5. Learn about "Consumption Tax"

1 Consumption Tax

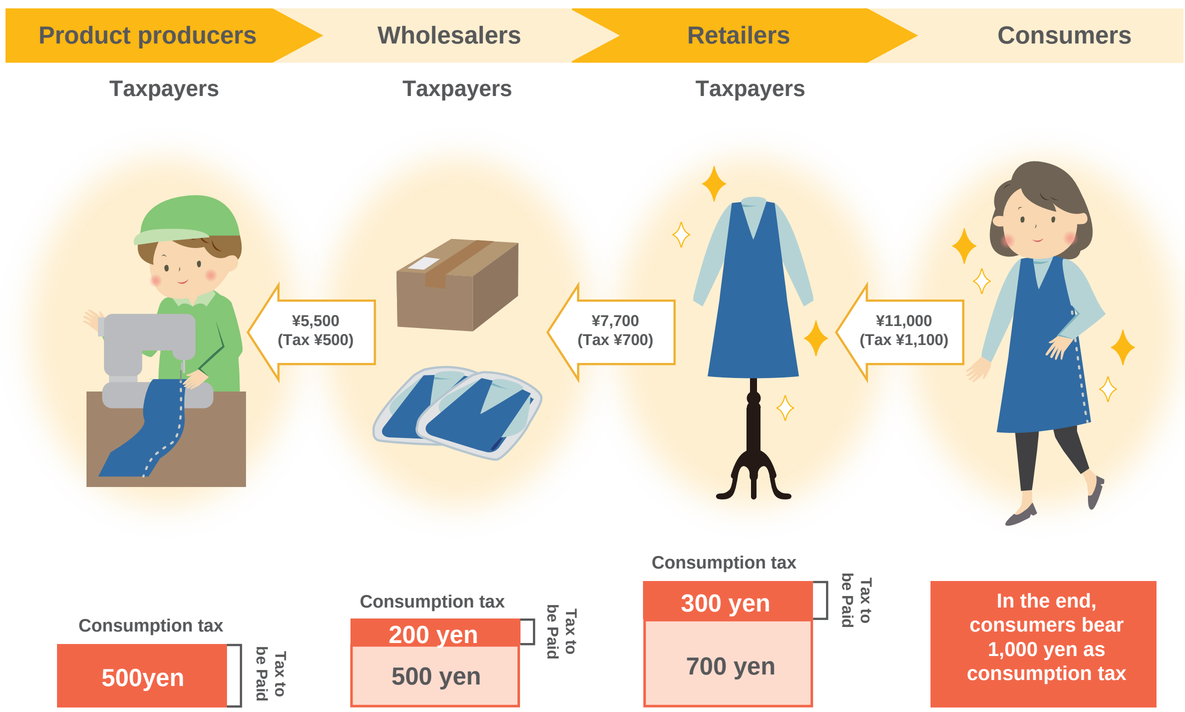
Consumption tax is levied broadly and fairly on consumption in general. In principle, sales and provision of goods and services in Japan are subject to consumption tax, and it is imposed on sales of business entities as taxable person. To avoid tax accumulation, business entities may deduct input tax from output tax they collected through their sales and pay the remainder to the tax authority.

Consumption tax paid by business entities is added to sales prices as cost and supposed to be borne by final consumers (in contrast to income tax called "**direct tax**", consumption tax of which taxable person and actual tax bearer are different is called "**indirect tax**").

* In this chapter, consumption tax (national tax) and local consumption tax (local tax) are collectively referred to as "consumption tax".

Structure of Consumption Tax

Business entities may deduct input tax on purchase from output tax on sales.



※Calculated with a 10% tax rate

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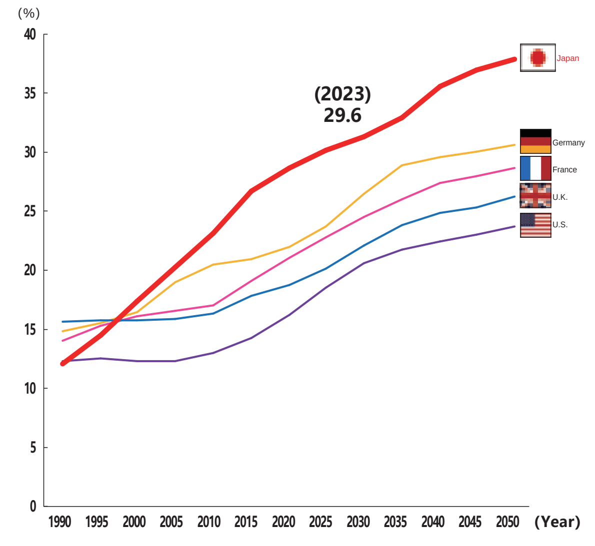
2 Use of Consumption Tax Revenue

The financial source of social security, in principle, is based on mutual support through insurance premiums. As it is difficult to cover social security expenses solely by insurance premiums, other than putting heavy burden on working-age population, tax revenues and debts are also used for that purpose. The cost of social security associated with aging continues to increase. Most of the expenses currently depends on the debts, which means the burden is deferred to future generations such as our children and grandchildren.
In order for all generations to share the burden of social security that we benefit from and to pass on the current social security system to the next generation, it is indispensable to **secure stable financial sources**.
Against this background, the consumption tax rate was increased from 5% to 8% in April 2014, then further hiked from 8% to 10% in October 2019.
All of the increased revenue due to the consumption tax rate increase will be allocated to social security, expanding the social security system, which was traditionally centered on the elderly, converting the social security focused on the elderly to cover "All Generations" by expanding the benefits for working and child-rearing generation through eliminating the waitlists for nursery/preschool as well as making preschool education and nursery free of charge.

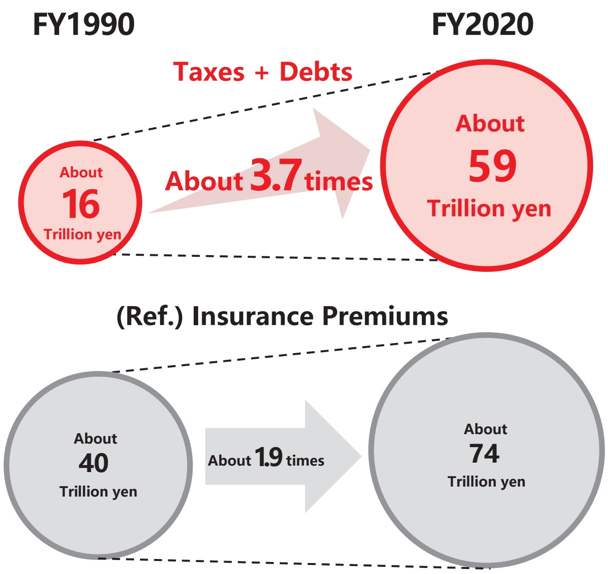
* Consumption tax is suitable as a stable financial source for social security, as the burden is not shouldered only by specific generations such as working-age population. In addition, the tax revenue is not easily affected by fluctuations in the economy.

Share of Old Age in Japan
(Share of Old Age = percentage of the population aged 65 years and older against the entire population)



(Source) Japan: "Population Estimates" by Ministry of Internal Affairs and Communications, and "Japanese Future Demographic Projection (April 2017)"by National Institute of Population and Social Security Research (Based on median births/deaths)
Other Countries: "World Population Prospects 2022" by United Nations

Increases in taxes and debts to cover social security benefits



(Source) "The cost of Social Security Benefits in FY 2020" by National Institute of Population and Social Security Research

3 Reduced Tax Rate System for Consumption Tax

Along with the change of standard tax rate to 10%, a reduced tax rate system is introduced, which applies 8% to the purchase of food and beverages (excluding liquors and eating-out), to take care the impact on lower-income group.

10%

(Standard Tax Rate)

8 %

(Reduction Tax Rate)

A catalogue of the images

○ Foods and drinks (excluding liquors and eating-out services)

○News (regular purchase contract concluded twice a week)

Invoice System (Qualified Invoice System)

With the implementation of the reduced tax rate system, the consumption tax rate is now either the standard rate of 10% or the reduced rate of 8%. In order for businesses to accurately calculate the amount of consumption tax, the Qualified Invoice System is going to be introduced from October 2023.

Under this new system, businesses that issue qualified invoices are required to clearly state the applicable tax rate and amount on their invoices or bills, so that both sellers and buyers can confirm that there are no errors in calculation of the tax rate, etc.

* A four-year preparation period from the implementation of the reduced tax rate system (from October 2019) has been provided to allow businesses to comply with the Qualified Invoice System.

Example of Qualified Invoice

Invoice

（December）　MM DD, YYYY

To: ABC Company

XYZ Company

① Registration Number: T123456・・・

Date	Item sold	Amount
11/1	Fish ＊ ④	5,000 yen
11/1	Pork ＊	10,000 yen
11/2	Towel Set	2,000 yen
	…	
Total	120,000 yen　Consumption Tax 11,200 yen	
②	8% Taxable: 40,000 yen　Consumption tax: 3,200 yen ③	
	10% Taxable: 80,000 yen　Consumption tax: 8,000 yen	

④ ＊ Subject to a reduced tax rate

Additional items for the Qualified Invoice from general invoice under single tax rate

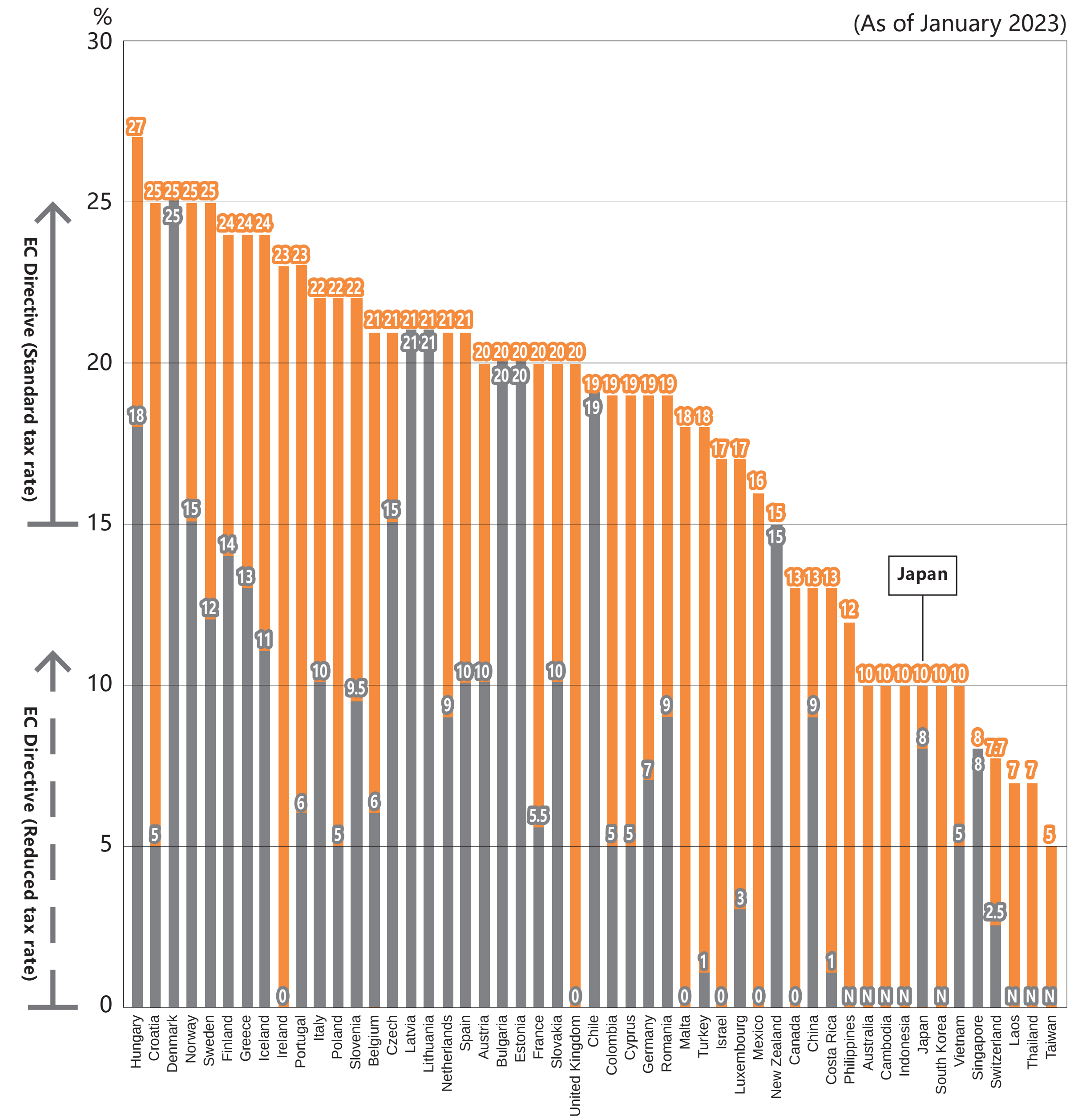
① Registration Number

② Tax rate applicable

③ Consumption tax

④ Indication that items are eligible for a reduced tax rate

International Comparison of Value-added Tax rates (standard rates and rates on food)



(Note 1) This figure above shows the basic rate applicable to typical items.
(Note 2) In this figure, the effective tax rates for food are shown as ▮. Those with "0" indicate a zero-tax rate applicable on food in the countries. Those with "N" indicate that food is non-taxable in the countries. The range of goods subject to the reduced/zero tax rate or being non-taxable varies depending on countries.
(Note 3) In Japan, 2.2% of the 10% (standard tax rate) and 1.76% of the 8% (reduced tax rate) account for Local Consumption Tax (local tax).
(Note 4) The EC Directive had originally denied zero tax rates and reduced tax rates less than 5%, but an amendment in April 2022 permitted them for certain items.
(Note 5) Figures as of July 2022 for Denmark, Greece, Italy, and Czech Republic. Figures as of January 2022 for Cyprus.
(Note 6) As for Canada, there are three types of taxation systems: 1) Provinces with only federal GST/HST; 2) Provinces with a provincial value-added tax in addition to the federal GST/HST; and 3) Provinces with a federal-provincial value-added tax. In this figure, the tax rate of Ontario categorized as 3) is shown (13% federal-provincial value-added tax, including 8% provincial tax).
(Note 7) In Poland, the main tax rates are 22%, 7%, and 5%, but there is a provision to change the tax rates depending on the fiscal situation. Currently, 23%, 8%, and 5% are applied as special exceptions.
(Source) OECD Statistics, websites of the European Commission and each country, and IBFD.