collection on 5% basis and on 8% basis at the beginning of the contract

Special measures to ensure appropriate passing on of JCT

Effective 1 October 2013 to 31 March 2017

Correction of Obstructive Practices

Companies supplied by enterprises with capital of JPY300 million or less, or by self-employed suppliers, shall not:

1. Engage in price reduction/ slashing
2. Coerce suppliers to make purchases/ use services
3. Refuse to negotiate based on prices net-of-tax
4. Issue reprisals

To implement these special measures, government will:

1. Conduct reporting/ inspections
2. Provide guidance/ advice
3. Request measures from Japan Fair Trade Committee
4. Issue recommendations/ publications

Correction of Obstructive Representations/ Price Display

Enterprises shall be prohibited from representing that:

1. JCT is not passed on to customers
2. Price will be reduced by some/all of the JCT amount that customers will incur

Special exemption from requirement to display JCT-inclusive price - Prices may be displayed on a JCT-exclusive basis, provided measures are taken to prevent customers mistaking these prices for JCT-inclusive amounts

Price Display Issues

From JCT-Inclusive to JCT-Exclusive

Requirement to Display JCT-Inclusive Prices

Since April 2004, JCT taxpayers have been required to display JCT-inclusive prices on labels, adverts, websites and in shops, where such prices are on display to the general public

JPY 10,584

JPY 10,584
(JCT inclusive)

JPY 10,584
(JCT exclusive: JPY9,800)

JPY 10,584
(JCT JPY784)

Special Exemption

For the period to 31 March 2017, JCT taxpayers can display JCT-exclusive prices, provided measures are taken to prevent customers mistaking these prices for JCT-inclusive amounts



JPY 9,800
(JCT inclusive: JPY10,584)



JPY 9,800
(JCT exclusive)



JPY 9,800
(+ JCT)



JPY XXX

JPY XXX

JPY XXX

JPY XXX

JPY XXX

JPY XXX

All Prices of goods displayed on this flier are JCT exclusive prices



JPY9,800
(JCT inclusive: JPY10,584)



JPY 9,800 (JCT inclusive: JPY10,584)

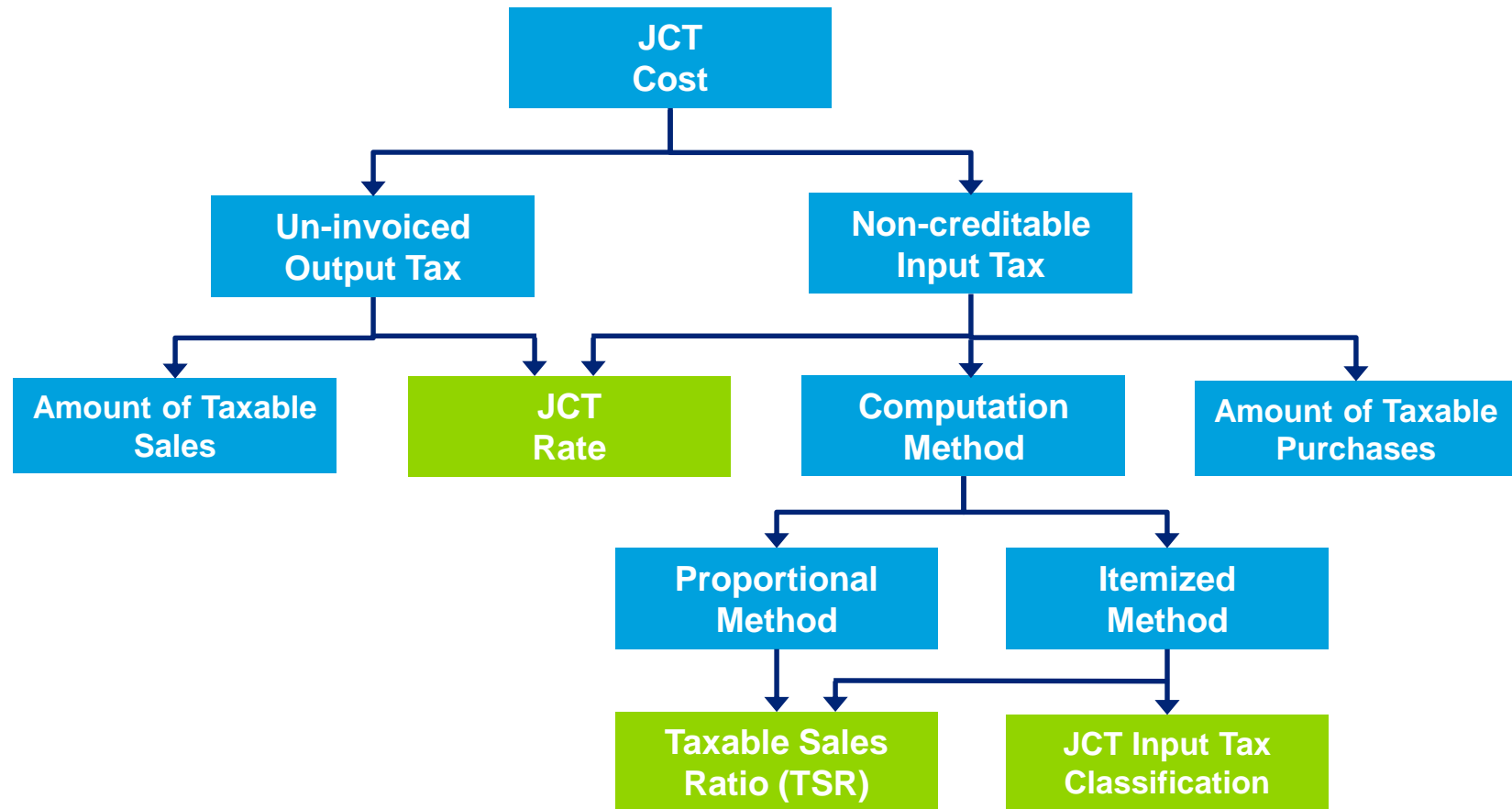


JPY 9,800
(JCT inclusive: JPY10,584)

Tax Considerations

Drivers of JCT cost to a business

Non-creditable input tax and un-invoiced output tax are a cost to the business.
Cost is amplified by JCT rate hike.



Tax Considerations – Transitional Rules

Transitional measures

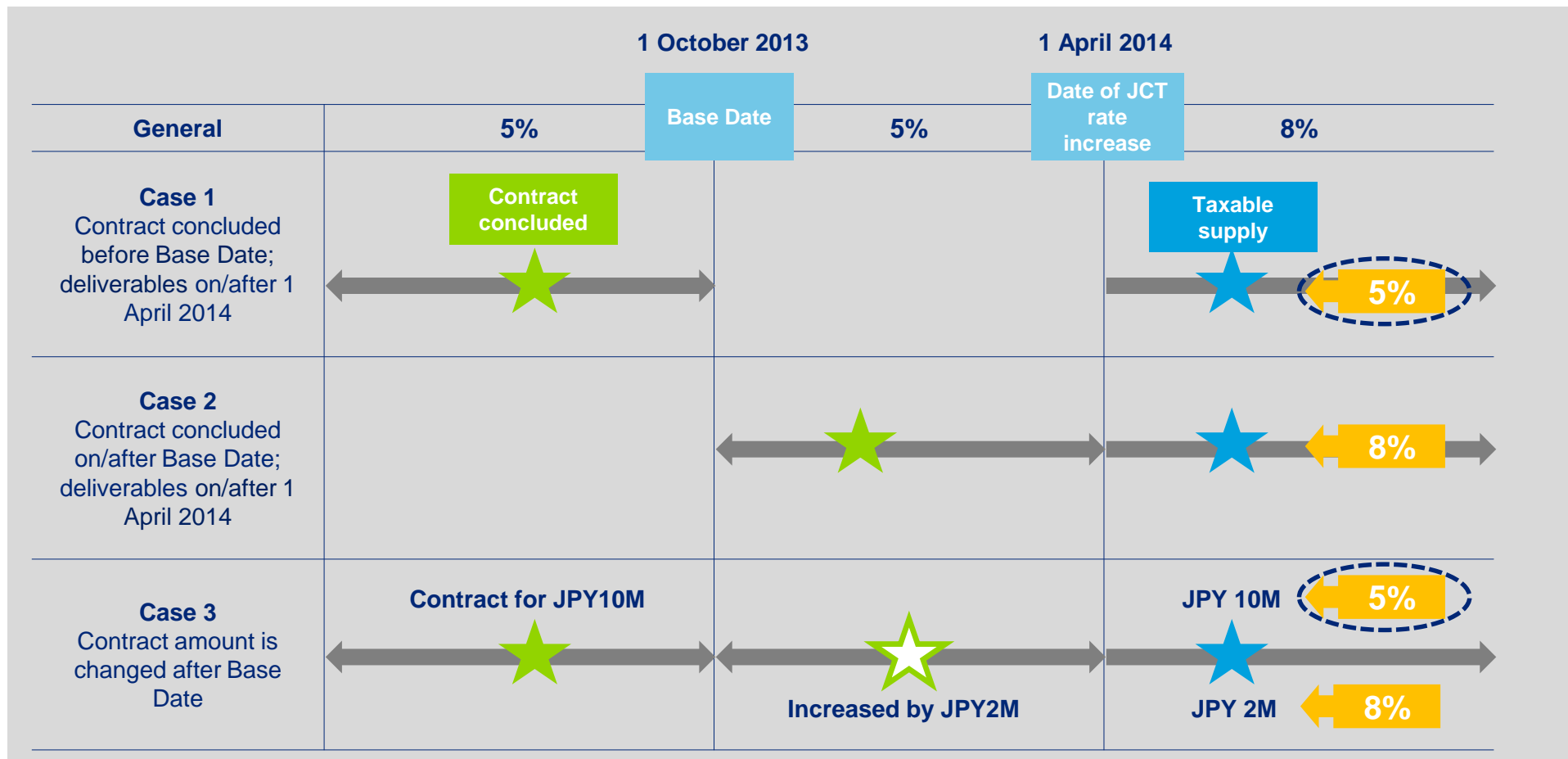
Following rate increase to 8%, the current 5% rate will continue to apply during a transitional period for the following transactions (under certain conditions)

1. Freight charges and admission fees
2. Utilities and telecommunication services
3. Contracts for work (including industrial & services)
4. Lease contracts
5. Installment sales
6. Long-term and large-scale construction
7. Subscriptions
8. Regularly published newspapers
9. Mail-order (catalogue / website) sales
10. Lump-sum fees to nursing home
11. Return of purchased goods

3. Contracts for work (including industrial & services)

5% rate is applicable if all the following requirements are met

- Contact is concluded before 1 October 2013 (“Base Date”)
- All deliverables specified under the contract are delivered at one time
- Work is undertaken pursuant to customer instructions set out in the contract



4. Lease contracts

5% rate is applicable if all the following requirements are met

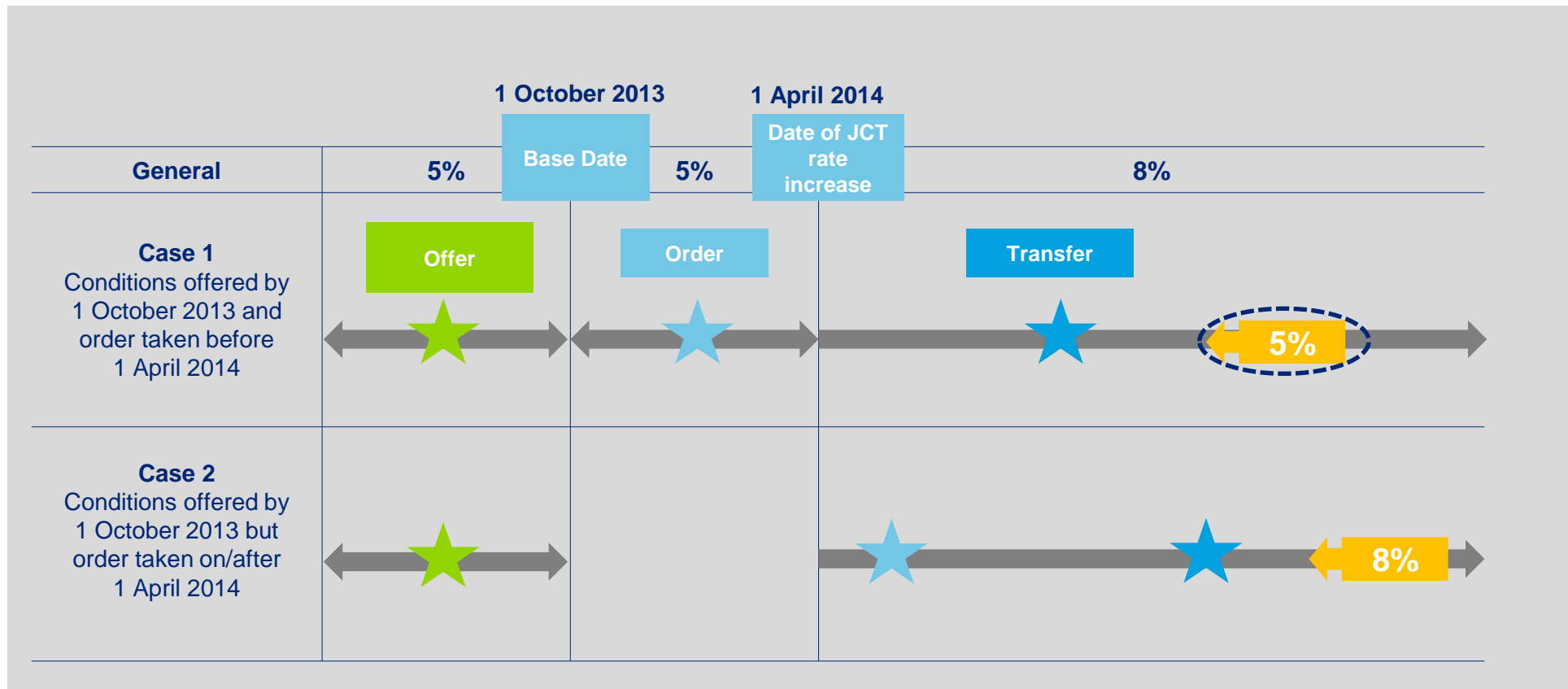
- Contract was concluded before 1 October 2013 (“Base Date”), and rent amount is not changed subsequently
- Asset has been leased continuously from before 1 April 2014
- The contract satisfies requirements 1 and 2, or 1 and 3 below:
 1. Lease term and rent are fixed
 2. Contract does not permit lessor to change the rent
 3. Contract does not give lessor and/or lessee the freedom to terminate the contract at any time



9. Mail-order (catalogue/ website) sales

5% rate is applicable if all the following requirements are met

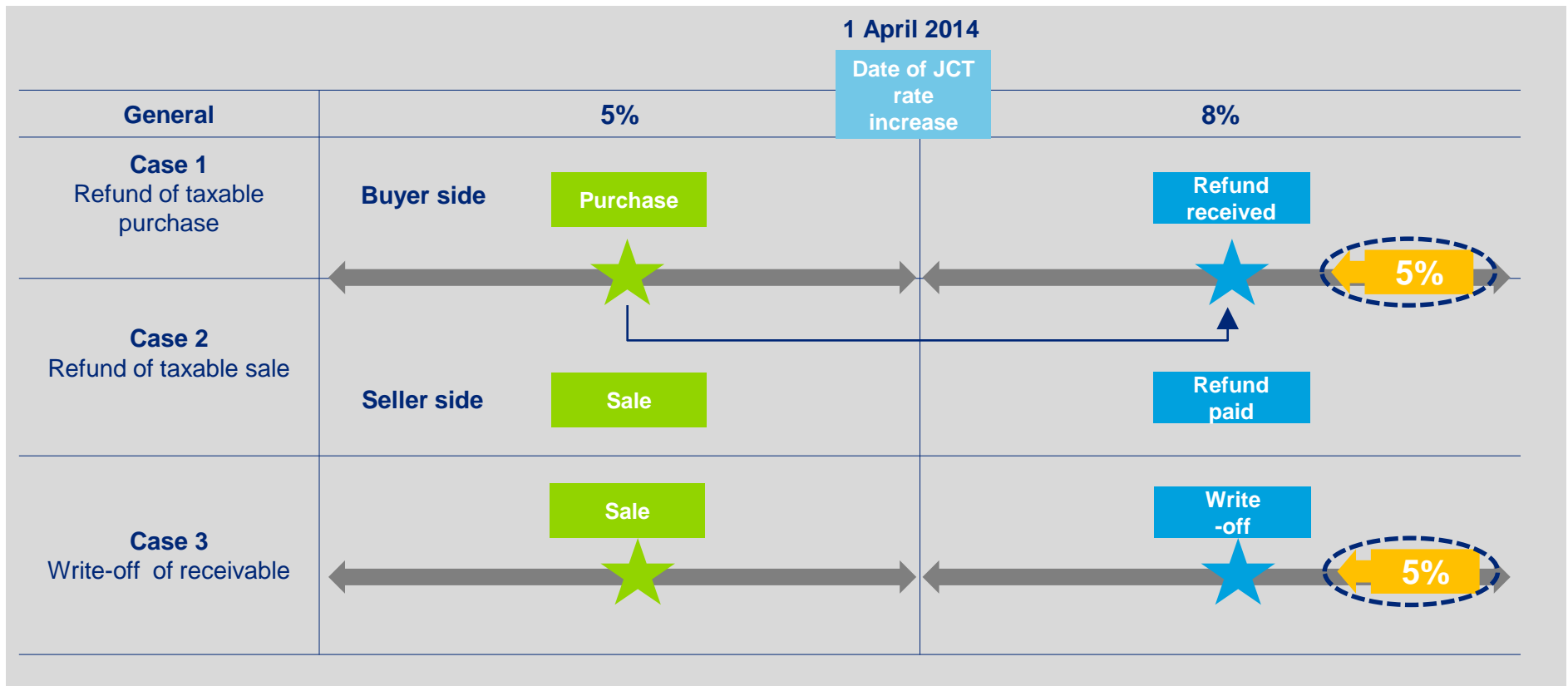
- Mail-order firm offers conditions, or completes preparation of offer conditions, by 1 October 2013 (“Base Date”)
- Order taken before 1 April 2014 and goods sold (except for books etc. sold by subscription) under offered conditions on or after 1 April 2014



11. Return of purchased goods: General rules

5% rate is applicable in the following cases

- Case 1: Payment for a taxable purchase before 1 April 2014 is refunded to buyer on or after 1 April 2014
- Case 2: Receipt for a taxable sale before 1 April 2014 is refunded by seller on or after 1 April 2014
- Case 3: Consideration for a taxable sale made before 1 April 2014 is wholly or partly unrecoverable

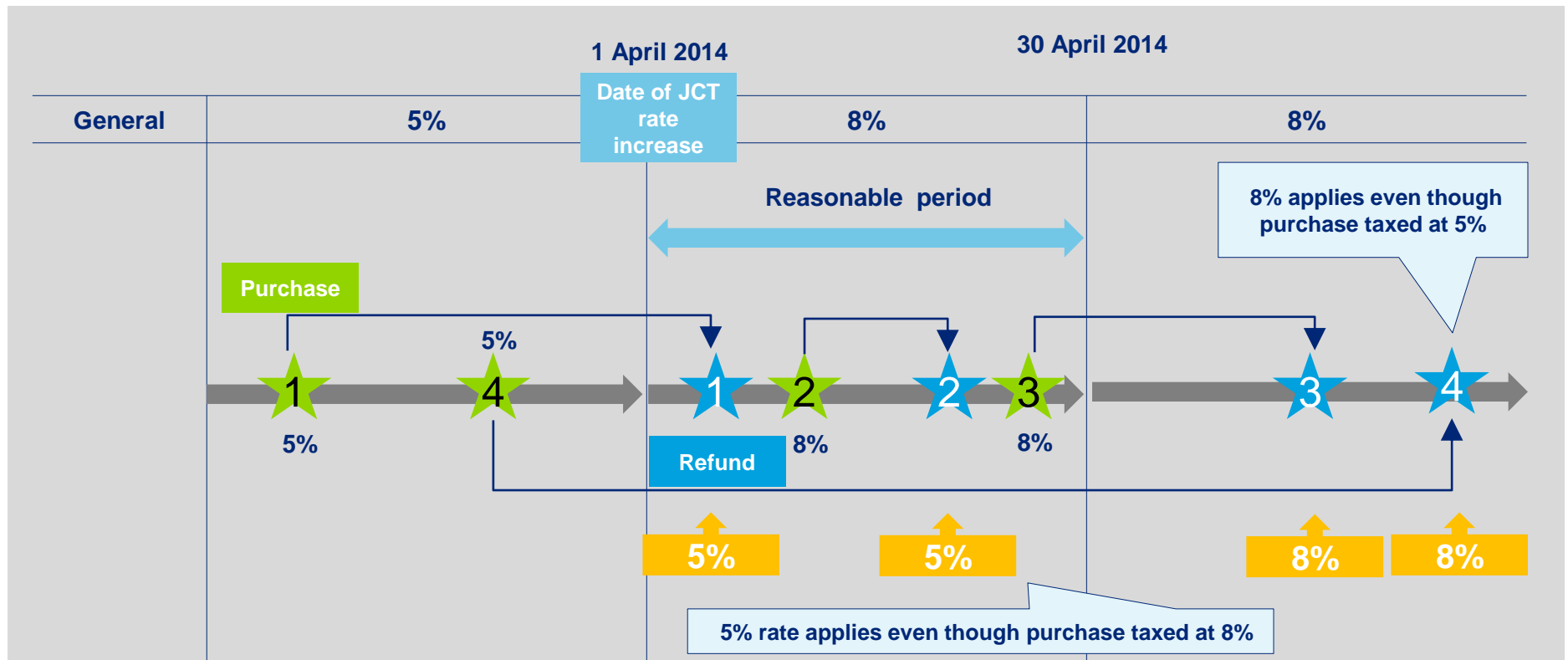


11. Return of purchased goods: Practical measure

5% rate is applicable if the following requirement is met

- Reasonable treatment agreed between buyer and seller, and adopted by both, can be applied instead of the general rule

Example: buyer and seller agree that returns in period 1 - 30 April 2014 are to be deemed a refund of purchase/sale made on or before 31 March 2014



Tax Considerations – Creditable Input Tax

Taxable sales ratio (TSR)

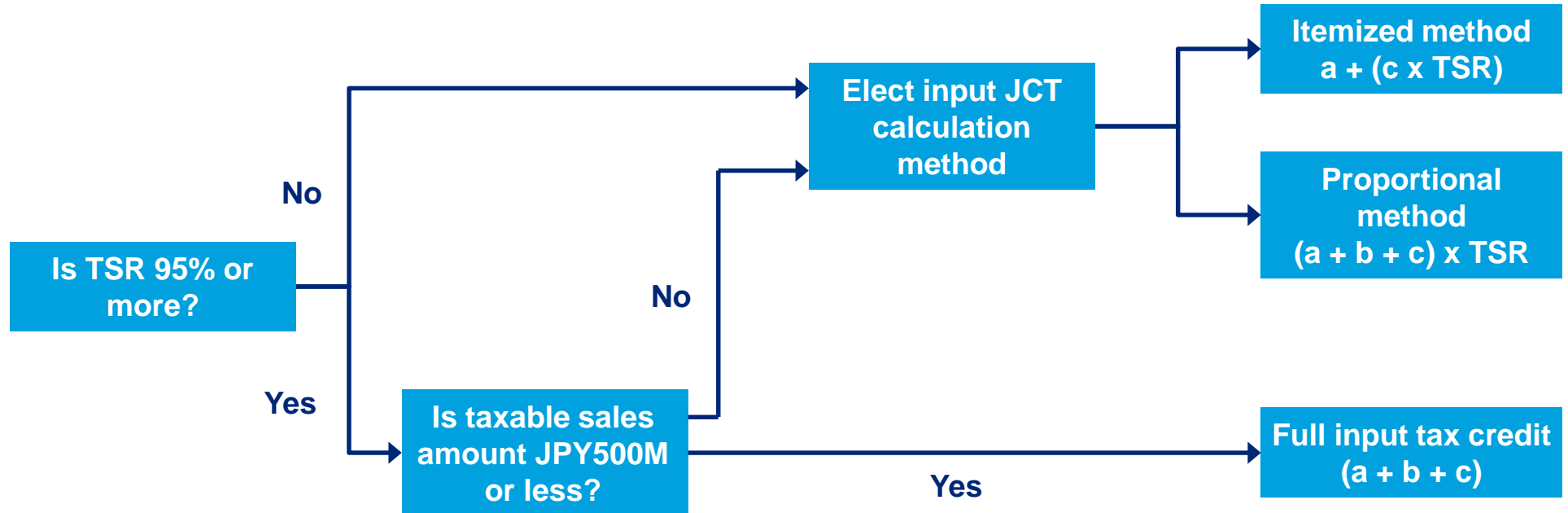
- Previously, if the Taxable Sales Ratio (TSR) is 95% or more, 100% of the input JCT is creditable
- Change to calculation of creditable input tax
 - Applied to fiscal years starting on or after 1 April 2012
 - Large companies must calculate using either Proportional method, or Itemized method
- Small enterprises with taxable sales ≤ JPY500 million can still credit 100% of input JCT if taxable sales ratio is ≥ 95%

$$\text{TSR} = \frac{\text{JCT taxable sales}^*}{\text{JCT taxable sales}^* + \text{exempt sales}}$$

*Including zero rated sales (i.e. taxable at 0%)

Classification of JCT input tax

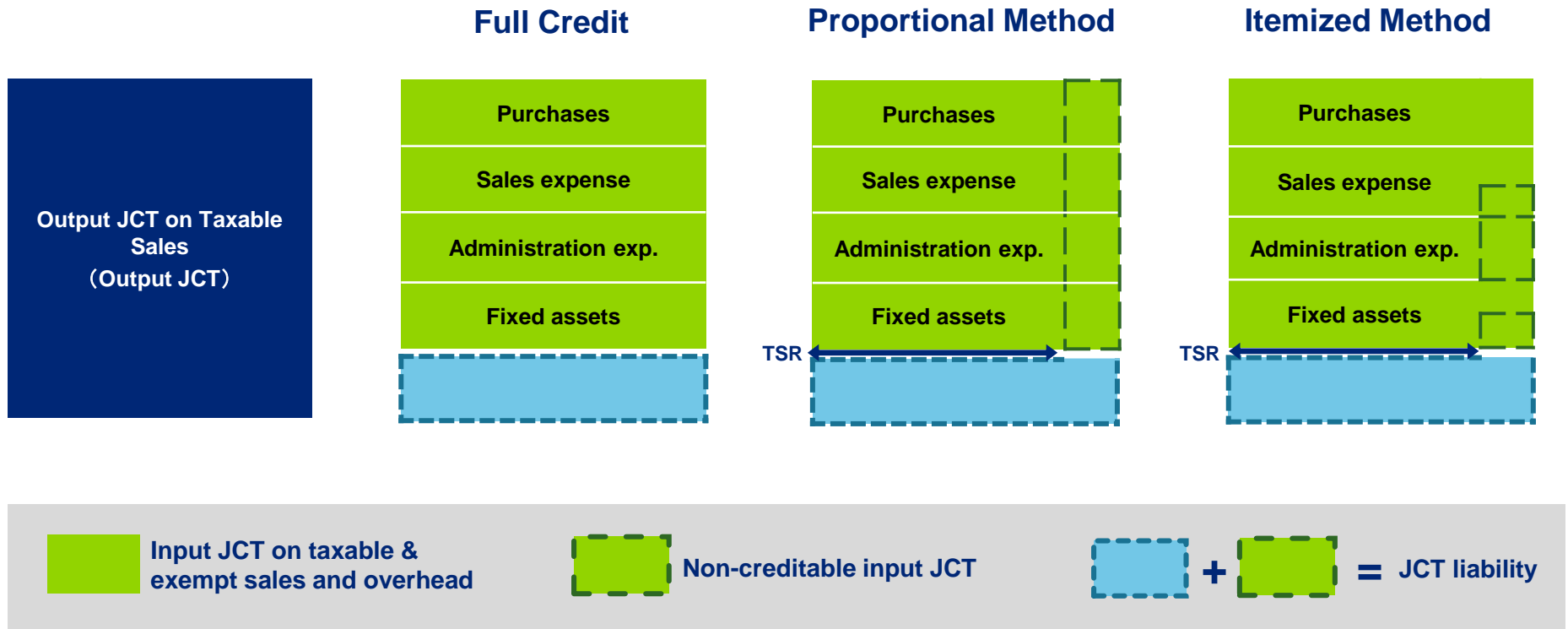
Classification of JCT input tax as attributable to taxable/exempt sales and overhead will impact on computation of creditable input tax



a – input JCT attributable to JCT taxable sales (including zero rated sales i.e. taxable at 0%)
b – input JCT attributable to exempt sales
c – input JCT attributable to overhead (i.e., attributable to both JCT taxable and exempt)

Proportional versus itemized method

Non-creditable JCT input tax amount may be lower under itemized method of computing creditable input tax



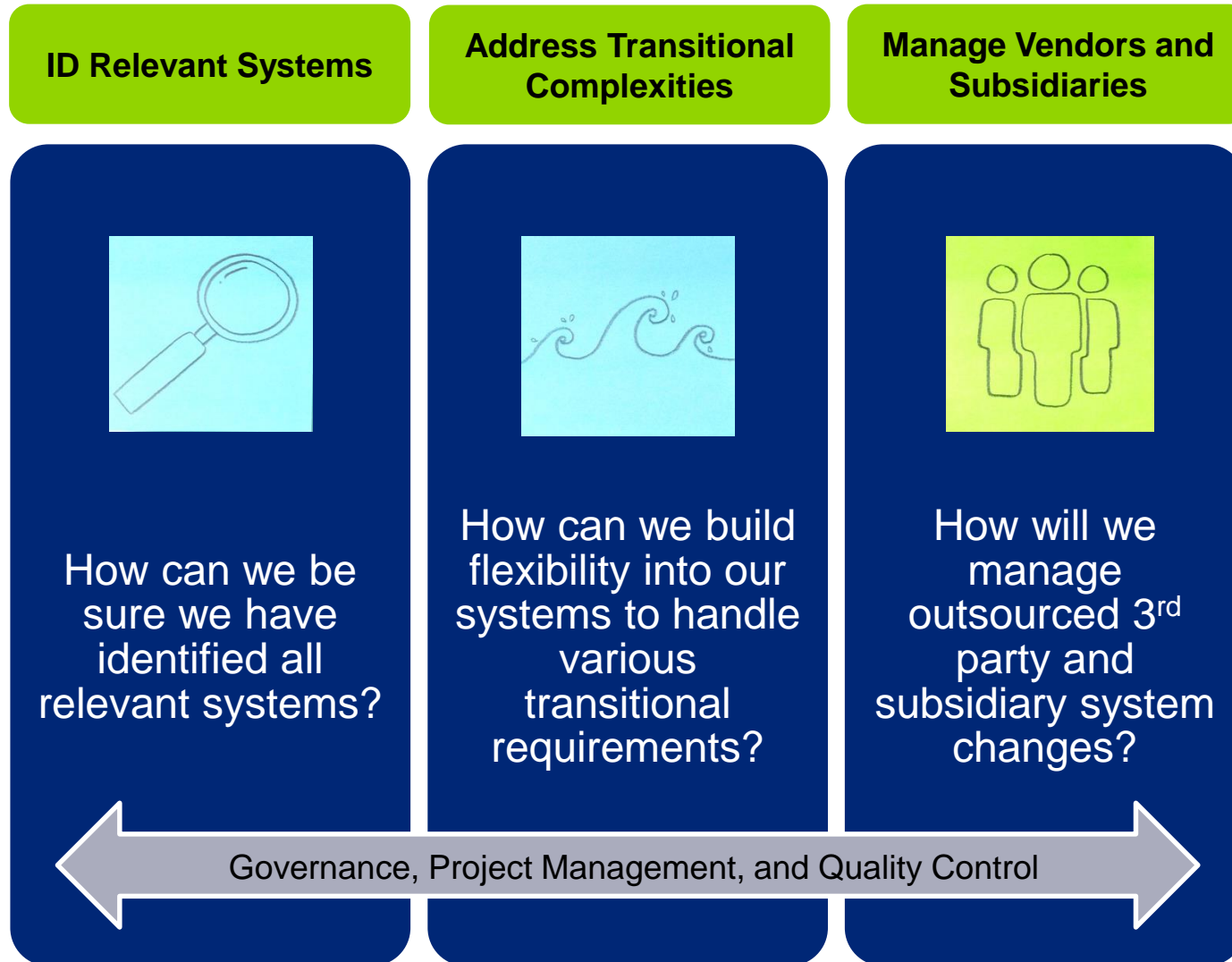
Proportional versus itemized method (cont'd)

Proportional method is simpler and easier to administer than Itemized method

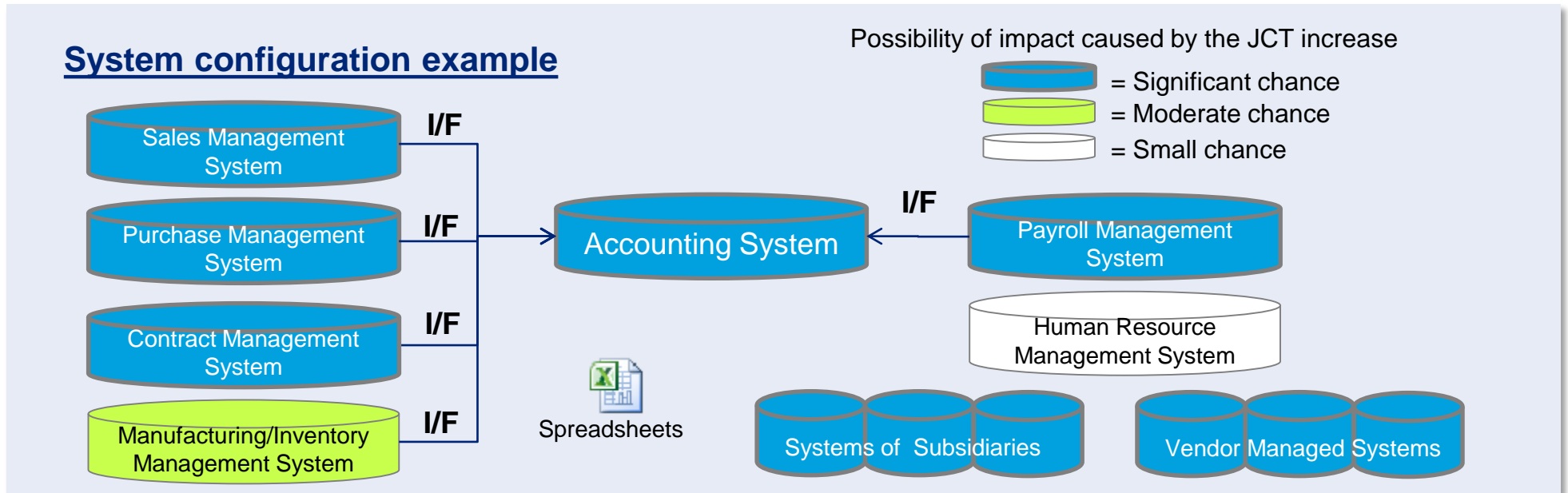
	Proportional method	Itemized method
Pros	<ul style="list-style-type: none"> • Not necessary to classify input JCT • No additional administrative burden 	<ul style="list-style-type: none"> • By classifying “overhead” input JCT into “taxable sales” or “exempt sales” using a rational criteria, calculation of creditable input JCT is no longer affected by TSR • Use of approved quasi-TSR may increase the creditable input JCT
Cons	<ul style="list-style-type: none"> • If the TSR decreases, non-creditable input JCT increases • Once method adopted, cannot change for 2 years 	<ul style="list-style-type: none"> • Increase in administrative burden to classify the input JCT amount (e.g., understanding classification, etc.) • Additional cost if existing software needs to be replaced

System Considerations

Main Challenges of JCT Rate Increase from Systems Perspective



Identify Relevant Systems



JCT rate increase will likely impact the following (non-exhaustive) areas:

- General Theme: Hard-coded logic calculating JCT and related database tax tables are likely to require updates
- Sales/Purchase Management System: Logic of JCT tax computation
- Contract Management System: Differing tax rates for each contract based on certain conditions and differing tax rates for the same contract based on timing
- Manufacturing management system: Price of inventory (if an enterprise manages it by tax-inclusive price)
- Accounting System: Tax calculations, tax reporting, and election of proportional or itemized method (if applicable)
- Payroll Management System: Reimbursement of expenses, travel expenses etc.
- Don't forget key spreadsheets/EUCs – Many before/after tax calculations occur in spreadsheets for management reports
- Subsidiary/Vendor managed systems: Additional project management/communication challenges for these systems. Will vendor managed e-Commerce sites display product prices inclusive or exclusive of tax?

Address Transitional Complexities

Systems should be designed with **flexibility** in mind to address transitional complexities and uncertainty in regulatory requirements – and to minimize time and cost when the JCT rate changes again in October 2015

Variable tax rate tables, applicable dates, and transaction characteristics (e.g. returns, leases, construction, service contracts, etc.) will be inputs for conditional tax calculation methods

Communication between IT and the business to define decision points will be a critical success factor

High Level Transitional Requirements

- ✓ Systems must identify and accurately calculate the tax treatment for each relevant transaction
- ✓ Systems must be able to handle a transaction with two or more applicable JCT rates
- ✓ Systems must calculate taxable sale, taxable purchase, output JCT and input JCT at various JCT rates

Refund of Sale/Purchase

- ✓ Systems must process refunds/payment discounts at JCT rates that differ from the original sale/purchase JCT rate

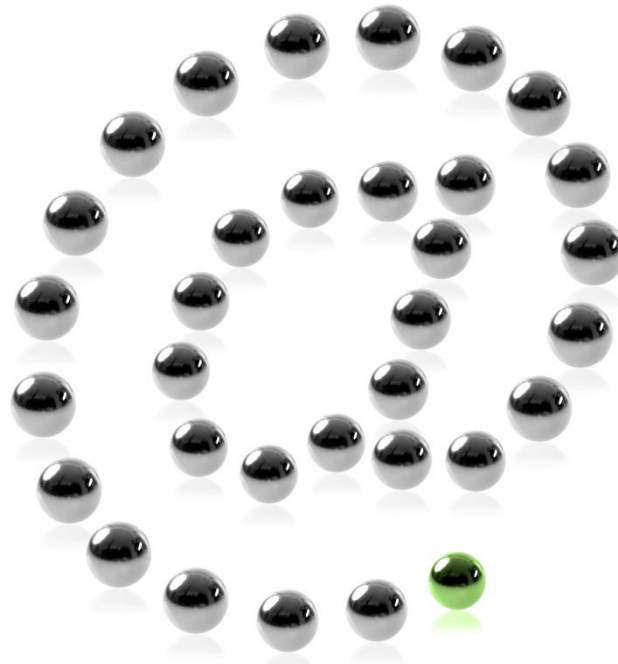
Transactions that Span 1 April 2014

- ✓ Systems must apply the appropriate JCT rate before and after 1 April 2014
- ✓ Invoices and contracts displaying various tax rates may be required

Manage Vendors and Subsidiaries

Two major concerns exist related to vendor and subsidiary management:

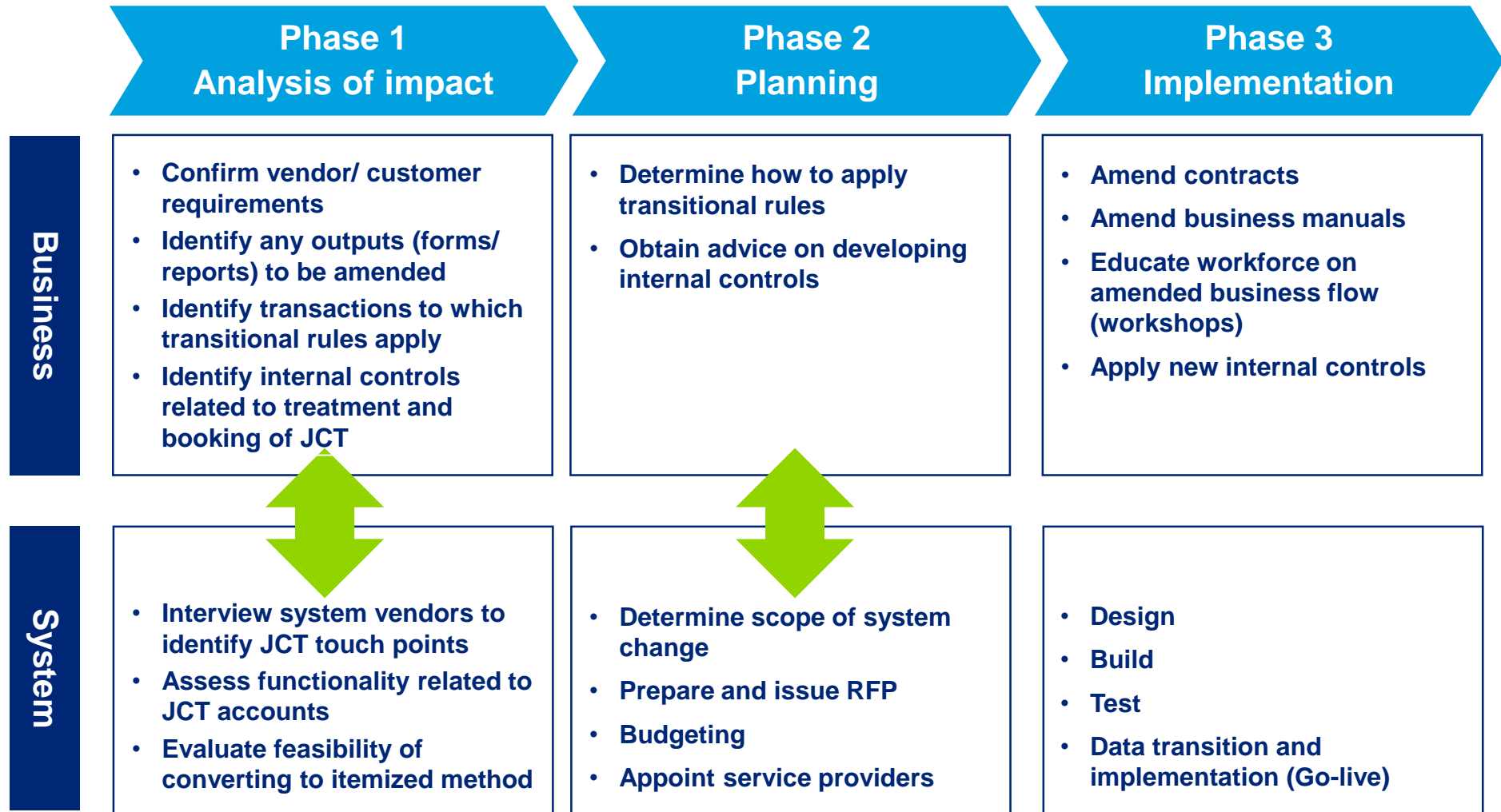
- 1) Increased project risk due to increased stakeholder management and communication overhead
- 2) Consistency between head office and subsidiary/vendor JCT increase implementation plans



A Strategic Approach

Strategic approach

Be methodical and flexible in addressing impact of tax law changes from systems and business perspectives



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