11 September 2009 (No. of pages: 6)

Democratic Party of Japan and Securities Tax Policy

Taxes could increase

Japanese report: 31 Aug 09

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Summary

- On 30 August the Democratic Party of Japan won 308 seats in the House of Representatives, a landslide victory.

- The DPJ's INDEX 2009 policy document says that the 10% tax rate on stocks will be maintained for the time being, but its expiration will depend on the "economic and financial situation." If economic and financial situation improves, the tax rate could be increased even earlier than 2011.

- The DPJ's "INDEX 2009" policy document says that ultimately it would be preferable to include financial income in the tax on aggregate income, but for the time being, it intends to expand the scope of gain/loss aggregation on different financial incomes while taxing financial income separately. If it becomes clear that fiscal resources are insufficient to carry out the policies spelled out in the Manifesto, the new government could increase taxes on financial income as part of an overhaul of special taxation measures (interest, dividends and capital gains are subject to special taxation measures).

- The direction that the new DPJ government will take on securities and financial tax policy will likely be heavily influenced by who is appointed to the relevant positions. The need to cooperate with the Social Democratic Party and other parties may also influence policy.

1. Hard to Be Optimistic About Future of 10% Tax Rate

The following is a comparison of the outgoing government/LDP Medium Term Program and the DPJ's "INDEX 2009" policy document.

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Medium-term Reform Policies (Taxes on Financial Income): Outgoing Government/LDP vs. DPJ Chart 1

Taxes on financial income

	Outgoing Government/LDP Medium Term Program	DPJ Action Program (December 2008)	DPJ's INDEX 2009 policy document (July 2009)
10% tax rate on listed shares and other securities	Extend 10% rate to end of 2011 (Ruling Party Tax Reform Outline, 2009)	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, and broaden the scope of aggregation of gain and loss on different financial incomes	

Source: Compiled by DIR Legal and Tax Research Dept.

Note: Main changes of DPJ proposals marked in red.

Assuming that the "groundwork for unified taxation is ready" sometime around 2012 at the earliest, it appears that the DPJ intended to maintain the 10% tax rate until 2011 when it released its Action Program. However, the DPJ's INDEX 2009 policy document says "considering the economic and financial situation." Although it is not absolutely clear, this leaves open the possibility that the tax rate could be increased from 10% to 20% even earlier than 2011 if the "economic and financial situation" improves, irrespective of whether the environment is right for unified taxation or not.

In the DPJ Tax Reform Outline that was released by the Democratic Party of Japan in December 2007, the party said that it would not extend the reduced rate for capital gains tax on stocks and publicly offered equity funds. At the same time, it said that it would maintain the reduced rate for dividend income, with the aim of addressing the double-tax on dividends and helping to foster stable individual shareholders. In doing so, it clearly indicated its intention to maintain the 10% rate on dividends from listed shares and to increase the tax rate on capital gains to 20%.

However, a bill was submitted at the 2008 ordinary Diet session that mimicked the ruling party's position, keeping the 10% rate on both dividends and capital gains up to a certain limit.

While the DPJ Tax Reform Outline gave the need to address the double tax on dividends as a reason for making the 10% rate on dividends permanent, the DPJ's INDEX 2009 policy document doesn't specifically mention this.

The DPJ's INDEX 2009 policy document mentions securities tax policy, but it is not mentioned in the Manifesto, so we can deduce that it is not a high priority item for the DPJ. Proposals have changed depending on how the wind is blowing. As a result, we aren't entirely optimistic about the future of the 10% tax rate.

2. Ultimate Goal is Tax on Aggregate Income

When it comes to taxes on financial income, the DPJ's INDEX 2009 policy document says that for the present, the DPJ intends to expand the scope of gain/loss aggregation on different financial incomes while continuing to tax financial income separately. However the DPJ also says that "aggregate taxation" of combined income would be preferable, so the party sees unifying taxes on financial income as a step along the way to aggregate taxation.

In other words, because the aggregate taxation is the ideal, it is not inconceivable that the government could skip intermediary steps a move straight to aggregate taxation.

The DPJ's Manifesto contains the following section about tax policy:

> 9. Create a Fair and Simple Tax System
> Policy objectives
> ・Eliminate all entrenched interests in the tax system.
> ・Review the effectiveness of special taxation measures and make the tax system more transparent and trustworthy.
>
> Specific Measures
> ・Clarify the scope of special taxation measures and create a mechanism for reviewing their effectiveness.
> ・Abolish any special taxation measures that are not clearly effective or that have outlived their purpose. Retain those that are genuinely necessary as permanent, not "special," measures.

Looking at today's taxes on financial income, the 20% separate withholding tax on interest income, the 10% tax rate on listed stock dividends capital gains (in principle 20%), the aggregation of gains/losses on dividends and capital gains, the 18% separate withholding tax on redemption gains on discount bonds, and the 20% separate withholding tax on listed futures and options are all provisions of special taxation measure laws (the national portion).

The DPJ will have to prioritize the policies that are currently in place in order to secure the fiscal resources needed to implement the policies spelled out in its Manifesto. The DPJ's INDEX 2009 policy document mentions securities and financial tax policy, but the Manifesto does not. There are fears that if securing the needed fiscal resources becomes problematical, the party will see the special taxation measures that make up the securities and financial tax system as "entrenched interests" that are unnecessary and nonessential when compared with other policies. If this happens, the current system, which revolves mainly around separate taxation, could be discontinued as part of the overhaul of special taxation measures, and the government could move towards aggregate taxation. Or it could increase the tax rate, especially the current 20% rate. Above all, the securities tax system is vulnerable to emotional criticism that it favors the wealthy, and it warrants close attention because of this.

If it is going to implement aggregate taxation, the government will have to introduce some kind of taxpayer number scheme as a tool to accurately gauge income[1]. The DPJ Manifesto says that the party intends to merge the Social Insurance Agency and the National Tax Agency to create a new revenue agency that will collect taxes and insurance premiums in a unified manner. In both the Action Program and the INDEX 2009 policy document, the DPJ also says that it intends to introduce a refundable tax credit, but to enact this, it would of course be necessary to accurately measure individual income. We think that this increases the likelihood that a taxpayer number scheme will be introduced as a tool to accurately gauge income[2].

Note 1: It is also conceivable that the government could collect up to a 50% withholding tax, and individuals who are subject to a lower aggregate tax rate could apply for a refund, but we think that it is unlikely that the government will go so far as to adopt this method.

Note 2: In any case, a taxpayer number scheme could become necessary as part of a tax payment system for unifying taxes on financial income.

The DPJ has some securities industry veterans in its ranks, including House of Councillors member Tetsuro Fukuyama (Daiwa Securities), House of Councillors member Tsutomu Okubo (Morgan Stanley), and House of Representatives member Mitsu Shimojo. The three played important roles before the election. According to the DPJ website (19 May 2009), Tetsuro Fukuyama is the acting chair of the Policy Research Committee, and he is slated to become the next vice cabinet secretary. Okubo and Shimojo are slated to become senior vice ministers of finance, responsible for economic and fiscal policy. Okubo has also served as a director of the House of Councillors' Committee on Financial Affairs. In 2007 this same committee questioned whether the tax rate on dividends and capital gains on long-term stockholdings could be lowered.
Kaname Tajima (House of Representatives), vice chair of the policy research committee, has advocated lowering the tax on stocks to zero for a limited time, while Banri Kaeda (House of Representatives), the former chair of the policy research committee who defeated LDP member Kaoru Yosano in the recent election, has pointed out the difficulty of understanding the new tax system, which eliminated the separate withholding tax on stock transactions and combined the capital gains tax on stocks into the declared separate income tax, and has said that capital gains on stocks should be tax free for the time being.
At the 22 February 2008 meeting of the House of Representatives' Committee on Financial Affairs, Katsumasa Suzuki (House of Representatives), acting head of the finance committee, expressed opposition to the ruling party bill establishing a limit on the 10% tax rate for capital gains and dividends on listed stocks. He noted that because this would increase the number of investors required to file a tax return it would be enormously problematical from the standpoint of facilitating and simplifying tax administration; and furthermore, the effective termination of the reduced tax rate would have a substantial impact on investor activity at a time when share prices are already extremely weak.
Based on what these representatives have said, there is some hope for the future of the securities tax system.

At a 24 March 2009 meeting of the House of Councillors' Committee on Financial Affairs, Naoki Minezaki, who is thought to play a major role in formulating the fiscal and monetary policies of the DPJ (according to his profile, he is the acting head of the DPJ policy research committee and a member of the House of Councillors' Committee on Budget and Committee on Financial Affairs, and he has also served as the chair of the House of Councillors' Committee on Financial Affairs) expressed his opinion that rather than raising the consumption tax, the government should reinforce the redistributive function of the income tax. With respect to income from assets, such as interest, dividends and capital gains, he indicated that the basic idea is to move towards aggregate taxation. He went on to suggest that because it is impossible to have aggregate taxation without a taxpayer number scheme, a different method could be used to tax income from assets, such as interest, dividends and capital gains. The details aren't clear, but he said there could be a withholding tax of about 30%, and if the taxpayer's tax rate on aggregate income was lower than this, he could file to receive a refund (if he did not file, it would become a separate tax at a 30% rate).

・As an example, the income from assets, such as interest, dividends and capital gains, could be taxed separately at a rate of about 30%.
・Taxpayers whose tax rate is lower than 30% would receive a refund.

It appears that Minezaki's thoughts have had a fair amount of influence on what has been written in the Policy Guide: INDEX 2009 about securities and financial tax policy.

Hirohisa Fujii (House of Representatives), the DPJ's top advisor and head of its policy research committee, opposed including the extension of the reduced 10% rate for one year in the FY2008 tax reform legislation[3]. Afterwards, he also supported making the 10% tax on dividends permanent and enforcing a 20% tax on capital gains, as spelled out in the DPJ Tax Reform Outline that was released in December 2007[4]. When the debate over the FY2009 tax reform legislation began, he indicated that he thought that the 10% rate could be continued for 2-3 years, and when the situation returns to normal the 10% rate maintained for only dividends[5]. In February 2009 ,he explained that the DPJ Tax Reform Outline(2007) says that the 10% rate on dividends should be made permanent and he told that financial income should be included in aggregate taxation at some time in the future, but the first step will be to unify taxes on financial income (gain/loss aggregation)[6].

Note 3: Nihon Keizai Shimbun, 2 October 2007.
Note 4: Gekkan Zeiri, 17 April 2008.
Note 5: Nihon Keizai Shimbun, 14 November 2008.
Note 6: Zeikei Tsushin, February 2009, "Fiscal 2009 Tax Reform and Future Issues."

As discussed above, the direction that the new DPJ government will take on securities and financial tax policy will likely be heavily influenced by who is appointed to the relevant positions, especially who is named to the government's tax policy research committee, which will be made up of lawmakers and the Minister of Finance (discussed below in item 3)[7].
Note 7: 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 Minster of Finance.

The DPJ does not have an outright majority in the House of Councillors. Given that, although the DPJ did win a major victory, it did not get two-thirds of the seats in the House of Representatives, so if legislation fails in the House of Councillors it will be unable to override that it the House of Representatives to pass legislation without outside help. To pass legislation it will have to take the views of the Social Democratic Party into account, and this could take securities and financial policy in a tougher direction.

3. Disbanding the Party's Tax Policy Research Committee

Under the LDP-Komeito administration, the government's tax policy research committee set the basic policy for tax reform, while specific details were hammered out by the ruling party's tax policy research committee after considering, and then accepting or rejecting, demands from various industries.

However, the DPJ is disbanding the party's tax policy research committee and it will create a new government tax policy research committee made up of Diet members to examine tax reform. The details are still unclear, but it seems that the DPJ intends to shut down the demands from industry representatives.

4. Protecting taxpayer rights

To protect the rights of taxpayers, in its Action Program and DPJ Policy Guide INDEX 2009, the DPJ has proposed establishing a "taxpayers' bill of rights," overhauling the time limit on corrections, and reviewing how the National Tax Tribunal should operate. If this happens, if tax authorities change an interpretation of how a financial product should be taxed, it would be difficult for the government to suddenly strengthen tax enforcement in that area, as one example.

This could be a positive development for taxpayers who invest in securities.