



Japan exempts virtual currencies from consumption tax

Global Tax News

31 MAR 2017

By: Keitaro Uzawa | Hidehiro Go | John Chambers

Japan's Cabinet has approved proposals for the 2017 fiscal year tax reform which include an exemption from consumption tax (the Japanese value added tax) for the transfer of virtual currency (VC-cash exchange).

The exemption will be embodied in an amendment to the Enforcement Order of the Consumption Tax Act, which is being prepared by the Ministry of Finance, and it is highly likely that it will apply to VC-cash exchanges executed on or after July 1, 2017.

Comparable treatment can be found in Europe, where EU member states exempt virtual currencies from taxation as a result of the Court of Justice of the European Union's ruling on October 22, 2015 stating that the exchange of traditional currency for Bitcoin virtual currency (and vice versa) is exempt from value added tax in the EU. After the Enforcement Order comes into force, VC-cash exchanges will receive a taxation treatment in Japan similar to that already found in EU member states.

Background

The transaction volume of virtual currencies in Japan has rapidly increased since the amendment to the Payment Services Act [1] was enacted in May 2016. In January 2017, for example, the monthly transaction volume of virtual

currencies was more than JPY539 billion (US\$4.7 billion).[2] A slight recession in the virtual currency market occurred in 2014 following the bankruptcy of Mt. Gox Co., a major exchange service operator in Japan, but the virtual currency market has since rebounded resoundingly.

The amended Payment Services Act defines a virtual currency as (i) property of value, (ii) usable for payment to unspecified persons, (iii) purchasable from and sellable to unspecified persons and (iv) transferable by electronic processing devices. The Act also explicitly excludes traditional currency from its definition. Bitcoin is understood to fall under the definition of virtual currency in the Act because it is electronically exchanged for traditional currency by exchange service operators and can be used by anyone accepting Bitcoin as payment. According to the definition, virtual currency is not only distinguished from traditional currency but also from electronic money. Electronic money has a specific issuer and is generally usable only by the issuer or the person designated by the issuer. Meanwhile, virtual currencies like Bitcoin have no such issuers and are usable by any accepting individual.

The Act also introduces regulations for the registration of all virtual currency exchange businesses. This regulation is consistent with the declaration made at the 412st G7 Summit at Elmau in 2015. Currently, most Bitcoin-cash exchange services available in Japan are operated by Japanese companies. However, the amendment to the Act could be **an opportunity for foreign VC-cash exchange service providers to expand their business into Japan**, because the new registration system is also open to foreign entities.[3] Every exchange business will need to segregate customer property and report on its business and finances on a regular basis. Virtual currency transactions may therefore become more credible through the improvement of the market environment as a result of the Act. It is anticipated that the consumption tax exemption applicable to virtual currency will also accelerate trading volume.

Exemption for virtual currencies

A transfer (including a lease) of assets or provision of services undertaken in Japan (domestic transactions) for business purposes is subject to consumption tax. Also, import of foreign goods into Japan (import transactions) is subject to consumption tax when such goods are delivered from bonded areas. However, if such assets/services fall into any of the designated non-taxable categories, including the transfer of payments prescribed in the Foreign Exchange Act and the transfer of prepaid payments prescribed in the Act, consumption tax is not imposed. The amendment to the Enforcement Order adds VC-cash exchanges to the list of non-taxable transactions.

VC-cash exchanges are not considered import transactions because virtual currency cannot be delivered from a bonded area. Whether VC-cash exchanges could be considered domestic transactions would be determined by the location of the transferors' office where the location of the assets is unclear. Prior to the amendment of the Enforcement Order, VC-cash exchanges operated by domestic exchange service operators would fall under domestic transactions, while vc-cash exchanges operated by foreign exchange service operators would not be classified as domestic transactions. The amendment seeks to eliminate this discrepancy between domestic and foreign exchange businesses. To that end, domestic exchange service operators have insisted on the exemption not only for cost-saving measures but also to level the playing field with foreign operators.

Virtual currency as a payment

While VC-cash exchanges would be exempt from consumption tax, the exchange of virtual currency for assets or services (*i.e.*, when someone pays virtual currency to a seller of assets or services) is still subject to consumption tax in the same way as those transactions which are paid in traditional currency. In such a case, the main problem in need of an effective solution is calculation of the tax base.

The tax base for non-virtual currency transactions is equal to the amount of money paid. On the other hand, when the consideration is for something other than money, the tax base is calculated by the market price of the asset or service. The Consumption Tax Act does not specify further details. Therefore, it is not clear how the tax base for the exchange virtual currency for assets or services will be calculated until the National Tax Agency announces a circular notice. In the meantime, a taxpayer may refer to other available circular notices regarding the treatment of foreign currency transactions.

Tax on income

As is the case with the consumption tax, the National Tax Agency has not released any official statements regarding income tax or corporate tax levied on transactions involving virtual currency. However, in April 2016, the Minister of

Finance, Mr. Taro Aso, stated in the National Diet (Japan's parliament) that profits arising from the transfer of virtual currency are subject to such taxes.[4]

The tax base for these forms of taxation is the income attributable to that of residents or domestic companies. The concept of income is considered an economic gain. Therefore, in practice, it is understood that economic gains derived from transactions of virtual currency are subject to income or corporate taxation measures. Several researchers, including an official of the National Tax Agency, have discussed income taxation on virtual currency and not one of them opposes the taxation. The researchers classify possession of virtual currency depending on its purposes either as inventory, intangible fixed assets or deferred assets, and try to explain accounting processing and income tax treatment of the virtual currency in accordance with these classifications.

Additionally, discussion on new accounting standards for virtual currencies is still in the initial stage at the Accounting Standards Board of Japan and no proposal or draft has been publicly announced yet.[5] If the accounting standards are approved and published by the board, calculation of profits and the cost of the transactions will be harmonized and the tax treatment will become more predictable.

Next steps

The Enforcement Order of the Consumption Tax Act will be established in the months ahead, around the enactment of the proposal coming in March. The Enforcement Order will be applicable to VC-cash exchanges carried out on and after July 1, 2017, and VC-cash exchanges will no longer be subject to consumption tax. Finally, regarding income taxes, the release of new accounting standards is anticipated in the near future.

As we have seen, the taxation of virtual currencies is undergoing many developments in Japan. We will continue to follow changes in taxation, regulations and practices affecting virtual currencies.

[1] The Act will come into force in June 2017 at the latest.

[2] See this page.

[3] For foreign companies, both an office and a representative located in Japan are required for registration.

[4] The House of Representatives, minutes of treasury and finance committee.

[5] Accounting Standards Board of Japan, summary of the advisory council.

AUTHORS



Keitaro Uzawa

Of Counsel

Tokyo | T: +81 (0)3-4550-2800

keitaro.uzawa@dlapiper.com