

Mid-Term Report By The Tax Commission
A Sustainable Tax System for Japan's Aging Society
(June 2003)

A year ago, the tax commission published a report " Policy Guidance on the Establishment of a Desirable Tax System " (June 2002). In March, as a first step, the FY2003 tax reform was implemented.

The new report discusses further a new desirable tax system for the invigoration of the socio-economy of Japan and sustaining vitality in the aging society in the future, through drastically improving the efficiency of the public sector at national and local levels.

Given the severe fiscal situation, an increased national tax burden in the future may be unavoidable. Drastic expenditure cuts and removing distortions and inequity in the tax system should be carried out in order to achieve the understanding of Japanese citizens.

A new tax system for sustaining vitality in the aging society

Given that Japanese society is rapidly aging, and the major impacts of this on our socio-economy, a new tax system should be established in order to sustain the vitality of the aging society in the future .

A new tax system with :

- Confidence: Secure stable revenue sources for public services. Carry out Expenditure reform.
- Participation: Younger and older generations pay equally according to their ability to pay.
- Enhanced Vitality: Neutral and simple tax system with minimum distortion in economic choices and easy to understand.

Individual Income Tax

The level of individual income tax burden in Japan is the lowest of the G7 countries.

- To regain its basic functions as a main tax, i.e. revenue raising and income redistribution is an urgent task.

Remove distortions and inequity in the current tax system so that the tax system has as little distortion as possible vis-à-vis choices of economic activities.

- Broader and more equitable sharing of tax burden among different groups: Tax considerations to individuals will be given through integrated personal exemptions (eg. Basic exemptions or dependant exemptions), rather than exclusion from / deduction for the income tax base (eg. deduction for pensions, deduction for employment income)

Review of Taxation of Pension Benefits

- Currently, pensions are effectively excluded from the tax base (through allowing an exemption for social security contributions at the time of making contributions and a deduction for public pensions at the time of receiving benefits). In the future, elderly people with the ability to pay tax should share the burden appropriately with people of working generations.
- Review of exemptions and deductions for public pensions to ensure equity between older and younger generations and among elderly people.

Review of Taxation of Employed Workers

Employment income

- Clarify characteristics of deduction for employment income as that for necessary expenses at their activities. At the same time, review the scope for itemized deduction of employment income and increase the filing of their tax returns

Retirement income

- Review taxation of retirement income to improve neutrality to the choice of work styles in the increasingly mobile labor market.

Review of the Framework of Personal Exemptions

- Personal exemptions should be designed to be neutral to the choices of work styles of family members.
- Additional tax care will be needed for families with children who will be the mainstay of Japanese society and the economy in the future.

Inhabitants Tax (local tax)

- Promote sharing of tax burden more broadly among community members through increase in per-capita rates and broadening of the tax base.

Consumption Tax

Measures taken in FY2003 tax reform¹ promoted transparency of and taxpayers' confidence in the tax system.

- Preceded by a drastic reform of budget expenditures, and obtaining the general support of Japanese citizens, the tax rate (currently 5%) would be raised to two digits in the future.
- Items for further review when the increase of the tax rate will be considered.
 - Adoption of reduced rates for foods, etc.
 - Introduction of VAT Invoice method for input tax credit (currently, book-keeping method is applied).
 - Clarify the role of consumption tax in relation to social-security expenditure and payment of social security contributions.
 - Ensure the role of local-consumption tax in the financing of local governments.

¹ Diminishing of tax exemptions for small vendors and scaling down of the simplified method for tax calculation.

Corporation Tax

Corporation tax should be compatible internationally and less distorting and neutral to economic choices. Measures should continue to be taken as necessary in order to promote structural reform and revitalization of the economy.

- Further reduction of corporation tax rates is an issue that should be examined in the future from viewpoints such as the economic situation, the level of tax and its role in the overall tax mix, and the balance with the level of tax in other advanced countries.
- Ensure appropriate taxation that will promote business and investment activities of various entities and non-profit making activities of the private sector. Appropriate taxation of profit-making activities of Public Interest Corporations should be examined.
- New local taxation of corporations (by the size of their businesses) that was introduced in the FY2003 tax reform should be fixed in the local tax system.

Inheritance and Gift Taxes

- The re-distribution function of the inheritance tax at the time of inheritance has become increasingly important
- Support for elderly people has become a social responsibility (rather than a family responsibility as in the past), implying attribution of burden to personal assets left at the time of inheritance.
- The tax base of inheritance tax should be further broadened

Excise Duty

- Given diversification of life style and increase in service activities, possibilities for new taxation in this area shall be examined, including such taxation under local taxing autonomy.

Decentralization

Preceded by streamlining of the expenditure of local governments, establish a revenue structure founded on their own revenue bases (such as local taxes) that would allow local governments more responsibility and autonomy in providing public services to local inhabitants

Review the roles of national and local governments. Streamline and rationalize local subsidiaries and review the function of guaranteeing minimum revenue in local allocation tax grant. Allocation of revenue sources of national and local governments will be reviewed comprehensively, including transfer of revenue sources from national government to local governments.

Use of local taxation rights could contribute to clarification of the relationship between burdens and benefits for local inhabitants. Its framework should be reviewed so that it can be used more proactively.

Other issues

Taxation of income from financial assets: more unified approach

Tax Compliance Strategies

- Continue examination of the possible use of Taxpayers Identification Numbers (TINs).
- Review publication of high-income taxpayers.
- Strengthening the capacity at tax administration to collect tax related information return.

Environmental taxation

- Further examine the use of tax measures in the overall environmental policy.

International taxation

- Expand and review tax treaty networks. Carry out comprehensive review of taxation in this area.

Non-performing loans

- Tax treatment of non-performing loans should also be reviewed as a part of the overall examination of related issues, such as financial supervision policies and financial accounting standards.