

RESEARCH NOTE 5

Indirect Taxes, Invoice Systems, and Input Tax Deductions

in the UK and US

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1. Introduction

With the implementation of the Qualified Invoice System (Invoice System)¹ in Japan in October 2023, input tax deductions² for taxable purchases from tax-exempt businesses (businesses that satisfy requirements such as taxable sales of 10 million yen or less in the base period and are accordingly relieved of the obligation to pay consumption tax) were, in principle, completely disallowed (Ministry of Finance, 2023). However, to cushion the sudden increase in the tax burden on buyer-side businesses (including public interest corporations, small and medium-sized enterprises, Silver Human Resources Centers, etc.) that trade with tax-exempt businesses, as well as to prevent the exclusion of tax-exempt businesses from commercial transactions,³ transitional measures have been put in place that reduce the deductible percentage in stages. Put simply, immediately after the introduction of the Invoice System, a buyer purchasing from a tax-exempt business can continue, as before, to deduct part of the consumption tax equivalent incurred on its purchases from its own consumption tax liability, but this percentage shrinks in stages and eventually reaches zero.

The deduction rates under the transitional measures were revised by the FY2026 (Reiwa 8) tax reform. Buyers are permitted to deduct 80% of the input tax equivalent for the three-year period from October 1, 2023, to September 30, 2026; 70% for the two-year period from October 1, 2026, to September 30, 2028; 50% for the two-year period from October 1, 2028, to September 30, 2030; and 30% for the one-year period from October 1, 2030, to September 30, 2031. On or after October 1, 2031, the transitional measures themselves will expire, and no taxable purchases from tax-exempt businesses will be eligible for input tax deductions (National Tax Agency, 2026a). To illustrate with a specific example, where a buyer purchases services from a tax-exempt business for 11,000 yen, an amount that, in line with customary practice, includes a consumption tax equivalent of 1,000 yen, the buyer can deduct 800 yen of that 1,000 yen from its consumption tax liability until September 2026, and 700 yen from October 2026 onward. From October 2031, however, none of the 1,000 yen can be deducted, and unless the transaction price is revised, the buyer's burden will increase.

The FY2026 tax reform also attached a monetary ceiling to these transitional measures. Where the total amount (tax-inclusive) of taxable purchases from any single person other than a qualified invoice issuer exceeds 100 million yen in the year or fiscal year concerned, the transitional measure cannot be applied to the taxable purchases in excess of that ceiling (the ceiling before the amendment was 1 billion yen). Because the ceiling applies to taxable periods beginning on or after October 1, 2026, a corporation with a March year-end will first be affected in the fiscal year

¹ Qualified Invoice (Invoice): An invoice or similar document issued by a seller to inform a buyer accurately of the applicable consumption tax rate and tax amount. Only "Qualified Invoice Issuers" registered with the National Tax Agency can issue them, and buyers can claim input tax deductions for consumption tax by retaining these invoices (National Tax Agency, 2026b).

² Input Tax Deduction: A mechanism whereby a business calculates its tax liability by subtracting the consumption tax paid on its own purchases from the consumption tax received on its sales. Without this deduction, tax on the same product would pile up two or three times over as it passes through the stages of distribution; the mechanism exists to prevent such double taxation.

³ Relevant government ministries and agencies have cautioned that forcing tax-exempt businesses to convert to taxable status, or unilaterally demanding price reductions from them, may be problematic under the Antimonopoly Act, the Act on Proper Transactions with Small and Medium-Sized Entrusted Business Operators (the "SME Transactions Act"; in force from January 1, 2026; formerly the Act against Delay in Payment of Subcontract Proceeds, Etc. to Subcontractors), and the Act on Ensuring Proper Transactions Involving Specified Entrusted Business Operators (the "Freelance Act"; in force from November 1, 2024) (Ministry of Finance, Fair Trade Commission, Ministry of Economy, Trade and Industry, Small and Medium Enterprise Agency, Ministry of Land, Infrastructure, Transport and Tourism, 2022; Fair Trade Commission, 2025).

beginning April 2027 (National Tax Agency, 2026a). Since the test is applied supplier by supplier, it should be borne in mind that organizations placing continuous and concentrated orders with a particular tax-exempt business are the most likely to be affected.

Concerned about the impact on the outsourcing of work to Silver Human Resources Centers for elderly workers and on public interest activities carried out in partnership with sole proprietors and small non-profit organizations, practitioners in the field—including our association—are strongly requesting the “continuation for the time being and permanent adoption of the 70% input tax deduction transitional measure (from October 2026) for taxable purchases from tax-exempt businesses” (Japan Association of Charitable Organizations, 2026).

Against the backdrop of these tax reform requests, this research note analyzes and compares, for two major countries—the United States and the United Kingdom—the structure of their indirect tax systems, the measures that relieve the tax burden on procurement from and transactions with small or unregistered businesses (equivalent to Japan’s tax-exempt businesses), and the methods used to accommodate the non-profit and public interest sectors, in order to set out the challenges and countermeasures surrounding Japan’s Invoice System.

2. Actual Conditions Under State Retail Sales Tax (RST) in the United States

2.1 Absence of Federal Value-Added Tax (VAT) and the Mechanism of State Sales Tax

In the United States, there is no federal-level Value-Added Tax (VAT)⁴ or unified national consumption tax. Instead, state and local governments (such as counties and cities) independently impose a “Retail Sales and Use Tax (RST)” (a state-level sales tax has been introduced in 45 states and the District of Columbia—all except the five states of Alaska, Delaware, Montana, New Hampshire, and Oregon)⁵ (Tax Foundation, 2025/2026). To break it down simply, while Japan’s consumption tax uses a system that “taxes goods and services bit by bit every time they pass from hand to hand”, the US sales tax is closer to a system that “taxes only once at the store cash register”, making the underlying mechanisms fundamentally different.

The US sales tax is a single-stage tax levied only at the “final consumption” stage. Therefore, the concept of an “input tax deduction” (deduction of prior-stage tax)—which is standard in Japan and Europe—does not exist as a general rule (Tax Foundation, 2025/2026).

2.2 Business-to-Business (B2B) Transactions and Procurement from Small Suppliers

Under a sales tax system, when a business purchases goods for the purpose of reselling them (Resale) or buys items that are directly incorporated as raw materials in the manufacturing process, the buyer presents a “Resale Certificate”⁶ to the seller. As a result, the sales tax at the time of purchase is fully exempted (non-taxable) (Sales Tax Institute, 2025a). In other words, because imposing tax on inventory intended for later resale would result in double taxation, the system postpones that tax until the “moment the goods are sold to the final consumer”.

On the other hand, for transactions that constitute “final consumption”—where a business purchases operational supplies or various services (such as advertising, consulting, cleaning, etc.)—a final consumption tax (or a complementary “Use Tax”⁷) is incurred, regardless of whether the seller is a registered business or a small unregistered business (Sales Tax Institute, 2025a). Unlike purchases from tax-exempt businesses in Japan, paying the tax itself cannot be avoided in the US; the distinctive feature is simply that the party responsible for remitting the tax to the tax authority shifts between the seller and the buyer:

- When the seller is a registered business: Sales tax is charged and collected at the time of purchase.

⁴ Value-Added Tax (VAT): A multi-stage indirect tax that taxes the value added at each stage of production and distribution, with businesses deducting the tax paid on their purchases when calculating their tax liability. Japan’s consumption tax and the UK’s VAT belong to this category, which has been adopted by many OECD member countries (OECD, 2024).

⁵ These five states have no state-level sales tax, but in Alaska, municipalities and boroughs levy sales taxes of their own, so that sales tax does in fact arise in parts of the state.

⁶ Resale Certificate: A certificate presented to a seller by a business purchasing goods for the purpose of resale. When it is presented, sales tax is not levied at the time of purchase, and taxation occurs for the first time when the item is sold to the final consumer.

⁷ Use Tax: A complementary tax self-reported and remitted by the buyer when the sales tax that should normally have been charged was not collected at the time of purchase. It serves to prevent tax leakage in situations such as purchases from out-of-state vendors on which sales tax is not assessed.

- When the seller is small and not obliged to collect sales tax (or is an out-of-state unregistered vendor): The buying business bears the obligation to calculate the “Use Tax” itself and to self-report and remit it directly to the state tax authority (Consumer Use Tax).

2.3 Sales Tax Treatment of Non-Profit Corporations (Section 501(c)(3) Organizations, etc.)

In the United States, recognition under Section 501(c)(3)⁸ of federal law does not, by itself, bring exemption from state sales tax. Sales tax is a state tax, and whether an exemption is available, how far it extends, and what procedure applies are all matters for each state’s own law; an organization must therefore apply separately in each state and obtain that state’s Exemption Certificate (Sales Tax Institute, 2025b).

In practice, many states—among them New York, New Jersey, Texas, Florida, Illinois, Pennsylvania, and Maryland—grant broad exemptions for purchases a non-profit makes for its own exempt purposes, and no sales tax is charged at the point of purchase once the exemption certificate is presented. Arizona, California, Hawaii, South Carolina, and Washington, by contrast, provide no blanket exemption for non-profit purchases, and some states, such as Georgia, confine the exemption to narrowly defined purposes (Sales Tax Institute, 2025b; Wiss, 2025).

The common assumption that “501(c)(3) recognition makes purchases tax-free anywhere in the United States” is therefore inaccurate. In those states that do grant an exemption, however, no tax burden falls on the purchasing non-profit regardless of whether the counterparty is a small vendor—an allocation of burden fundamentally different from Japan’s Invoice System, under which the buyer’s burden varies with the seller’s registration status.

3. Actual Conditions Under UK Value-Added Tax (UK VAT)

3.1 Basic Structure of UK VAT and High Registration Threshold (Exemption Point)

The United Kingdom adopts a multi-stage taxation (VAT) system using an invoice-based method. The most prominent feature of the UK system is that a very high mandatory VAT registration threshold (exemption point) is set (HM Revenue & Customs, 2026).

The mandatory VAT registration threshold in the UK is £90,000 in taxable sales over the previous 12 months (unchanged since April 1, 2024, and equivalent to approximately 19 million yen at an exchange rate of about 210 yen to the pound)⁹ (HM Revenue & Customs, 2026). Set nearly twice as high as Japan’s 10 million yen threshold, it allows many small businesses in the UK (such as freelancers, sole proprietors, and local non-profit groups) to continue to operate as unregistered businesses. In other words, because far more small businesses in the UK than in Japan can remain in a position where they “do not need to register in the first place”, friction of the kind surrounding Japan’s Invoice System is less likely to occur.

3.2 Procurement from Unregistered Suppliers and Input Tax Deductions

Under the UK VAT system (administered by HMRC: HM Revenue & Customs), when goods or services are procured from an unregistered business, VAT (standard rate of 20%) is not included in the invoice (HM Revenue & Customs, 2026).

The tax accounting treatment and economic impact on the buyer side (a VAT-registered business) in this case are shown in Table 1.

⁸ Section 501(c)(3) of the Internal Revenue Code: A provision under which the Internal Revenue Service (IRS) recognizes organizations operated for religious, charitable, educational, scientific, or similar purposes as non-profit entities, exempting them from federal corporate income tax and other liabilities (Internal Revenue Service, 2024).

⁹ In the UK, businesses whose taxable sales exceed the registration threshold (£90,000) are obliged to register for VAT with HMRC (HM Revenue & Customs), after which they must charge and remit VAT and file VAT returns. The deregistration threshold is set at £88,000 (GOV.UK, 2026).

Table 1: Vendor Categories and Buyer Burden Structure Under the UK VAT System

Transaction Category	Breakdown of Invoiced Amount	Input Tax Deduction (Input VAT Recovery)	Buyer's Net Cost and Tax Impact
Purchases from VAT-registered suppliers	Base Price 100 + VAT 20 = Total 120	Full deduction of 20 possible (Net Cost = 100)	Input VAT is offset against output VAT, resulting in zero net tax cost.
Purchases from unregistered suppliers	Base Price 100 (No VAT charged) = Total 100	0 (Because no VAT eligible for deduction exists)	Because no VAT is added, no input VAT to be deducted arises for the buyer in the first place (Net Cost = 100).

In the UK, because unregistered suppliers do not add VAT to their invoices, no input VAT to be deducted arises for the buyer in the first place, and the buyer's cost is the base price alone. A distinctive feature is that the distinction between taxable businesses and unregistered businesses is clear from the outset of each transaction, and prices are formed on that basis. It should be noted, however, that an unregistered supplier's price may include VAT that it has itself borne on its own purchases (and cannot deduct), so that tax cascading in that sense does occur in the UK as well.

In Japan, by contrast, the bookkeeping method was adopted when the consumption tax was introduced, and because taxable businesses and tax-exempt businesses could not be told apart from the outward form of a transaction, a practice became widely established whereby even tax-exempt businesses invoiced at prices that included a consumption tax equivalent (Ministry of Finance, 2026). The National Tax Agency has likewise stated that the consumption tax system does not contemplate a tax-exempt business showing a "consumption tax amount" or the like on its invoices and separately receiving a consumption tax equivalent (National Tax Agency, 2026c). The Invoice System was introduced to ensure proper taxation under multiple tax rates (Ministry of Finance, 2026), and it can be said to aim at making the distinction between taxable and tax-exempt businesses clear and at clarifying how consumption tax is actually levied in each transaction. It is therefore not appropriate to regard the denial of an input tax deduction "despite having paid a tax-inclusive price" as, in itself, a double burden. That said, a long period has passed since the consumption tax was introduced, during which it has been taken for granted that even tax-exempt businesses invoice amounts that include a consumption tax equivalent, and there are also cases—such as Silver Human Resources Centers—in which prices were never formed with consumption tax in mind in the first place; it is therefore true that the impact of the Invoice System is significant. The difference from the UK can be said to lie less in the design of the system itself than in the process of moving from long-established pricing practices to transactions in which the tax relationship is clear.

3.3 Differences Between Zero-Rated and VAT Exempt

In the UK VAT system, "Zero-rated" and "Exempt" are strictly distinguished from one another (HM Revenue & Customs, 2026):

- Zero-rated: Food, children's clothing, books and newspapers, equipment for disabled persons, and other specific items. While consumers are not charged VAT, businesses can claim a full refund of the input VAT incurred on their purchases. Put simply, this is a "standard VAT-taxable transaction that happens to have a 0% tax rate," and the key point for businesses is that they can fully recover the VAT paid at the purchasing stage.
- Exempt: Financial services, insurance, education, medical care, certain charitable activities, and other selected sectors. Businesses cannot charge VAT on these sales, but at the same time they are not allowed to deduct the related input VAT paid on purchases (requiring complex apportionment calculations under the Partial Exemption rules).¹⁰ While "Zero-rated" refers to a VAT transaction that merely has a 0% tax rate, "Exempt" refers to a transaction that lies outside the VAT system altogether, and it is essential in practice not to confuse the two.

¹⁰ Partial Exemption: A mechanism whereby businesses making both taxable supplies (on which VAT can be charged) and exempt supplies (on which VAT cannot be charged) must apportion their input VAT so as to exclude the portion attributable to exempt supplies from deduction. Because the calculation methods are complex, it is a practical burden for many UK businesses. The inability to recover input VAT attributable to exempt supplies has also long been identified as a burden on UK charities.

4. Conclusion

Table 2 provides a comparative summary of the indirect tax and invoice systems of Japan, the United States, and the United Kingdom, and of the structure of the tax burden on procurement from small suppliers.

Table 2: Comparative Summary of Indirect Taxes and Invoice Systems in Japan, the United States, and the United Kingdom

Comparison Item	Japan (Consumption Tax / Qualified Invoice)	United States (State Retail Sales Tax: RST)	United Kingdom (Value-Added Tax: UK VAT)
Basic Tax Structure	Multi-stage taxation (Invoice method)	Single-stage taxation at the final consumption stage only	Multi-stage taxation (Invoice method)
Business Exemption Threshold	Taxable sales of 10 million yen in the base period	No general exemption threshold for in-state businesses; out-of-state sellers are subject to state Economic Nexus standards (e.g., \$100,000 in sales)	Sales of £90,000 (approx. 19 million yen)
Transactions with Unregistered / Tax-Exempt Suppliers	Deduction limitations apply (transitional measures: 80% → 70% → 50% → 30% → 0%; the portion above 100 million yen a year from any single supplier falls outside the measure)	Purchases for resale are exempt via resale certificates. Final business consumption generates Use Tax.	No VAT is added, so no input VAT to be deducted arises
Presence of “Tax” in Transaction Prices	Under the bookkeeping method, the practice of tax-exempt businesses also invoicing at prices including a consumption tax equivalent became established	Tax-exempt and unregistered vendors do not charge tax	Unregistered vendors do not charge VAT (20%)
Special Provisions for Public Interest / Non-Profit Entities	Same invoice rules apply as for general commercial businesses	A state-by-state matter. Many states exempt purchases on presentation of an exemption certificate, but California, Washington, and others provide no blanket exemption	Zero-rated and exempt provisions exist for charities

Note: “Economic nexus” in the United States refers to the principle that even an out-of-state business becomes obliged to collect and remit a state’s sales tax once its sales or number of transactions in that state exceed a specified threshold; it was adopted by many states following the 2018 US Supreme Court decision in *South Dakota v. Wayfair, Inc.* It differs in character from the business exemption thresholds of Japan and the UK.

What this international comparison has made clear is that in the US and the UK, transaction prices are formed on the premise that tax-exempt (unregistered) businesses do not add tax, and because the tax relationship is clear from the outset of each transaction, friction of the kind seen in Japan over purchases from tax-exempt businesses is unlikely to arise.

- In the **United States**, resale certificates prevent double taxation at the stage of business-to-business transactions. For purchases by non-profit organizations, too, no tax burden arises at the purchasing stage in states that grant an exemption, once an exemption certificate is presented (although whether an exemption exists, and how far it extends, varies from state to state) (Sales Tax Institute, 2025a, 2025b).
- In the **United Kingdom**, the trading practice whereby unregistered businesses do not charge VAT has been established from the outset, so no input VAT to be deducted arises for the buyer. In addition, small businesses are protected by the high exemption threshold of £90,000 (HM Revenue & Customs, 2026).

Because Japan's consumption tax operated for many years under the "bookkeeping method" (a pricing practice that effectively incorporated the so-called "tax-benefit profit", or ekizei, issue), a consumption tax equivalent has in effect been embedded in the transaction prices of tax-exempt businesses (such as Silver Human Resources Center members, freelancers, and small NPOs). Here, "tax-benefit profit" (ekizei) is the popular term for a tax-exempt business keeping the consumption tax equivalent it receives from its customers instead of paying it to the government; eliminating this ekizei is also one of the purposes of the Invoice System.

Under these circumstances, if the transitional deduction rate is lowered to 70% from October 2026, the portion above 100 million yen a year from any single supplier is placed outside the measure, and the deduction measure itself then comes to an end (0%) from October 2031, sectors that directly support or engage small businesses and elderly workers—such as public interest corporations—may, unless transaction prices are revised, be forced into a difficult choice between "changing (excluding) suppliers" and "accepting an increased burden themselves" (Japan Association of Charitable Organizations, 2026). The transitional measures were established precisely to mitigate impacts of this kind.

Practical Recommendations

- **Mitigating Abrupt Change and Improving the Trading Environment in Line with the Purpose of the Transitional Measures:** The transitional measures are intended to mitigate the impact of moving from pricing practices established under the bookkeeping method to the Invoice System, and in light of the purpose of the Invoice System, it is difficult to argue for making them permanent. At the same time, some transactions are heavily affected, as in fields such as the work of Silver Human Resources Centers, where prices were never formed with consumption tax in mind. It is important to monitor the impact as the transitional measures are phased down, and to continue to call for the consideration needed so that appropriate revisions of transaction prices and improvements to the trading environment move forward.
- **Considering Buyer-Side Special Provisions for Public Interest Corporations:** In the United States, although practice differs from state to state, mechanisms under which no sales tax is charged on purchases by non-profit organizations on presentation of an exemption certificate are widely used. Drawing on this idea of "consideration focused on the attributes of the buyer", it would be worth examining, over the medium to long term, how consideration might be given to the consumption tax borne by corporations engaged in social mutual aid and public interest activities.
- **Clarifying How the 100 Million Yen Ceiling Will Operate:** Because the monetary ceiling on the transitional measures introduced by the FY2026 tax reform is tested against the annual total for each individual supplier, organizations that deal continuously with large numbers of small businesses will face a new administrative burden of aggregation and record-keeping. Concrete examples of the method of determination and of the bookkeeping requirements should be published at an early date.

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