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DPJ Administration's Tax Reform Policy (Outline)

Comparison with the outgoing LDP administration's policy

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Summary

- In the general election held on 30 August 2009, the Democratic Party of Japan (DPJ) took 308 seats in The House of Representatives, giving it a majority. The result is the emergence of a new administration dominated by the DPJ. In the run-up to the general election, the DPJ's manifesto declared the party's commitment to fundamental tax reform, and fundamental reform of Japan's tax system is expected to proceed in line with the DPJ's election promises.
- Until the election, the objective of fundamental tax reform declared by the outgoing LDP-led administration was to secure reliable sources of income for social security through reforms that included raising consumption tax rates. In contrast, fundamental tax reform by the DPJ administration will construct a new fundamental tax reform framework with the aim of making the tax system fairer.
- Reforms are considered here in terms of six categories: (1) taxation on financial income, (2) other income tax, (3) consumption tax, (4) inheritance tax, (5) corporation tax, and (6) excise taxes. We also compare the DPJ's proposed new framework for tax reform debate with the system used to date.

This report is based on our Japanese language report of 24 July 2009 concerning tax policies in the DPJ's "INDEX 2009" policy document, but updated to reflect the results of the lower house elections on 30 August. It summarizes the fundamental tax reform policy of the DPJ administration. Further detail is given in the 24 July Japanese language report. Please refer to "DPJ Administration's Taxation On Financial Income" (written by Kazuhiro Yoshii) regarding taxation on financial income. (The Japanese version was released on August 31 and the English version will be released soon.)

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1. Overview of Fundamental Tax Reform by New DPJ Administration and by Outgoing Government/Parties

In the general election held on 30 August 2009, the Democratic Party of Japan (DPJ) took 308 seats in The House of Representatives, giving it a majority. As a result, a special session of the Diet will be held within a few days, leading to the formation of a new cabinet dominated by the DPJ. In the run-up to the general election, the DPJ's manifesto declared the party's commitment to fundamental tax reform, so the incoming DPJ administration will commence implementing reforms in line with those election promises.

Details of the fundamental tax reforms to be pursued by the DPJ on forming an administration are set out in the party's Action Program published (in Japanese) on 24 December 2008. The DPJ Manifesto ("The Democratic Party of Japan's Platform for Government") published on 27 July 2009, and the party's INDEX 2009 policy document (in Japanese) published on 23 July include almost identical content, although there are a few modifications from the Action Program.

The medium-term tax reform direction espoused by the old administration, a coalition of parties centered on the Liberal Democratic Party (LDP) (hereinafter the "outgoing LDP coalition") was set out in its Medium Term Program, a policy document published on 24 December 2008 and partially revised on 23 June 2009. Details are in Article 104 of the Supplementary Provisions to the Ministry of Finance's FY2009 Tax Reform Act. The LDP Manifesto published on 31 July 2009 indicates that the party intended to conduct fundamental tax reform in line with these policies.

Since the details of Article 104 of the Supplementary Provisions to the FY2009 Tax Reform Act are not the same as framework for fundamental tax reform under the DPJ administration, we expect legislation to introduce revisions that delete this supplementary provision.

The Medium Term Program produced by the outgoing LDP coalition declared the principal orientation of fundamental tax reform to be raising consumption tax rates for the purpose of securing stable revenue sources for the social security system. In contrast, the DPJ's INDEX 2009 policy document declares the principal orientation of fundamental tax reform to be fundamental revisions to the Act On Special Measures Concerning Taxation with the aim of constructing a tax system revision process that is fair and transparent from the taxpayer's viewpoint.

There are many points where the two policies differ in detail. Concerning income tax, for example, the outgoing LDP coalition intended to consider raising the top tax rate, whereas the DPJ administration plans to transform the system of income tax deductions to refundable tax credits. Section 2 of this report examines the orientation of reforms for individual tax items, dividing them into six categories. A detailed index is presented in Chart 1.

Chart 1. The medium-term reform policies by Outgoing Parties and the New DPJ Administration

		Page No. in this report	Outgoing parties' policy	DPJ administration policy
(1)	Taxation on financial income	P.3	Extend 10% rate to end of CY2001	End term of 10% tax rate is unclear
			Continued progress towards unifying taxation on financial income	Continued progress towards unifying taxation on financial income for time being (Fundamentally it should be 'aggregate taxation')
(2)	Other income tax	P.3	Cap employment income deduction	
			Raise top tax rate	Replace income tax deductions with refundable tax credits
(3)	Consumption tax	P.4	Tax increases conditional on upturn in economy	Tax increases conditional on an end to 'wasteful spending'
			Consider introducing refundable consumption tax credits	
(4)	Inheritance tax	P.4	Consider inheritance tax approach	Consider estate tax approach
(5)	Corporation tax	P.5	Inclined to cut tax rates	DPJ not inclined to cut tax rates
(6)	Excise tax	P.5	Simplify automobile-related tax system, reducing taxation (DPJ is keener)	
				Radical reform of tobacco and alcohol taxes

Source: Compiled by DIR Legal and Tax Research Dept

In order to build a fair and transparent process for tax reform, the DPJ has clearly declared its intention to abolish the current system. The current system of having both a government Tax Commission and the ruling party's Research Commission on the Tax System will be replaced by a new government Tax Commission to provide a framework where politicians take the initiative in decision-making on tax reforms. Section 3 of this report examines the proposals for a new framework for debating tax reforms under the DPJ administration, and compares it with the old system.

2. Comparison of Specific Tax Items

(1) Taxation on financial income— End term of 10% tax rate become unclear, continued progress towards unifying taxation on financial income for time being (Fundamentally it should be 'aggregate taxation')

The following chart summarizes the policies of the outgoing LDP coalition and the new DPJ administration on taxation of financial income.

Chart 2. The medium-term reform policies by Outgoing Parties and the New DPJ Administration: Taxation on Financial Income

	Government policy under old LDP administration	DPJ Action Program (December 2008)	DPJ INDEX 2009 policy document (July 2009)
10% tax rate on listed stocks	Extend 10% rate to end of CY2011 (Covered by FY2009 tax reforms)	Extend current preferential tax system until groundwork for unified taxation is ready	Considering the economic and financial situation, maintain reduced tax rate for time being
Principles underlying taxation on financial income	(Not specified in Medium Term Program)	Fundamentally, it is desirable to have aggregate taxation that taxes total income	
Unification of taxation on financial income	Make further progress towards unified taxation of financial income	For the time being, use separate taxation for financial income, but broaden the scope of aggregation of profit and loss	

Source: Compiled by DIR Legal and Tax Research Dept.

Note: Main changes of DPJ proposals marked in red.

Extending 10% tax rate on listed stocks

Under the FY2008 tax reforms, the tax rate on dividends and capital gains from listed stocks above a certain threshold was to have been raised to 20%, but under the FY2009 tax reforms, the 10% rate was extended to the end of CY2011.

The DPJ has also been planning to extend the current 10% tax rate on dividends and capital gains from listed stocks since launching its Action Program in December 2008, but there has been a slight change in wording from the Action Program to the DPJ's INDEX 2009 policy document.

In the DPJ's Outline of Tax System Reforms of December 2007, the party's proposals for listed stocks, etc. specified its intent to maintain the 10% tax rate for dividends, but to raise the tax rate to 20% for capital gains, saying, "Concerning stocks and publicly offered stock investment trusts, do not extend the reduced tax rate applying to capital gains. For taxation of dividends, maintain the reduced tax from the perspective of adjusting for double taxation and nurturing a stable base of individual equity investors."

Despite this position, the December 2008 Action Program stated "Extend the current preferential tax system until the groundwork for unified taxation is ready," changing the policy to one of maintaining the 10% tax rate until the system can be unified for both dividends and capital gains. The comment concerning adjustment for double taxation of dividends has also been deleted.

The position of the DPJ's INDEX 2009 policy document published in July 2009 regarding the 10% tax rate is one of "Considering the economic and financial situation, maintain the reduced tax rate for time being." With this wording, there is the possibility that the tax rate may be raised when there is an upturn in the economy, even if that is before all taxation on financial income is integrated[1].

The Act On Special Measures Concerning Taxation contains provisions on many different items relating to taxation on financial income, including the 10% tax rate on dividends and capital gains from listed stocks, etc., and separate withholding tax on interest. It must be kept in mind that the DPJ plans to secure tax revenues through fundamental reform of the Act On Special Measures Concerning Taxation.

Progress towards unification of taxation on financial income

Concerning the medium term orientation of reforms concerning taxation on financial income, the outgoing LDP coalition and the DPJ administration are in agreement on plans to make progress with the unification of taxation on financial income, and to broaden the scope of aggregation of profits and losses. (On this point, the INDEX 2009 policy document did not change the position).

Note, however, that the DPJ states, "Fundamentally, it is desirable to have 'aggregate taxation' that taxes total income," and that to "use separate taxation for financial income, but broaden the scope of aggregation of profit and loss," is a policy "for the time being."

(2) Other income tax—Tax increase for high earners through cap on employment income deductions

Concerning income tax, the outgoing LDP coalition and the DPJ had the same basic policy of correcting disparities and strengthening income redistribution functions. As the means to be employed to implement the policy, the outgoing LDP

coalition proposed raising the top tax rate, whereas the DPJ proposal is for reform of income deductions.

One of the income deduction reforms planned by the DPJ is to replace deductions for dependents and spouses with a 'New Child Allowance' taking the form of a fixed benefit. The effect of income deductions is to alleviate the tax burden to a greater extent for higher income taxpayers, so switching from income deductions to fixed benefits enables the distributional effect to be enhanced. However, since the DPJ proposal includes abolishing the existing (means tested) child allowance, it must be noted that when taken together, these reforms do not necessarily result in lower overall burdens (increases in disposable income) for people with lower incomes.

Concerning the employment income deduction, measures to cap the deduction are under consideration (both the outgoing LDP coalition and the DPJ administration have the same policy on this point). If such a change were to be implemented, the result would likely be a substantial increase in the burden on salaried workers with relatively high incomes.

Both the outgoing LDP coalition and the DPJ intend to consider introduction of a Taxpayer Identification Number system, but since the DPJ puts greater emphasis on accurate identification of income, the DPJ administration's inclination to implement such a system is likely to be stronger.

(3) Consumption tax—Consider consumption tax credit/benefit package

There is no change to the policies of both the outgoing LDP coalition and the DPJ administration to earmark consumption tax revenue for social security.

Regarding a rise in the tax rate, the outgoing LDP coalition planned such a rise conditional on the economy making an upturn, but the DPJ administration sets a condition of first eliminating 'wasteful spending'. The outgoing LDP coalition proposed to legislate measures that would raise the tax rate immediately the economy recovered, but the DPJ administration has committed to facing a general election with the size of the increase clearly defined before raising the tax. (Consequently, it is assumed that the DPJ administration will not raise the consumption tax rate before the next general election.)

For the benefit of those with low incomes, the DPJ administration suggests considering refundable tax credits (packages for providing a benefit payment or a tax credit against income tax or the like, equivalent to the amount of consumption tax paid). A similar approach to giving consideration to a package of consumption tax credits/benefits was also proposed under the old LDP administration in a report by a government advisory panel studying strategies to realize a secure society[2].

On the issue of introducing a system using invoicing to account for consumption tax, the outgoing LDP coalition did no more than listing it as an item to be examined, but the DPJ administration actually plans to implement such a system.

(4) Inheritance tax—Review approach for estate/inheritance taxation

Concerning inheritance tax, the outgoing LDP coalition had been investigating a change to an inheritance tax approach (a system for taxation of inheritances received)[3], whereas the DPJ administration plans to examine changing to an estate tax approach (a system for taxation of the estate subject to inheritance).

With the estate tax approach, taxes are levied on the total value of the deceased's estate. In principle, the total amount of tax paid by the successors as a whole is the same as the total amount paid on other estates of the same size, irrespective of the method by which the estate is partitioned. With the inheritance tax approach, tax is levied on each successor separately in accordance with the size of the inheritance acquired. In principle, the amount of tax paid by each successor is the same as the amount paid by another successor receiving an inheritance of the same size, irrespective of the overall size of the estate.

Japan currently uses a 'statutory share in inheritance' approach, which combines the two preceding methods. The tax is levied on inheritance of the deceased's estate, but the amount of tax is calculated as if the estate were inherited by only the statutory number of individual successors.

(5) Corporation tax—DPJ not inclined to cut tax rates

The outgoing LDP coalition had been investigating ways of broadening the corporation tax base and lowering the tax rate. The DPJ is also hinting at a stance of broadening the taxable base and lowering taxes, but the DPJ administration is less inclined to make such changes than the outgoing LDP coalition.

The Medium Term Program under the old LDP administration considered lowering the effective corporation tax rate.

In contrast, the DPJ Action Program plans to proceed with fundamental reform of special measures concerning taxation, and when the taxable base has been broadened, will "review corporation tax rates, taking into account the maintenance and enhancement of the corporation's international competitiveness, which appears to mean that lowering the corporation tax rate has no greater significance than as a means for adjusting the expanded part of the taxable base.

(6) Excise taxes—Preparing for fundamental revision of other indirect taxes

The DPJ's INDEX 2009 policy document states that excise taxes with no specific policy objective should be dealt with quickly. The basic stance of this document is one of 'tax cuts for the good/taxation for the bad', and it plans fundamental reform of excise taxes, listing automobile-related taxes and alcohol/tobacco taxes as examples proposed for reform.

The 'tax cuts for the good/taxation for the bad' approach is one of cutting taxes (or providing subsidies) where the consumption or sale of specific goods or services has a positive effect on the environment or health, etc., and increasing taxes when it has an undesirable effect, thereby providing guiding towards prices and consumption and production levels that are beneficial to society.

The Medium Term Program under the old LDP administration mentioned review of automobile-related taxes, but did not mention alcohol and tobacco taxes. The outgoing LDP coalition's outline policy document on FY2009 tax reforms lists alcohol and tobacco taxes as issues for examination, but it is fair to say that the DPJ administration is more inclined to reform alcohol and tobacco taxes.

DPJ has long advocated the abolition of 'provisional' taxes on gasoline, etc., but in the DPJ Action Program, it goes no further than stating that fuel taxes on gasoline etc. should be unified into a single global warming tax, with its revenue going into the general account. The tax rate is not specified. The DPJ's INDEX 2009 policy

document states that the local tax component of the provisional tax rates should be abolished as the first step to reforming automobile-related taxes.

The DPJ considers that alcohol and tobacco taxes should be revamped as taxes aimed at promoting health. It is considering an alcohol tax based on the alcohol content, and tobacco tax based on standards considering the extent that the particular product is detrimental to health, rather than on the number of cigarettes. This is likely to mean a system of tax proportional to the amount of harmful constituents.

3. Framework for Debating Tax Reform (Current System and DPJ Proposals)

In addition to details of reforms to the tax system, the DPJ Action Program set out a new framework for debating tax reform, which was to be implemented by a future DPJ administration. The DPJ's INDEX 2009 policy document contained similar statements. This proposed framework for debating tax reform is described below based on the details given in the Action Program.

Until now, the tax reform process has included separate debates in the government Tax Commission and the ruling party's Research Commission on the Tax System (predominantly the LDP's Research Commission on the Tax System). The government Tax Commission has largely provided advice on medium-term tax reforms, whereas the ruling party's commission has made decisions on the specific provisions to be actually included in each year's tax reforms. In effect, we consider that the ruling party's Research Commission on the Tax System made the actual decisions on specific details of actual tax reforms.

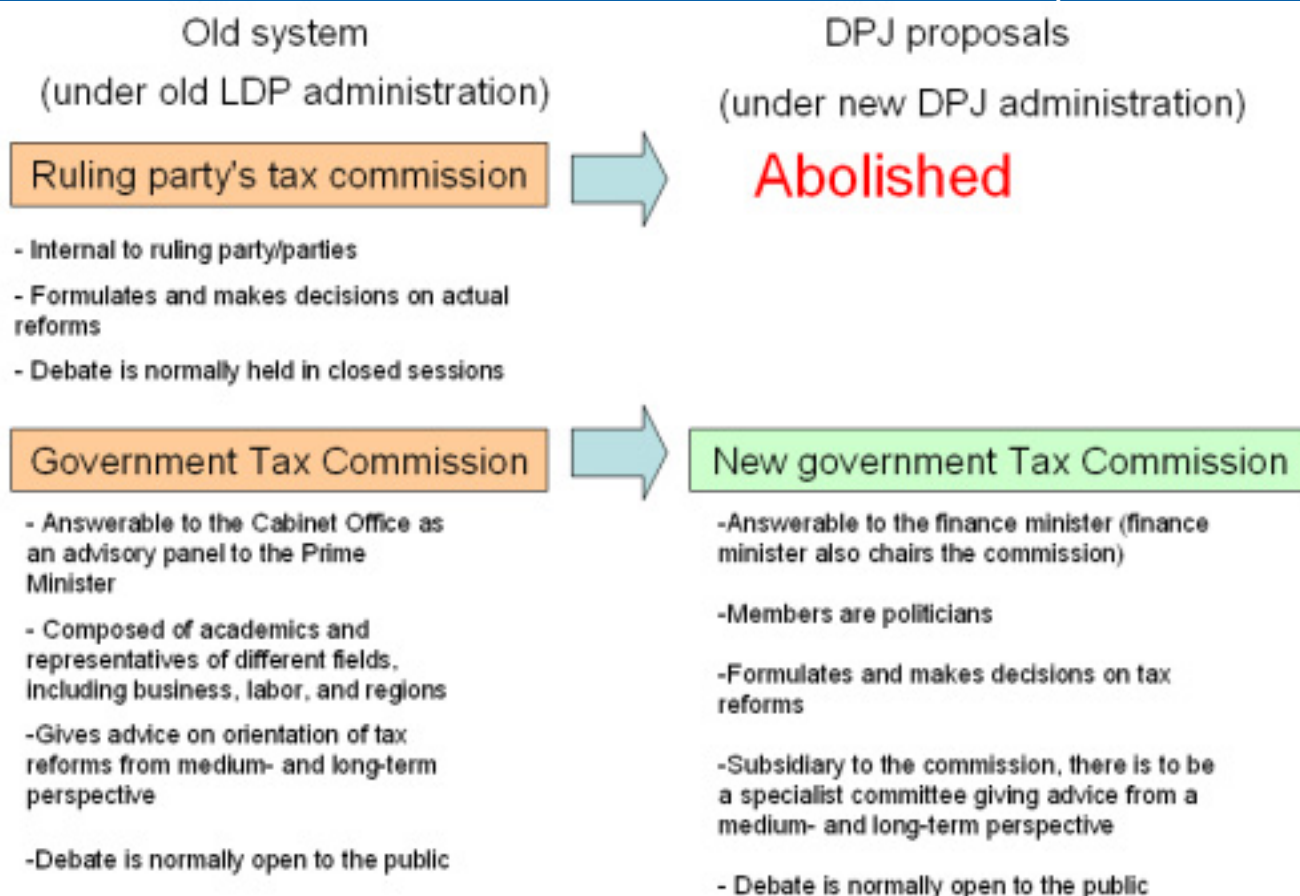
In the DPJ's Action Program, the ruling party's internal tax commission will be abolished. The reference here is to the new DPJ administration, so it is the DPJ's own internal commission that is to be abolished, not the advisory bodies internal to the outgoing LDP coalition. Instead, the DPJ will set up a single forum for formulating tax reforms, in the form of New Government Tax Commission under the finance minister. The finance minister will also be appointed chair of the New Government Tax Commission[4].

The New Government Tax Commission advocated by the DPJ will be composed mainly of politicians (Diet members), and the process of gathering opinions and making decisions will in principle be open to the public, with the aim of ensuring transparency in the tax reform process.

After abolishing the old Government Tax Commission, the Action Plan envisages replacing it with a new specialist committee answering to the New Government Tax Commission and composed of tax system experts to give advice on tax system approaches from a medium- and long-term perspective.

The DPJ proposals for entities involved in debate on tax reform are summarized in Chart 3 below.

Chart 3. Entities Involved in Debate on Tax Reform: Current Situation and DPJ Proposals



Source: Compiled by DIR Legal and Tax Research Dept on the basis of the Action Program etc.

Footnotes

- [1] It is unclear whether this means "Maintain the 10% tax rate to CY2011, then from CY2012 onwards, raise the tax rate if there has been an upturn in the economy, even if taxation on financial income has not been unified," or "The tax rate may be raised before CY2012 if there is an upturn in the economy."
- [2] Note, however, that the Medium Term Program under the old LDP administration listed "consideration of a number of tax rates" as its proposal for benefiting those with low income.
- [3] No specific mention of the taxation approach for inheritance tax in the Medium Term Program, but change to an inheritance tax approach was stated as a topic for investigation in Basic Policy in Formulating FY2009 Tax Reform, published by the government Tax Commission in November 2008.
- [4] The Asahi Shimbun newspaper reported on page 4 of its 20 August edition that on 19 August, DPJ supreme advisor Hirohisa Fujii, who chairs the party's tax panel, commented that the new government Tax Commission to be set up by the new administration should be chaired by the Minister of Finance.