Japan Tax & Legal Inbound Newsletter

Tax impacts of offering digital services to customers located in Japan post-COVID

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In Brief

COVID-19 has had a profound impact on businesses, effecting everything from revenues to the way companies operate to carry out their day-to-day working functions. As a result, many companies that have historically held meetings and seminars in-person are now shifting to holding such events online. Transitioning meetings and seminars to an online setting may have unexpected Japanese tax consequence, particularly in a cross-border context with a new focus on digital services. This newsletter discusses such issues from a Japanese consumption tax ("JCT") perspective, and provides a case study to demonstrate the effect the issues may have on businesses looking to conduct online events for customers located in Japan.

1. Overview of JCT digital services

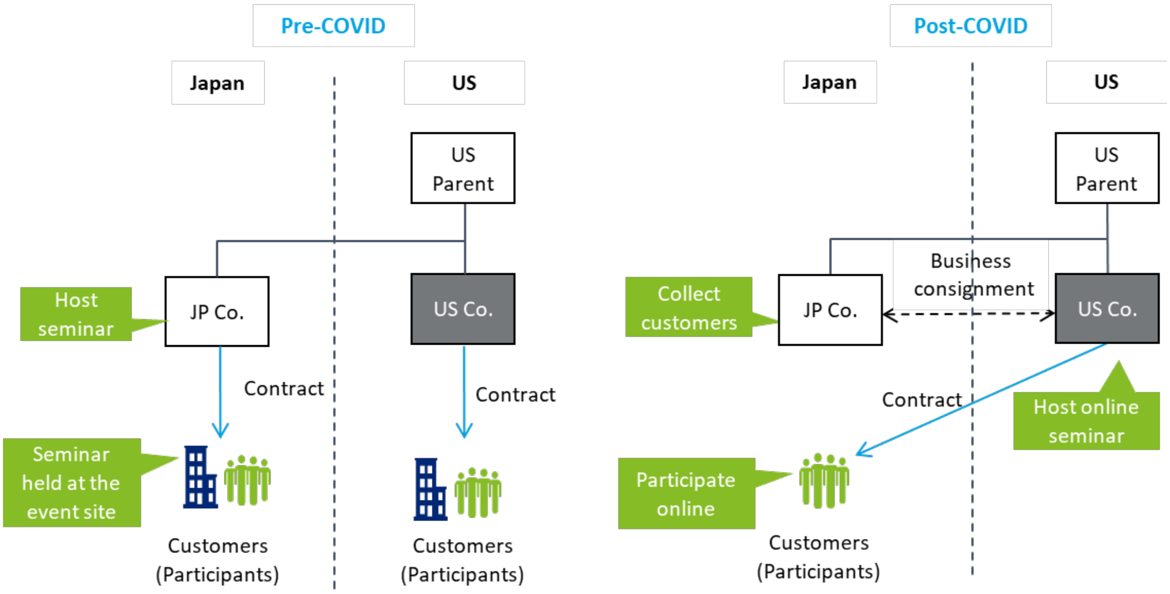
Under JCT law, digital services are generally defined as services provided via a telecommunications network and include, among other things, intercompany IT services, online databases, and online seminars/training. Since 2015, the place of supply for digital services is the location of the service recipient. Thus, digital services supplied to Japanese customers would generally be subject to JCT, regardless of whether the supplier is a Japanese or foreign company.

The JCT treatment of the supply of digital services by foreign companies differs depending on whether the transaction is categorized as business-to-business ("B2B") or business-to-consumer ("B2C"). Whether a service should be classified as B2B or B2C generally depends on the nature of the service or its terms rather than the recipient's status as a business or individual, and an analysis of contractual terms is typically required to make the determination. However, some services are generally viewed as clearly for businesses (i.e., B2B), such as online advertising and intercompany IT services, while online purchases of items such as music, e-books, games, etc. are generally viewed as clearly for individuals (i.e., B2C).

Digital services classified as B2B are subject to a reverse-charge mechanism, and the recipient (rather than the supplier) would be required to account for both input and output JCT on the transaction. The only obligation for foreign suppliers with respect to the supply of B2B services is notifying their Japanese customers beforehand that the transaction is subject to the reverse-charge. On the other hand, if a digital service is classified as B2C, foreign suppliers must charge JCT or treat the amount charged to Japanese customers as inclusive of JCT and account for output JCT. Foreign suppliers of B2C services would also need to appoint a JCT representative in Japan and file/remit JCT through the representative if they meet the requirements to become a JCT taxpayer based on volume of taxable sales, or elect for JCT taxpayer status.

2. Case study

One example of how JCT rules may impact companies forced to change the way they operate due to COVID restrictions can be seen in the following example. Prior to COVID-19, JP Co., a subsidiary of US Parent, hosted in-person seminars for Japanese customers. However, as a result of COVID, events could no longer be held in-person. Thus, for business reasons US Parent decided to have its US subsidiary, US Co., host a virtual seminar, with JP Co. collecting customers in Japan for the event. Tickets to the event would be sold online and customers in Japan would be able to obtain a pass, view content/webinars, participate in streamed sessions, etc. The chart below provides an illustration of the pre and post-COVID transaction structures of US Parent.



Pre-COVID the US entities were not impacted by JCT, as the events were hosted solely by JP Co. However, the virtual seminars held by US Co. post-COVID would be seen as the supply of cross-border digital services and may result in JCT filing/payment obligations for US Co. if classified as B2C and US Co. meets the requirements for JCT taxpayer status.

Deloitte's View

Restrictions on public gatherings, travel, etc. as a result of COVID-19 have forced many business to rethink the way they operate and interact both internally with employees and externally with customers. Changes such as hosting events virtually rather than in-person are often the best alternative for continuing operation in the current climate. However, companies choosing to go virtual should be aware of the potential tax implications that may arise in doing so and consult with their tax advisor to plan accordingly and avoid any adverse consequences.

For example, foreign companies holding events online for customers located in Japan may result in unforeseen JCT impacts. Whether JCT will apply depends on a number of factors, such as whether the service is considered a "digital service" for JCT purposes, whether the service is B2B or B2C, and whether the foreign business qualifies as a JCT taxpayer. Determination of such factors is not always straightforward, so businesses should make sure to perform a detailed analysis to help ensure the correct treatment.

Additionally, changes in operations as a result of COVID-19 may have other consequences outside the realm of JCT (e.g., potential permanent establishment risks resulting from employees of foreign companies working remotely from Japan). Companies should be aware of such risks as well when making operational changes to cope with the current situation and consult with their tax advisors to avoid any potential pitfalls.

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