5. Learn about "Consumption Tax"

1 Consumption Tax

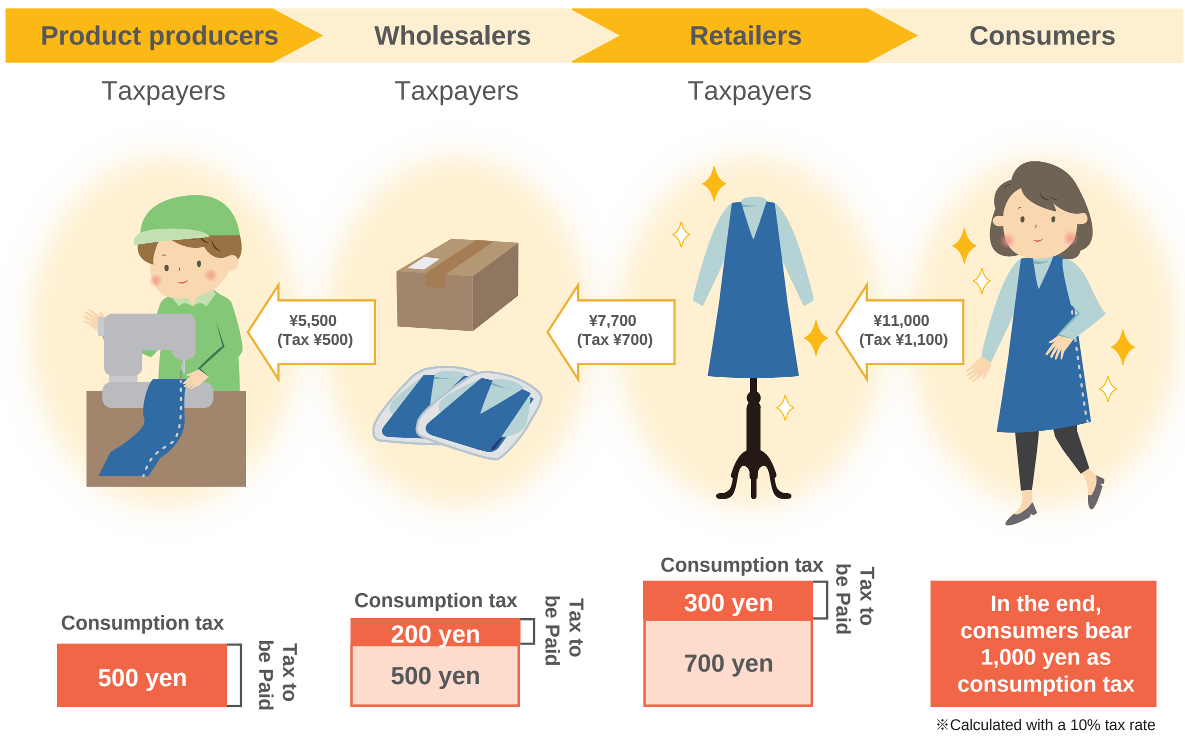
Consumption tax is levied broadly and fairly on consumption in general. In principle, sales and provision of goods and services in Japan are subject to consumption tax, and it is imposed on sales of business entities as taxable person. To avoid tax accumulation, business entities may deduct input tax 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.



2 Consumption Tax Rate Hike

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. In Japan, the aging progresses rapidly, which makes the cost of social security increase continuously. Most of the expenses currently depends on the debts, which means the burden is deferred to future generations such as our children and grandchildren.

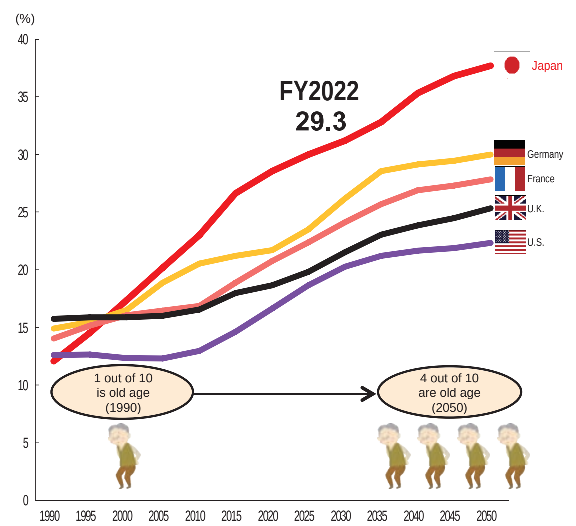
In order to make the current social security system sustainable to the next generation's era by sharing the burden of social security by all generation, it is indispensable to **secure stable financial sources**.

Under this background, the consumption tax rate was hiked from 8% to 10% in October 2019.

※ 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 impact on economic activities is relatively small, and the tax revenue is not easily affected by fluctuations in the economy.

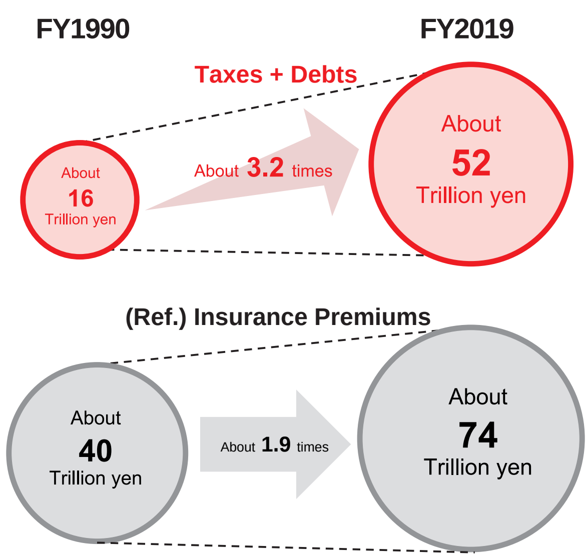
Share of Old Age in Japan

(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
Other Countries: "World Population Prospects 2019" by United Nations

Increases in taxes and debts to cover social security benefits



(Source) "The cost of Social Security Benefits in FY 2019" by National Institute of Population and Social Security Research

Convert to the Social Security System for All Generations

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.

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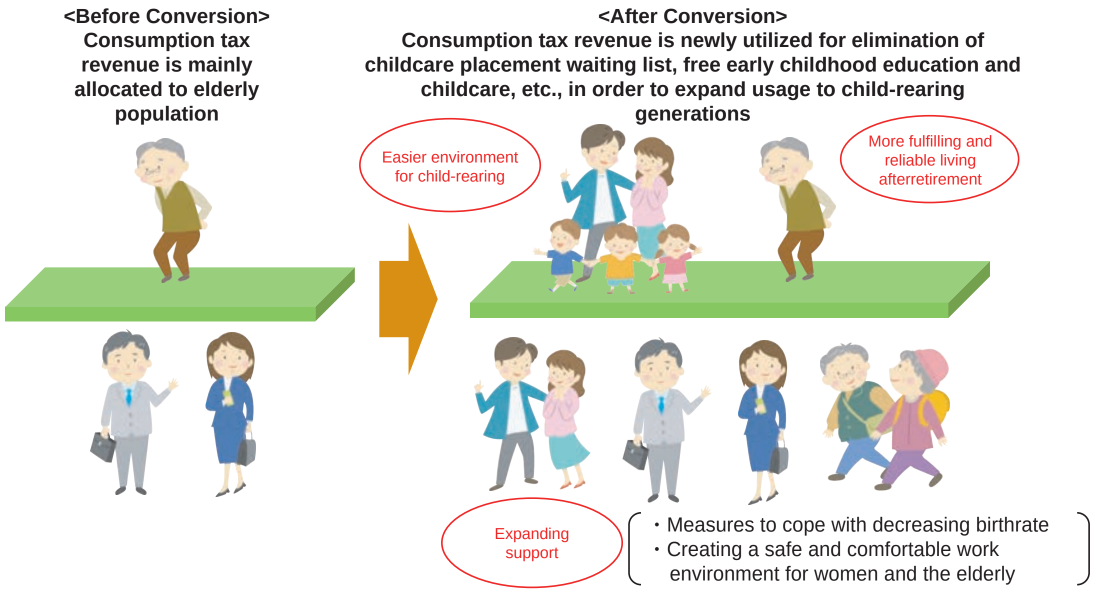
All of the increased revenue of the consumption tax hike is allocated to social security and converting to the social security system for "all generations"



Measures to be implemented at the time of consumption tax rate hike from 8% to 10%

Elimination of childcare placement waiting list

Offering additional 320 thousand child care places by the end of FY2020

Improvement of working conditions long-term care workers

Securing more support for nursing by improving benefits and compensation for care workers

Free early childhood education and childcare

Free preschool education (kindergartens, nursery schools, and certified childcare centers) for all children between the ages of 3 and 5 (For households of lower income, infants and toddlers of ages 0-2 will also be free of charge)

Reduction of contribution on long-term care insurance fee for elderly people with low income

More reduction of insurance premiums for the elderly population with low income

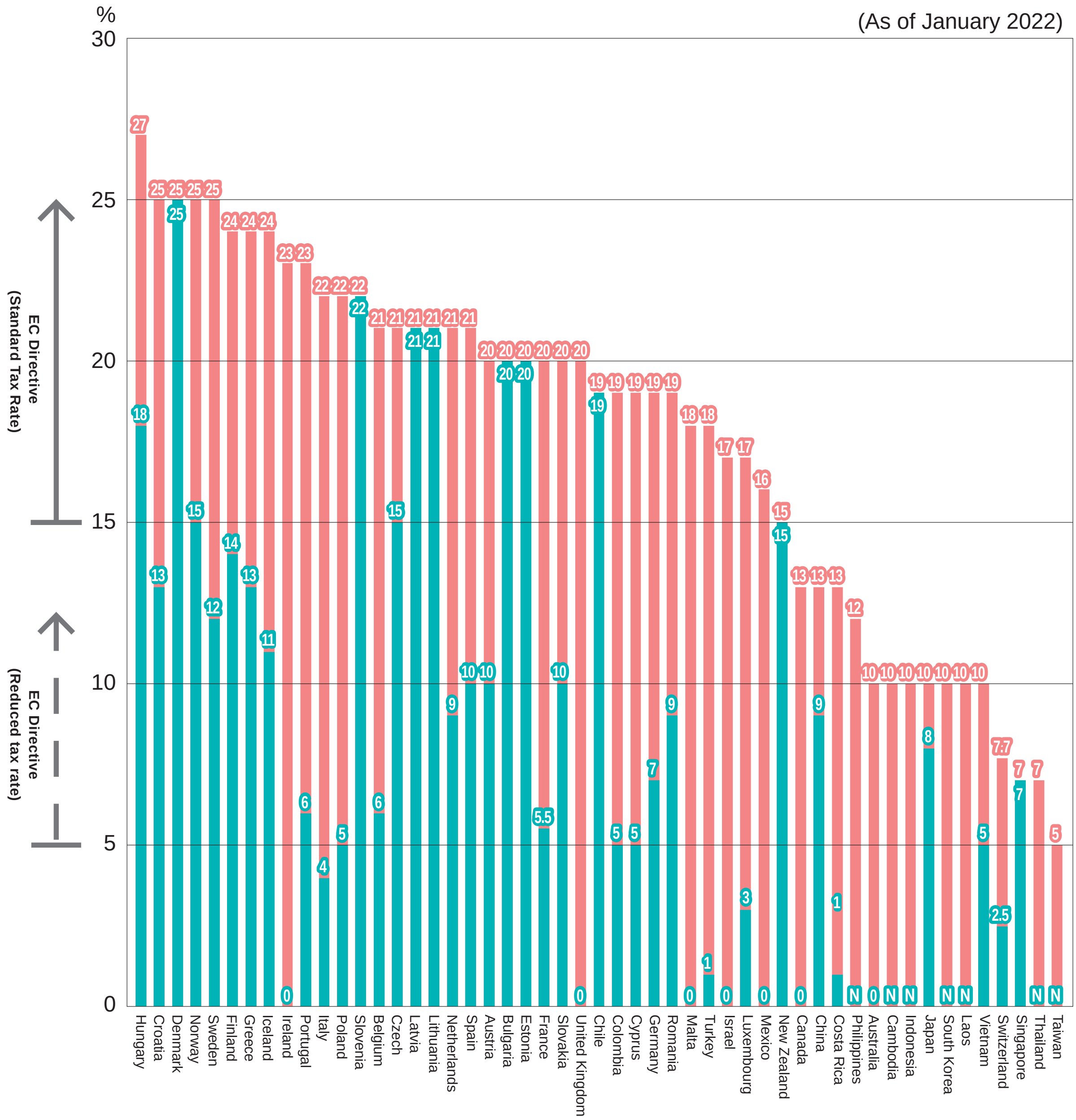
Free higher education

Reduced tuition/grant-based scholarship for students who are truly in need with lower income family background

Provision of benefits for supporting low-income pensioners

Benefit of up to 60,000 yen per year for pensioners with low income

<Reference> International Comparison of Value-added Tax Rates (standard rates and rates on food)



(Note 1) The above graph shows the principle rate, where only taxes for typical items are listed. It should be noted that the tax rates may vary depending on the item. In some cases, tax rates are reduced temporarily, or more items are subject to reduced tax as a measure against the COVID-19 pandemic.

(Note 2) The shades in blue are the effective tax rates for food. Those with “0” indicate countries with zero tax rate levied on food. Those with “N” indicate countries where food is non-taxable. The range of food items subject to the reduced/zero tax rate or being non-taxable varies from country to country, and certain kind of food may be handled differently from above.

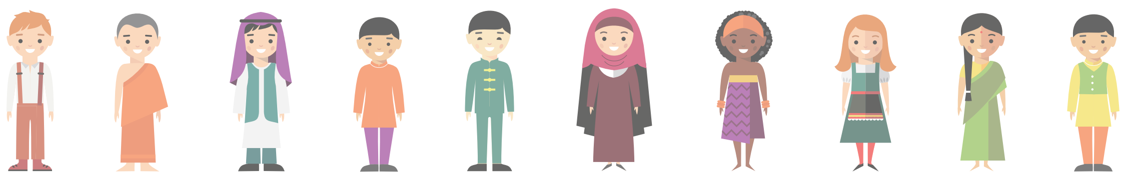
(Note 3) Figures as of January 2021 for Belgium, Croatia, Cyprus, Greece, Italy, Romania, and Slovenia.

(Note 4) 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 GST/HST; and 3) Provinces with a federal-provincial value-added tax. The table shows the tax rate of the Ontario, categorized as 3) (13% federal-provincial value added tax, including 8% provincial tax).

(Note 5) In Poland, the main tax rates are 22%, 7%, and 5%, but there is a provision to change the tax rate depending on the fiscal situation. Currently, 23%, 8%, and 5% are applied as special exceptions.

(Note 6) In the U.S., there is no federal value-added tax. Instead, sales tax (local tax) is imposed by states, countries or cities (e.g. 8.875% as total of New York State and New York City).

(Source) OECD Statistics, websites of the European Commission and each country, and IBFD.



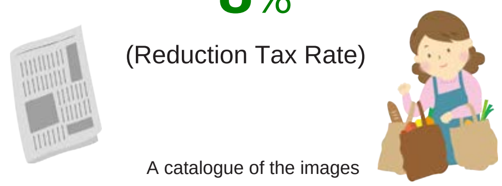
3 Reduced Tax Rate System for Consumption Tax

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.

The benefit of the scheme is to lessen the burden on household budget through applying the reduced tax rate on the goods consumed by almost all the consumers on daily basis, such as food and beverages.

10%
(Standard Tax Rate)

8%
(Reduction Tax Rate)



A catalogue of the images

〇Foods and drinks (excluding liquors and eating-out services) (※)

〇News (regular purchase contract concluded twice a week)

(※) The coverage of foods and beverages which are subject to the reduced tax rate