分類 E.3.3.1.1

案

管主	局長	次長
主任	地方課長	
電信課長		
發電係		

昭和25年8月9日起草

電送第　號　昭和25年8月10日　時　分發

暗　平略

合第二三二號

宛　京都連調事務局長
神戸連調事務局長
大阪連調事務局長
四国連調事務局長

發　大臣

件名　シャウプ博士一行の関西旅行日程に関する件

シャウプ博士一行六名（Dr. S. Shoup, Mrs. Shoup, Dr. S. Surrey, Dr. W. Vickrey, Dr. C. Warren, Mrs. Warren）は八月十一日より一週間に亘り関西方面へ旅行するが日程は

次の通りにつき参考迄

尚連絡局より東谷事務官同行する

（本件東京都総務課十日（金）朝東京都庁調査課に赴く中段であるが）

東京都特別調査課と連絡する

八月十一日（金）　九時三〇分　東京発（DIXIE LIMITED）
　十九時三〇分　京都着（ミヤコホテル宿泊）

全

八月十二日（土）　未定

八月十三日（日）　未定

八月十四日（月）　ミヤコホテルにて総司令部ESS

記帳済

電信案

モス歳入課長主催の民事部経済関係
係官会議に出席
八月十五日（火）右会
今日夕刻神戸に向ひ神戸より四国に向ふ
八月十六日（水）朝徳島着 夜徳島発
八月十七日（木）朝大阪着 夜迄大阪に滞在の後合流
を出発帰京の予定

外務省

E'3.3.1.1

連絡局
地方課長

記帳済

25.8.14
167

近連本第四五〇號
昭和二十五年八月十日

別紙添付

近畿連絡調整事務局

外務大臣 殿

シャウプ博士との税制懇談會開催斡旋に關する大阪商工會議所からの依頼について

一、今般大阪商工會議所から別添甲號の如き書簡を以て本件依頼があつたから、別添乙號八月十日附KHLCO No. 428 GA. 寫の通り當事務局から當地總司令部經濟科學局才入課大阪地方事務所に本件斡旋方申入れた。

二、就ては中央に於かれても、總司令部に對し、本件實現方何分の御配慮をお願いする。

連絡調整事務局

記帳済

(TRANSLATION)

8 August 1950

TO : Mr. SHIMA Shigenobu,
Director, Kinki Liaison & Coordination Office

SUBJECT: Request for Good Offices in Arranging Meeting with Dr. Shoup to discuss the Tax System

Dear Sir:

The Osaka Chamber of Commerce and Industry has heretofore possessed a deep interest in the tax system of our country, and has also made various studies in the field of tax system reform, having already presented its opinions to Dr. Shoup.

In this connection, and on the occasion of the arrival and visit of Dr. Shoup, it is our desire to hold a meeting of the sort indicated above and to ask the opinion of Dr. Shoup concerning the trend of the local tax system and other problems, and also to present the opinions of our financial circles direct to Dr. Shoup.

Your kind offices are therefore solicited in arranging such a meeting.

Yours sincerely,

SUGI Michisuke,
Chairman,
Osaka Chamber of Commerce and Industry

0158

連絡調整事務局

寫送付先 大阪商工會議所會頭

常時網司令部に對し傳達方依賴したものである。念の爲

二をお別添甲號大阪商工會議所書簡中言及しているシャウプ博士への要望書は各年十二月十七日附近連本第三四五號揃信を以て

0157

KINKI LIAISON & COORDINATION OFFICE SY/ai

Prefectural Building
OSAKA

10 August 1950

KKLCO No. 428 GA

TO : Chief, Osaka Regional Field Branch,
International Revenue Division,
ESS, SCAP

SUBJECT: Request for Good Offices in Arranging Meeting with Dr. Shoup to discuss the Tax System

1. This Office is in receipt of a letter from the Chairman of the Osaka Chamber of Commerce and Industry, dated 8 August 1950, subject as above, asking this Office to arrange a meeting with Dr. Shoup on the occasion of his proposed visit to this region in the near future.

2. The English translation of the above letter is forwarded to you inclosed herewith, and it would be greatly appreciated if you could possibly lend your kind assistance towards realizing a meeting of such nature.

S. Shima
Director

1 Incl: as indicated.

0159

RE'-0024

0211

E'3.3.1.1

Action

全自連會發第九五號

昭和二十五年八月十二日

全國地方自治協議會連合會

事務局長　大　迫　元

外務省連絡局長　木村四郎七殿

シャウプ博士に對し知事代表面會方連絡依頼の件

八月二十日より八月二十二日の間に於て知事代表がシャウプ博士に對し地方税、財政の實情につき説明申上げたく面會につき御配慮を願上げます

なお八月二十一日午前十時より世話人知事會議が都道府縣會館に於て開催されますので八月二十一日午后に於て面會が出來るよう御取計い願えれば一層好都合です何分宜敷く御願致します

E'3.3.1.1

連絡局
地方課長

神連本第三六五號
昭和廿五年八月十九日

神戸連絡調整事務局長 田中

外務大臣 吉田茂殿

ヴィッカリー博士地方税制視察來神の件

關西地方、四國方面に地方税制視察旅行中のシャープ博士一行の内ヴィッカリー博士（Dr. W. Vickrey）は荻田地方財政委員會事務局長と共に昭和廿五年八月十八日午前十時半來縣、吉川副知事、谷本總務部長、加古税務課長等と地方税制について懇談した。同博士は兵庫縣徴税組織機構等を聽取した後谷本總務部長よりの地方自治体の財源として煙草、酒消費税、ガソリン消費税、電氣ガス税等の縣側への委譲方要望に對し、ガソリン消費税についてはその賦課方法の困難性、税率の問題、生産輸入が國家的見地より行はれている點から、煙草、酒消費税については現在の税金が既に相當荷重であること、專賣局側よりすれば現在の價格は極限であること、密造等の點より難點を指摘し確たる意見をのべなかつたが、電氣、ガス税の内電氣税については市より縣への委譲は電氣の普及一般性等よりみて煙草、酒等に財源を求めるより合理的である旨述べた。

尚附加價値税について同博士より縣側の意見を求めたところ、加古税課長は、1.徴税方法の難解なることによる吏員の訓練の必要なること。2.財政困難に苦しむ大會社は現行事業税の下では缺損の場合は納税を免がれるが附加價値税施行の際は納税義務を生じ、さらでだに勞務費支拂、借入利子支拂に困難を來すとみられる旨、所見を發表約二時間に亘る懇談を終了した。

連絡調整事務局

本信送付先 外務大臣
寫送付先 近畿、中國、四國、京都、東海北陸、横濱各連調

局長

記帳済

記 貼 了

外交 25.8.24

32

0161

連絡局
總務課長

便

四連調第二九六號
昭和二十五年八月二十五日

四國連絡調整事務局長

外務大臣　殿

シャウプ博士徳島縣下視察状況報告の件

貴電合第二二五號に關し

シャウプ博士（Dr. S. Shoup　）は徳島縣下市町村の財政事情及び新税制の運營面を視察の爲コロンビヤ大學のヴイッカリ Dr. W. Vickery, ウォーレン Dr. C. Warren サリイの三教授(Dr. S. Surrey)總司令部モス歳入課長と共に十六日午前四時半小松島港着、シャウプ博士、ヴイッカリ教授は午前中徳島縣廳を訪ね縣の財政事情を調査し、午后は徳島市役所、名西郡藍畑村役場を訪ね財政事情及び徴税の實際面につき熱心に視察を行つた。一方ウォーレン、サリイ兩教授は午前中徳島税務署、午后は鳴門税務署を訪ね新税制の末端機構の状況を調査し、

文書課 收 25.8.29

30

ヴイッカリイ教授を殘し一行は同夜小松島港發歸京した。

なお、當日徳島縣廳よりシャウプ博士に提出した資料何等御參考までに別添送附する。

連絡局　地方課長

記帳済

別紙添附

北連調[illegible]第三四四號
昭和二十五年九月十一日

北海道連絡調整事務局長　林

外務大臣　吉田茂殿

ショウプ博士一行の來道に關する件

當地方においては今回税制改革による地方税制の運營について、[illegible]歳入課札幌事務所長クライン中尉より日本側に對し種々の示唆乃至勸告が行われ、これが具體化につき當事務所が諸般の連絡に當つてきたことは既に屢次にわたり報告しておいたが、去る八月二十九日にはショウプ博士一行が來道、三十日函館市役所において開催せられた日本側關係者との會議に出席し、後者より主として地方税法改正前後の情況及び希望意見を聽取した。

本件については當事務局はクライン中尉の要望により総ての連絡調整の任に當つたが、會議開催に際しても、吉田事務官を函館に出張せしめ所要の連絡に當らせた。

なお、右會議の委細については別添同事務官の報告書に依り御承知願いたい。

外文書課 收 25.9.16 79

記帖了

E'3.3.1.1

RE'-0024

0215

シヤウプ博士一行税制視察に關する件

一、八月十四、十五日京都においてシヤウプ博士一行と[illegible]歳入課各地方事務所長との會議が開催されたが、この會議に出席するに先達ち、札幌事務所長クライン中尉より、道庁、札幌市役所及び國税局に資料並びに意見書の提出方を求めたが、道庁側の不準備のため當事務局に督促方依頼があり、當事務局は道庁に本會議の重要性を強調し漸く右資料を提出させた。

二、クライン中尉は京都における右會議においてシヤウプ博士に對し今回の地方税改正により、北海道においては却つて地方自治体の税收入が減少することを強調し、シヤウプ博士の現地視察を懇請した。

三、當事務局は道財政を担當している野田副知事に對し、今回の道側の不手際を指摘し、[illegible]歳入課札幌事務所とシヤウプ博士のラインを重視する樣申し入れた。

四、八月二十一日シヤウプ博士の來道が確定し、クライン中尉より當事務局に對し本件に關する協力方依頼があり、當事務局は本件に關す

る一切の連絡調整に當ることとなつた。當事務局は主力を道庁に注ぐこととし、資料並びに意見書の作製に意見を述べるとともにその飜訳をひきうけた。

五、八月二十六日日本側關係官庁並びに關係團体を集め、クライン中尉と最終的事務打合せを行つた。

六、八月二十八日函館への出發に先達ち道総務部次長とともに當事務局係官は道作製の意見書並びに資料についてクライン中尉に說明したが、中尉は十分滿足の意を表明した。

七、二十九日午前五時十分シヤウプ博士一行（別添表「参照」）來函、午前八時知事と會見、知事より北海道の概略について說明を聴取、八時半記者會見を行い「地方における舊税法と改正税法の比較對照、具体的には市町村の固定資産税の運營、道においては附加價値税の準備情況、地方自治体と地方財政委員會の關連に關心をもつている」とその視察目的を語つた。記者團より七百億圓減税、またこの減税と米國の税金の増徴とについて質問があつたが、「七百億減税は來

観すぎると思う。米國の税の増徴はなんら日本には關係がない」旨答えた。

一、ウオーレン博士は九時過ぎより函館税務署七飯村等に赴き主として固定資産税關係の調査を行つた。

一、三十九日シヨウプ博士、ヴイカリー博士は渡島支庁長の案内で午後一時半より函館南東郊濕地村鉄亀澤村を視察した。

一、二十九日午後六時よりシヨウプ博士一行、クライン中尉及び民事部關係者を知事が五島軒に招待、晩餐會を開いた。日本側の出席者は田中知事、野口副知事、坂東道會議長、西川國税局長、齋藤函館市長、原田札幌市第一助役、三森日銀札幌支店長及び當事務局吉田事務官等であつた。

一、三十日午前九時半より午後五時過ぎまで函館市役所第一應接室において、シヨウプ博士を中心に關係者が集り熱心なる討議が行われた。（會議内容に關しては別添参照）

一、午前中の會議の終了直後シヨウプ博士は會議室において記者團と會見したが、その談話の内容は午前中の會議において博士が道側に與えた回答と略ゝ同じであつた。

一、シヨウプ博士一行は三十一日午前六時半知事、市長等に見送られ離道した。

一、クライン中尉は本會議終了後小官に對し左の如き感想をもらした。

今回の會議における道側の説明は理路整然としていて充分シヨウプ博士に北海道の特殊事情をわかつてもらつたことゝ思う。シヨウプ博士自身も自分にその様な感想をもらしていた。

同じく民事部ヘイズ法政議長、ゴチョーク經濟議長も異口同音に本會議が成功であつた旨小官に語つた。

（別表一）

シャウプ博士一行名簿

カール・S・シャウプ博士	Dr. Carl S. Shoup
シャウプ博士夫人	Mrs. Shoup
ウィリアム・G・ウォーレン博士	Dr. William G. Warren
ウィリアム・S・ヴィカリー博士	Dr. William S. Vickery
グレン・モロー氏（民間諜報局）	Mr. Glen Morrow I.R. ESS., SCAP
高橋氏（天然資源局）	Mr. S. Takahashi NRS., SCAP
R・E・ブリックマン大尉（シャウプ使節団事務局）	Executive officer of Shoup Mission

赤谷事務官（外務省）

岸本事務官（大蔵省）

ウオーレン博士、高橋氏は三十日朝離道しました。

シャウプ使節団と北海道地方自治体との地方税制に関する会議

日時　八月三十日午前九時半―十二時半
　　午後二時十五分―五時半

場所　函館市役所二階第一應接室

出席者

シャウプ博士、ヴィカリー博士（シャウプ使節団）
モロー氏（民間諜報局）
赤谷事務官（外務省）
クライン中尉（民間諜報局札幌事務所長）
ヘイズ氏（民事部法政課長）
ゴチョーク氏（民事部経済課長）
吉田事務官（北連調）

萩田事務所長（地方財政委員會）
柴田府縣税課長（地方財政委員會）
田中知事、野口副知事、文木総務部次長、前野財政課長、
川越税務課長、浅野地方課長、篠永渉外課長
原田札幌市第一助役
齋藤函館市長
清水岩内町長（北海道町村會財政委員長）
西川國税局長、岩崎総務課長
田中、大島議員（北海道道議會）
三森日本銀行札幌支店長（北海道金融界代表）
その他地元市會議員及び商工會議所代表

会議内容

「先づ知事の簡単な挨拶の後、道総務部次長文木氏より次の如き説明があつた。

「道財政についてみるに新税法による二十五年度の道税收入見込額は二十五年度予算に比し二、四七八、三九一、三〇〇圓の減となり総收入において二十五年度予算に比し新税制によれば三、八一八、九七六、三〇〇圓の減收となる。しかして二十五年度の総收入は九、一六二、三三〇、九〇〇圓で総支出は一五、〇二六、四一八、二〇〇圓となり、この差額五、八六四、〇八七、三〇〇圓を平衡交付金に頼らなければならない。また北海道の全市町村財政についてみるに、その税收入において二十五年度の予算額計五、九一〇、四三一千圓に比較して新税法による二十五年度收入見込額は四、八一一、七五八千圓となり、一、一二五、八三〇千圓の減收となるが、このうち七市は計二九六、四

二五四千圓、三四町村は計八五、七三二千圓増加することになるので、この増加分も前述の二十五年度予算額と新税法の収入額との差引の中に含まれているので、この増加分は現實に他の減收町村に廻すわけにはいかない故、現實の北海道の市町村の減收分は一、四八〇、六五八千圓となる。

しかして二十五年度に必要とする市町村分の平衡交附金は二千四年度の調定額と新税法による税收見込額との差額一、七〇七、八一六千圓及び國庫支出金減收、地方配付税の減收、石炭、寒冷地手當、徴税強化費を含めて四、二八三、三七七千圓を必要とする。

北海道が道及び市町村何れも今回の税制改革により減收となるが道市町村とも財源に乏しく、從來は非常な超過課税及び多數の法定外独立税を設けていたが、新税法によれば、右が不可能になつたことがその理由である。

北海道の未開發性から來る財源の貧困に對し、他府縣に比し北

海道は左の點よりして特殊な支出を必要とする。

(イ)北海道の開發は、國家的見地からみても急務であるが、その費用についてみるに、大體は國費をもつてまかなわれるが、それに附隨する事業は道市町村費をもつてまかなわなければならない。最近國費と道市町村費の割合は前者が減少してきている。昭和二十五年度國費五、七一九、五三〇千圓、道費一、道予算額一、三〇七千圓、市町村費一、三八七、三九四千圓」

(ロ)北海道は寒冷雪積地であるため溫暖府縣に比し多額の一般行政費を必要とする。

要するに北海道は未だ幼年であり、人間には幼年に對して特別の加配が行われるように北海道への財政に對しても特別の加配を必要とする。

しかして現在考えられている平衡交附金の制度によれば、この特別加配が考慮に入れられてをらず、北海道は現制度によれば

永久に効年のまゝに放置されることになる。

したがつて平衡交附金の配分方法として、全國の標準縣、市町村を定め、北海道をその標準にするため如何程の費金を必要とするかを算定し、それの三十分の一、又は五十分の一を毎年もらうことにすれば、三十年後又は五十年後には北海道はこの標準に近づくことができるであろう。」

以上の文木所長の説明に對しショウプ博士は

「北海道の特殊事情はよく分つた（I realized the special condition of Hokkaido.）。」

新税法によると舊税法に比較して北海道が減收になることも理解できた。それは北海道においては從來非常に高い超過税率で課税されていたのであるが、しかし標準税率課税は今年度の道市町村の財政は苦しいであろうが、將來は自由に課税できるようになるであろうから（標準超過税率を採用できる）將來はこの問題はなくなるであろう。」

平衡交附金については北海道について相當愼重に考慮されなければならないと考える。すなわち北海道については(1)經營的な經費の他に(2)投資的な經費が必要である（北海道開發のため多額の建設的經費を必要とする）からこれについては平衡交附金で考えられるであろう。（自分の勘告書の中にもこの種の費用は平衡交附金で考えられるであろうと書いてある。）」と答えた。

ヴイカリー博士から道の附加價値税に對する準備體制及び本税に對する承唆について質問があつたが、道より鋭意準備中で本年度の事業税收入見込額一、〇七五百萬圓に對して附加價値税になると一、五〇〇百萬圓（調定額の九〇%の收入として）の收入見込があり四二五百萬圓の增收が見込まれるので早く附加價値税を實施してもらいたい旨回答があつて十二時過ぎ午前中の會議は終了した。

午後二時十五分より引續き會議が行われたが、市側を代表して原田札幌市第一助役より午前中の道側の説明と同樣統計をもつ

て北海道の市町村が新税法施行により他の地方とは逆に減収となる故、北海道は多額の平衡交付金を必要とする旨説明した他、左の點を要望した。

(イ)現在の平衡交付金制度では大都市に厚く、小さな町村に薄くなるという不合理性があるのでこれを是正する。

(ロ)北海道の諸事業は四、十一月迄に行われなければならないので平衡交付金の交付時期を北海道については、四月に半額、九月に四分の一、十二月に四分の一にしてもらいたい。

(ハ)市町村民税については源泉徴收の制度を設け、雇傭主に被雇用者の市民税納入の義務を負わすようにする。

(ニ)固定資産税について、國有財産の場合、使用者が課税されるが(一官舍等の場合)がこれは國から税をとる様に改める。

(ホ)起債の手續を簡素化してもらいたい。現制度では地方財政委員会と大藏省の二本建になつていて實際に金を受取るまで約一年かかる。もつと手續を簡素化し、大藏省は唯起債の枠を

定め、地方財政委員会はその枠内で許可するようにしてもらいたい。

(ヘ)電氣ガス税、鉱産税、木材取引税を府縣税に移譲すべしという意見があるがこれには反對する。

(ト)納税組合を設け市町村がこれを援助することを認めもらいたい。

二、次に岩内町長清水氏が北海道町村会財政委員長の資格で、岩内町の場合を例にとつて北海道の特殊事情、税法改正前後の税收見込、平衡交付金に對する意見の開陳があつた。

四、次に道側より次の如き發言があつた。

(野口副知事)

「地方自治を發達させるには、それに相應する財源が必要であるが現制度では地方自治體の財源は窮乏しているので一現在では道の財源の半分が國から出ている一地方自治體は獨立できない。都道府縣にさらに國税を移譲すべきである。一例えばガソリン税の府縣えの移譲)

また酒消費税を復活してもらいたい。かくの如く自治體の財源を強化すると同時に國はもつと國の行政を地方自治體に移譲すればよい。

新税法によると都道府縣税には安定性がなく、また道民とのつながりが非常に少くなつた。」

（文木委員）

「例えば道税で最も大きな附加税（償金）をみてもその納税者の數は十五萬で、道民税の場合は七十九萬であるので、道民とのつながりをつくる意味において道民税を復活してもらいたい。この場合のみ市町村民税と道民税との二重課税となるが止むを得ない。」

（野口副知事）

「起債の枠は七〇億であるが、この枠をもつと擴げてもらいたい。また起債の手續を簡素化してもらいたい。納税組合を認めてもらいたい。」

最後に宗藤函館市長より次の如き發言があつた。

「地方税額一、九〇〇億に對して地方平衡交附金はこれをもらう（地方平衡交付金が一〇五億にも達し地方財政はなお相当部分国費でまかなわれることになる。）自治體ともらわない自治體とあるべきである。

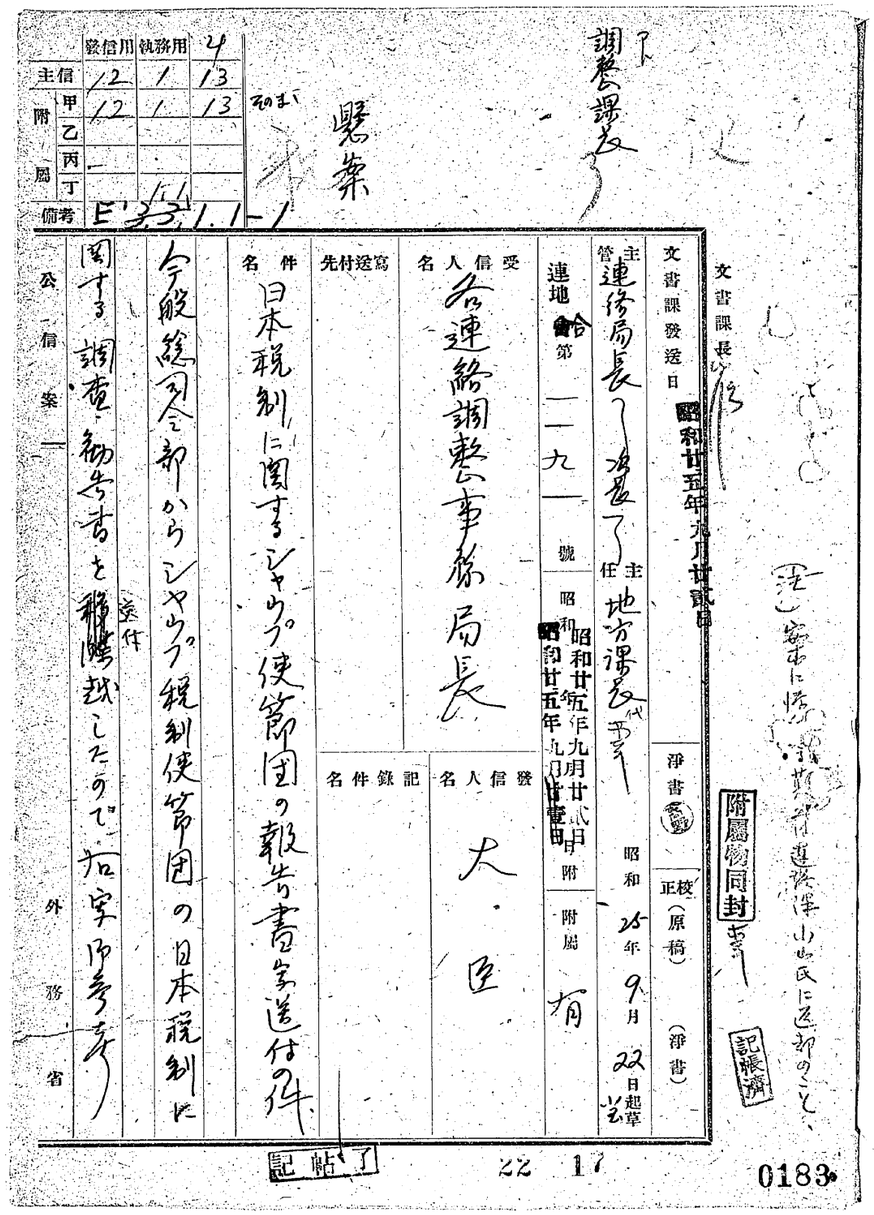
根本の方針として地方自治體は自己の税収入でまかなえるようにすべきである。それがためには現在の國民の税負擔は最高點までいつている故に、新らたな税を設けるよりも、むしろ國税を地方自治體に移譲すべきである。國から種々の施策（例えば衛生方面等）を施行すべき命令が地方自治體に來るが、それに伴う資金が送つて來ないため地方自治體は非常に弱つている。」

最後にモロー氏より固定資産の評價に關し、地方財政委員会の權限について、地方自治體の卒直な意見をきいたのに對し、道及び札幌市原田助役から大體次の如き意見が出た。

大都市は独立してやれるが小さな市町村は到底かゝる專門家を見出し得ない故、地方財政委員会及び道が相當細部にわたつて勸告指導してやることが望ましい。しかしこの勸告指導

を受入れるか否かはこれらの市町村の自由に委してよい。

ヤシヨウブ博士より種々有益な意見を拝聴して有難うとの挨拶があつて無事三十日の会議は終了した。



公信案

外務省

まず、とりあえず別添送付する。

附属

MEMORANDUM FOR : The Japanese Government

SUBJECT : Shoup Mission Report on Japanese Taxation :

(Inc. : Tax Survey Conclusions and Recommendations)

0184

GENERAL HEADQUARTERS
SUPREME COMMANDER FOR THE ALLIED POWERS
Shoup Tax Mission

20 September 1950

MEMORANDUM FOR: The SUPREME COMMANDER

SUBJECT: Tax Survey Conclusions and Recommendations

Submitted herewith is a statement of conclusions and recommendations covering our resurvey of the Japanese tax system, which we recommend be released both to the Japanese Government and to the Japanese public.

The statement is based primarily on the past 7 weeks of travel and study in Japan. When we arrived, the new national tax system had been in force for some months, but the new local tax system had been enacted by the Diet only the day before. Even under the national tax system, there had not been time for substantial experience. The first installment payment under the new reduced income tax, for instance, was just falling due.

On the other hand, there had been a year of intensive debate throughout Japan over the recommendations submitted last year. Despite the limited amount of experience with the new system, therefore, we found no lack of issues to study.

The present statement is consequently a compound of three things: an appraisal of such experience as has been gained under the new system; a statement of position on new issues that have developed in the public discussions of the past year; and an analysis of the chief problems that the coming year may bring. Unlike last year's report, it makes no attempt to be comprehensive; many segments or aspects of the tax system are not touched upon at all.

The main conclusions and a considerable amount of supporting data and reasoning are presented in this statement, but many technical details have been deferred to a series of supplementary memoranda to be released within the next week or so.

0185

A. The National Budget: The Uses That May be Made of the Prospective Surplus.

At the time this statement is being written (September, 1950), the exact amount of the surplus available for tax reduction in the 1951-52 fiscal year is still uncertain. We therefore consider what uses might be made of various amounts of surplus. There is no doubt, on present prospects, that there ought to be substantial tax reductions, and that the outlay side of the budget should be at a level to make such reductions possible.

Another uregent need, however, is the avoidance of unduly high and unfair local taxation, by increasing the equalization grant from the proposed 108 billion yen level. If this increase is not made there is little doubt that the localities will raise local rates well above standard rates in many cases, will levy special taxes, and will even fall back on the so-called voluntary contributions which our report last year condemned. The reasons why these events will occur if the equalization fund is not increased are given in the section below on Local Budgets. Again, the expenditure on services rendered by the national government should be at such a level as, combined with national tax reduction, will make this increased grant to localities possible.

In the tax field, we must again register our belief that the farmer, and to a less extent the other taxpayers who work independently, should receive treatment more nearly parallel to that accorded those who work for a regular employer. We recommend that the farmer and fisherman be given an earned income credit of 10 per cent of their net profit (but not more than 10 per cent of 150,000 yen). Extending the credit to other self-employed taxpayers might be considered in a later year if the budgetary condition improves. Meanwhile, "parallel treatment" means just as strict enforcement for the farmers and other self-assessed ~~taxpayers~~ as has already been reached under deduction at the source from wages. This goal has already been substantially achieved, for farmers. As to the others, a large part of our present statement is devoted to devising ways of ensuring that they pay the full amount of tax they owe, and we believe that it can be done.

An increase in the allowance for dependents is also a particularly good use for a budget surplus. We suggest increasing the allowance for the first two dependents in any one family.

If the prospective budget surplus turns out to be about 25 billion yen for 1951-52, we recommend that the three measures above be taken. The equalization fund increase should be at least 12 billion over the budget estimate of 108 billion (larger than this, if budget conditions permit, as noted below) to a total of approximately 120 billion. The credit to farmers would cost about 4 billion. The rise in the dependents allowance could be set so as to take up the balance.

Another urgent need under the income tax is a decrease in rates and an increase in the basic exemption. If the budget surplus promises to be 45 billion or so, we recommend reduction of the rates in all of the brackets except the first (where the starting rate should not be low, to avoid processing many more returns with only a nominal tax) and the brackets above 300,000 yen. As much relief as possible should be given within the brackets 50,000 to 150,000, for reasons given below. The basic exemption should be raised as far toward 30,000 yen as the revenue needs will allow.

In making estimates of the revenue loss from those income tax changes, the probability that compliance will improve as the exemptions go up and the rates go down should be allowed for. The revenue loss may be expected to be appreciably less than if no improvement in compliance could be anticipated.

If the surplus promises to be still larger, the commodity taxes on business items and on articles of common household use should be repealed. And the equalization fund should be increased by another 10 billion yen, to a total of approximately 130 billion yen. At this point, about 60 billion of surplus will have been used up. If the national government has still more available, certain reductions might well be made in the remaining commodity taxes.

We now present more of the reasoning that prompts those proposals for the personal income tax.

High priority on the above list is given to reductions in the personal income tax. Such reductions are necessary if tax officials and taxpayers are to be given adequate opportunity to complete the transformation of the income tax from its former status as an arbitrarily determined tax characterized by extreme evasion and great delinquency in payment, into a modern tax instrument that spreads the burden fairly under a law that taxpayers respect and administrators enforce. The progress made toward this goal during the past twelve months has been as substantial as we last year had expected it would be. The greater part of the job still lies ahead, however. The number of taxpayers must be reduced to make the task of administration more practicable, and the amount of tax due from each taxpayer must be reduced more nearly to what he will regard as a reasonable amount. To be sure, if international events should induce a substantial rise in inflationary pressure in Japan in the next few months, income tax reduction may have to be foregone in the interests of price stabilization. Barring such a development, we regard a reduction in the income tax as imperative.

But in reducing the personal income tax it is necessary to decide whether to emphasize basic exemption and dependents allowance, or to stress decreases in the tax rates.

Those who argue that emphasis should be on increasing the exemptions point out that:

(1) By raising the exemptions, large number of taxpayers are removed from the tax roll entirely, thus reducing the administrative burden more than would a reduction in rates, which takes no taxpayers off the roll;

(2) It thereby takes a greater load off the lowest-income taxpayers than would a reduction in rates.

(3) At the same time, an increase in the exemptions does give some relief to every taxpayer, even the largest.

With regard to the rate scale, an important question is whether the marginal rate -- the rate that applies to the next yen that the taxpayer might obtain by additional work or additional business activity -- is so high as to discourage him from working more, or doing more business. For manual workers who have to decide whether to work overtime, etc., the critical area is probably in the brackets of 50,000 yen to 100,000 or 150,000 yen of taxable income. The first two of these amounts corresponds approximately to a monthly wage of about 12,000 yen for a taxpayer with a wife and three dependent children, or a single taxpayer respectively. The present taxable rate on that part of the taxable income (i.e., income after exemptions), from 50,000 to 80,000 yen, is 25 per cent, to which may be added an average inhabitants tax (local tax) amounting to another 4 percentage points -- 29 per cent, altogether. In the range 80,000 to 100,000 yen the combined national and local bracket rate is 30 per cent plus 5.4 per cent, or 35.4 per cent. This marginal rate is close to, if not beyond, the point at which it may be deterring extra work by wage and lower-salary employees. In the 100,000-120,000 bracket of taxable income the combined rate is 41.3 per cent; in the 120,000-150,000 bracket, 47.2 per cent.

The impact of those rates will be automatically moved to a higher income level if exemptions are raised, and (for farmers) the earned income credit extended; the marginal percentages given above will apply only to workers with slightly higher incomes. But the difference will not be material. On the other hand, for reasons to be given later in this statement, it is likely that next year the municipalities will be forced to select an option under the inhabitants tax of a kind that adds somewhat more than the percentages listed above to the marginal tax on those with incomes of 10,000 yen a month or less.

The present combined national and municipal rate on the 150,000 - 200,000 yen bracket is 53.1 per cent (45 per cent plus 8.1 per cent). On the bracket 200,000 yen - 500,000 yen it is 59 per cent; and on all over 500,000 yen

the marginal rate is 64.9 per cent. Very few workers, farmers, or small business men are found in these ranges. The question here, rather, is the effect on incentive to invest, or to work toward high-paying executive positions. We do not believe that those deterrent pressures are too strong in Japan at the present time, especially in view of the elimination of double taxation of corporate income through the dividend credit granted under the income tax.

As to the deterrent effect on manual laborers, if it does does exist, it may still result in little or no reduction in total production of the Japanese economy. The slack might be taken up by workers who do not have a full job to do, but who are nevertheless on the payroll on part time, or are available to be hired at once. Consequently, if one worker decides to indulge in foregoing overtime work, or in absenteeism, or in slack work under a piece-rate wage system, there may be another worker ready to produce that extra amount of product.

Another reason given for substantial rate reduction, including a reduction in the brackets above 200,000 yen, is that the taxpayers in those brackets do not regard the present system as a just one and will simply refuse to comply with the law until the rates are moved down to levels that correspond with those individuals' ideas of what they ought to be asked to pay. This argument is difficult to appraise. No tax can succeed if it really runs directly counter to deep-seated notions, especially those founded in tradition, of what the taxpayer thinks is reasonable. But taxpayers' complaints on this score can scarcely be taken at their face value. If those Japanese taxpayers who represent, say, the top 10 per cent of income recipients in the country are inclined to believe they are being too harshly treated by the present income tax schedules (plus the net worth tax), they may feel less strongly on this point after contemplating the tax burdens of their British and American counterparts in the income distribution.

B. Local Budgets

The prefectures and municipalities will probably have to increase their total expenditure in the 1951-52 fiscal year. There are several reasons for this:

1. There are no substantial items in the local budgets like price subsidies and debt retirement, which have been large because of inflation and the program of checking it, and which may now be reduced greatly as inflation has come under control.

2. The national government is contemplating an increase in the demands it makes on localities to render certain services, or the inducements to do so, while it at the same time proposes to defray a part but not all of the cost of these services. The rest of the cost adds to the total of expenditures that the localities must meet from their own resources. The Local Finance Commission has estimated that the draft of the national budget now being considered by the Cabinet for 1951-52 contains items of this kind which would, if enacted, result in an additional expenditure by localities in 1951-52 (over 1950-51) of 13 billion yen for welfare activities and another 12 or 13 billion yen for public works.

3. The national government is proposing abandonment of the arrangement in force this year with respect to the cost of repairing damage to public properties by natural diasters. This arrangement callssfor 100 per cent of the cost to be borne by the national government, with some exceptions. The national budget for 1951-52 is at present predicated on a substantial return to the old system, whereby the local governments in general paid one-third the cost of such rehabilitation. The Local Finance Commission estimates that this would add 16 billion yen to local expenditures next year.

4. The national government proposes to raise the salaries of its employees in 1951-52. Article 9 of the Supplementary Provisions of the Local Autonomy Law and Article 55 of the Cabinet Order No. 19 of 1947 which implements that law are interpreted by some to mean that the localities must follow suit; and in any event, it seems likely as a practical matter that the localities will be obliged to do so. The Local Finance Commission estimates that this would add 17 billion yen to local expenditures (teachers, policemen, and firemen, 11 billion yen; others 6 billion yen).

5. The normal growth in population will call for 2 or 3 billion yen additional expenditures.

On the other hand, there is no doubt room for appreciable saving by increasing the efficiency of operation of the local governments. In part, such increase can be obtained overnight simply by having the will to do so; but in part it can be obtained only gradually over the years, as local officials gain experience and skill in managing their own affairs -- something in which they have not had much experience so far.

The total additional expenditures in items 2 to 5 above is 60 billion yen. Even if it is discounted a good deal, it remains too high to be covered by additional tax revenues that the localities should try to extract from their existing system. Moreover, these remarks so far make no allowance for the likelihood that the current year's outlays will be substantially below what is needed for the services that the local units are supposed to render, but in fact may not be rendering owing to inadequate revenues.

For these reasons, we believe that, if inequitably high and economically harmful levels of local tax rates are to be avoided in 1951-52, the national goverment must forego some of the national tax reduction that it could otherwise obtain, and (1) refrain from throwing back on to the localities so much of the cost of disaster rehabilitation as the present plans contemplate, (2) increase the size of the equalization grant. Although national taxes would under this plan be somewhat higher than they would otherwise be, we believe that this failure to decrease national taxes still further would be less harmful than the heights to which local taxes might otherwise rise.

There would not, of course, be a 1-to-1 correspondence; the amount of increased local taxes avoided would not be as great as the decrease in national taxes foregone. But this difference is justifiable on the grounds that, regardless of items 1 to 5 listed above, an increase in the equalization grant is called for. This is discussed in a separate section below on the equalization grant.

Even with reasonable increases in local tax rates, and the measures recommended in the second paragraph immediately preceding, the localities will probably be short of funds, and therefore may request permission to borrow more in 1951-52 than in 1950-51.

In general, then, 1951-52 will be a critical year for local finance. The way in which the problem is met will in large part determine whether local autonomy will develop. Local autonomy will not be harmed by an equalization grant, for the locality is still able to reap its own rewards (in the form of a lower local tax rate) by increasing its efficiency and thus diminishing its expenditures; and the locality is still put under the necessity of financing 100 per cent, from its own taxes or borrowing, any increase of services beyond those possible under the grant. But inadequate total finances can kill local autonomy.

In addition to all these factors, there is the influence of the forth-coming report of the Local Administration Investigation Committee to take into account. The findings of this committee will be of great importance in judging the revenue needs of the localities.

The problem of a local financial system adequate to support local autonomy in Japan is on the road to solution, but is still some distance from the end of the journey.

C. Administration of the National Income Tax

February, March, and April of this year were in many ways one of the most difficult periods that income taxpayers and income tax administrators in Japan have ever encountered. Although tax relief has been enacted, it could not take effect until July, 1950 (with minor exceptions). The very high rates and very low exemptions of the old system were still in force; but the inflation of money incomes had been stopped, and some taxpayers were suffering from reduced business, or unemployment. Hence the tax administration found it difficult to induce complete compliance.

At the same time, the administrators were forbidden to use the old methods of arbitrary reassessment, aimed at meeting a predetermined goal, or quota, for each tax district.

Under the circumstances, it is not surprising that taxpayer compliance was inadequate, and that arbitrary reassessment was not completely eliminated. Truly, the period of early 1950 was a formidable hurdle to surmount. It has left behind it some problems, including a huge tax delinquency that must be attended to within the next few months.

Nevertheless, the hurdle has been cleared. Every taxpayer who has filed his preliminary return for 1950-51 must have realized, upon computing his tentative tax, how substantial is the tax relief brought about by the Diet's action last winter. And most taxpayers, we believe, are aware that a new era has dawned in Japan in the relation of tax administrater to taxpayer.

Our Mission has studied this last point in some detail. We can assure the Japanese taxpayer that the top officials of the Tax Administration Agency and the Texation Bureau are sincerely engaged in an ambitious effort to administer the income tax precisely in accordance with the law, without arbitrariness. No doubt this spirit has not yet been completely realized in action. At some of the lower levels of administration the old faults remain. But such faults will be eliminated fairly rapidly, provided that the taxpayers, in their turn, likewise show a respect for, and confidence in, one another. This is the aim. When it is substantially achieved, both parties will wonder how they ever could have lived under the old system of mutual distrust and recrimination.

We turn now to listing some of the specific measures that will aid in reaching this aim. They fall into these main groups;

1. Determining Income and Tax Liability
2. Collecting the Tax
3. Tax Administration Personnel and Office Operations
4. Taxpayers' Representatives
5. Prosecution of Tax Evaders
6. Elimination of Corruption
7. Statute of Limitations and Other Points

In each one of these groups we make a number of specific recommendations. Further details will be given in supplements to this report, to be released shortly. Any one of the recommendations taken by itself may seem of minor importance, or sometimes even trivial. Yet by taking action on all these points at once it will be possible to improve administration of the income tax substantially.

1. Determining Income and Tax Liability

a. The tax-return form can be simplified further.

b. It should be made clear to the taxpayers that (1) minor bookkeeping errors will not deprive them of the blue-return privilege; (2) farmers and small business men can file a blue return even if they have only a single-entry, not a double-entry, system of keeping books; (3) actual posting in a ledger of sales and purchases invoices is not necessary if those invoices are carefully filed. The Tax Offices, in turn, should realize that not every blue return need be investigated. The Tax Offices should encourage the filing of blue returns by all taxpayers who are willing to meet the minimum requirements for doing so.

2. Collecting the Tax

On July 31, 1950, there was 73 billion in unpaid self-assessed income tax. Of this large total, 47 billion was on 1949 incomes. The other 26 billion was on earlier years' incomes.

So long as this huge amount of unpaid back taxes stands in the way, it will be difficult, if not impossible, to administer forthcoming tax assessments and collections fairly. Indeed, the single most important administrative problem under the income tax at the present moment is how to clear up this accumulated delinquency. It should be cleared up by the end of this calendar year, or at least by the end of the current fiscal year. To a considerable degree, this aim can be achieved by transferring personnel from many of the rural tax offices, where delinquency is not so serious a problem, to industrial regions, especially Osaka and Fukuoka, where the delinquency rate for taxes on 1949 incomes is exceptionally high, and Tokyo, where the total amount is great, although the rate of delinquency is about average. Additional temporary personnel will also be required.

How may a recurrence of such delinquency be prevented? Partly by taxpayers' keeping better books and records, so that they are not reassessed in amount much beyond that which they had expected to pay; but chiefly by the development of savings plans for txpayers.

Farm Cooperative Associations have done valuable work in assisting farmers to save to meet their tax payments, and should increase this activity. Fishermen have associations which should develop similar savings plans. In some places, taxpayers have formed tax savings associations; annual dues are paid to these associations in return for the service of collecting small amounts from their members at frequent intervals and holding the sums for tax payment. Such associations should be encouraged, so long as their membership is not composed of only one or a few trades; otherwise, they might develop into the old boss-dominated industry associations. The associations should not be permitted to represent their members in discussions with the tax authorities, or to file tax returns on behalf of their members. These are duties and responsibilities of each taxpayer.

Cooperative banks are promoting savings by small taxpayers through the use of solicitors or collectors; other banks and financial institutions might also develop systems of periodical house-to-house collection of savings for tax payments.

Attachment of property for non-payment of tax will no doubt still be necessary, even if these improvements in collection are realized, but much less frequently than at present. Attachment should become so rare that it brings with it a moral stigma, characterizing the taxpayer as an irresponsible member of the community.

3. Tax Administration Personnel and Office Operations

a. The number of existing personnel in tax administration should not be reduced. The immediate loss in tax collections would exceed by many times the economy in salaries; and the decline in taxpayer compliance would further imperil the collections for future years.

b. The existing personnel should be reassigned in part, to provide more collectors, some assistants to the supervisors, more conferees, and more investigators. The Tax Administration Agency is in need of immediate additions to personnel for post-audit review, for processing of information returns, and for handling requests for notices or rulings.

c. Although a marked improvement over last year is evident in tax-office procedure, there remains an urgent need for for two things; more space (more and larger buildings), and more office equipment, such as filing cabinets, carbon paper, and binders -- also more transportation equipment.

d. The establishment of the Tax Administration Agency on June 1, 1949 has contributed materially to the improvement in tax administration. The Agency should be further strengthened, and should not be burdened with non-tax responsibilities.

e. Taxpayers' Representatives

We recommend that attorneys and certified public accountants be allowed to represent the taxpayer before the tax administration officials, without any examination other than a character examination; that Zeimu Dairichi (tax practitioners) already in practice as of the present date be allowed to continue, subject only to a character examination, but that anyone who wishes to obtain the status of Zeimu Dairichi in the future be required also to pass a written examination testing his professional competence; and that Keirishi (who are not also Zeimu Dairichi) who wish to continue to represent taxpayers be required to pass both a character examination and a written examination testing their professional competence. There can be no new Keirishi. Each person thus admitted by the Tax Agency to practice before the tax officials would obtain a card giving his name and professional class.

5. Prosecution of Flagrant Tax Evaders

There should be promptly initiated a rigorous enforcement program for the application of penalties to those taxpayers who do not comply with the tax laws, and for the criminal prosecution of the more flagrant tax evaders.

6. Elimination of Corruption

The attainment of a high standard of integrity among all tax officials and employees is essential to the development of a vigorous, democratic and efficient tax system. Some instances of bribery and embezzlement among tax officials have come to our attention. In some of these cases appropriate action was taken; in others, however, no action appears to have been taken. In such cases prompt and stern criminal action should be immediately taken against both the tax official and the taxpayer involved. The employee should be not only dismissed from the Government Service, but also, together with the taxpayer involved, prosecuted to the full extent of the law.

7. Statute of Limitations and Other Points

a. The Statute of Limitations governing the assessment of taxes is provided by Article 30 of the Accounting Law, which deals with claims by and against the government. Under it, tax assessments must be made within five years from the date that the tax is due and payable. It appears that the five year statutory prohibitions against assessment applies even though the taxpayer has filed a fraudulent return. A period of five years for reassessment against a taxpayer appears unusually long. Taxpayers should be assured, within a reasonable time after the filing of a return, that no adjustment will be made in their tax liabilities in the absence of fraud. We therefore recommend that the present Statute of Limitations be changed so as to prohibit the assessment or reassessment of personal and corporation income taxes, three years after the date on which the return was due, or two years after the date on which the return was filed, whichever is later. This statutory prohibition should not, however, apply in the case of fraud on the part of the taxpayer or failure to file a return.

b. The Taxation Agency should prepare and sell a loose-leaf tax service containing not only the tax law but also the interpretive rulings and other administrative pronouncements of the officials, the court decisions on tax cases, and other materials useful to the tax practitioner, taxpayer, and teachers and students of tax law.

c. Courses in the legal aspects of taxation (as distinguished from the fiscal policy or general public finance aspects) should be introduced into the curriculum of The University Law Schools. Sufficient funds should be provided in the national budget to provide for such courses in the major government universities.

d. The program inaugurated this spring whereby Japanese tax officials visited the United States should be continued and expanded.

e. A similar program should be instituted for leading accountants.

D. National Tax Problems not Involving Substantial Changes in Revenue

1. Liquor Taxes

The liquor tax problem remains one primarily of evasion. Part of the illegal production is by rice farmers who brew sake almost entirely for home consumption (including parties, festivals, etc.) -- that is, "home-brew", not "bootleg". Another part is by shochu distillers in the urban areas who are not legitimate producers (that is, all their output is illicit). A third part is due to diversion of alchohol from industrial alcohol plants. Finally, there may be some evasion by legitimate, known producers of sake and shochu who sell a part of their production without paying the full tax.

To meet this evasion problem, three alternatives are available.

One way would be to reduce liquor tax rates sharply. This would weaken the incentive of farmers to make their own sake, and would diminish the profit of the urban evaders. This measure might produce more liquor tax revenue from the farmers. But the total liquor tax revenue would, in our opinion, almost surely decline, because the check to illicit production outside the farm field would almost surely be far from making up for the decline in revenue from liquor that is already being taxed.

A second alternative is to keep the rates where they are, and enhance enforcement measures. As experience elsewhere shows, home-brew on the farm will always be a problem, under rates that aim at producing a large revenue. With respect to illicit liquor production off the farm, we believe it has not yet been shown that tax rates must be reduced if evasion is to be substantially reduced. Our argument rests on the fact that there are some additional measures of enforcement that may be tried, and, until they are tried, the need for rate reduction is not compelling.

We recommend that the industrial alcohol plants be brought under the jurisdiction of the Ministry of Finance, and that responsibility for the production and control of all alcohol be assigned to that Ministry. It is this Ministry that has the greatest incentive to see that no industrial alcohol is diverted to consumption.

We recommend that additional personnel be employed and trained, so that a much closer, more continuous inspection may be made of the sake, shochu, and other liquor plants. It is our impression that the present force is inadequate.

We believe the above measures, if vigorously undertaken, can reduce the non-farm evasion to tolerable levels.

A third alternative is to combine rate reduction to the rice farmers (to discourage home-brewing) with maintenance of the revenue by keeping the present liquor tax rates for other consumers. This might be done by increasing the ration of liquor available to rice farmers at low prices, under special low tax rates. This method, however, may be attacked as unfair to other consumers, and catering to evasion.

The third alternative might be viewed as a temporary measure, designed to get the farmers back into their pre-war habit of respect for the liquor tax law, while at the same time meeting the national government's pressing need for reduction of tax revenue in the income tax field. In this view, it might be hoped that within a few years the financial situation would permit a general reduction of liquor tax rates in line with other tax reductions, plus a redevelopment of tax observance among the farmers, so that the ration, special-tax element in the system could be abandoned.

Given the present need of the national government for revenue, and for reduction in other taxes, we do not favor the first alternative. If we are in error about what would happen to the revenue -- and on this point

there is certainly room for error -- there is a good deal in favor of this action, with the further reservation that its effect on the food supply would have to be studied carefully.

The second alternative is in our opinion the one to choose for the time being: keep the rates where they are, and increase enforcement efforts.

The third alternative is not recommended by us. It should be explored more fully than we have had a chance to do; at a time when Japan becomes economically self-supporting.

2. Net Worth Tax

In most of the tax offices and regional bureaus that we have visited we have found the tax administrators aware of the important role of the net worth tax in the new tax system. Some of them have prepared records of all taxpayers within their jurisdictions who would likely be subject to the tax and are preparing to mail to them a complete summary of the law.

In other instances, however, the tax administrators have not given any attention to the tax. Their delay has been explained on the ground that the first date on which anyone becomes liable under the tax is December 31, 1950.

Every effort should be made to initiate this tax successfully. It is more important that the revenue yield would indicate. If it does not receive the necessary administrative attention and those affected to not voluntarily comply, then high surtax rates from 55% to possibly 85% may be reenacted by the Diet. The net worth tax is an effective substitute for high surtax rates, provided the tax is properly enforced. Tax administrators should therefore energetically expedite an effective administrative program for the net worth tax.

3. Gasoline Tax

The tax should be altered from an ad valorem to a specific tax, of so many yen per kilo-liter, for convenience in administration of both taxation and gasoline distribution.

The level of the tax should remain unchanged so long as rationing is in effect, except that if further study shows that illegal diversion of gasoline, tax-free, is so substantial as to require some reduction to check evasion.

E. Local Tax Problems

1. Inhabitants Tax

a. Most of the municipalities will probably have to change the basis of their inhabitants tax next year, imposing the tax as a percentage of taxable income instead of as a percentage of the national tax. Otherwise, they will suffer substantial declines in revenue.

b. Municipalities should be encouraged to experiment with levying the inhabitants tax on a current year basis, including withholding of tax from salaries and wages, instead of the present system whereby this year's tax is based on last year's income.

c. The per capita maximum rates should be reduced to the present standard rates (800 yen in cities of 500,000 or more; 600 yen in cities of from 50,000 to 500,000; and 400 yen in other cities and all towns and villages.)

These recommendations are explained, and other technical recommendations are given, in a supplementary memorandum.

2. Property Tax

a. Government Properties and Public Utility Enterprises

National Government properties pose special problems for the property tax law. Also the problem of taxing government property merges into that of taxing public utilities in general, since much of the public utility activity in Japan is carried on by the government. These problems are highly technical ones, which demand special treatment; it is discussed in some detail in a supplementary memorandum to be released shortly.

b. Duties and Responsibilities of Local Finance Commission

The Local Finance Commission was delegated certain broad duties and responsibilities under the Local Tax Law in connection with the property tax.

The successful carrying out of these functions is essential if the property tax is to assume its designated role as the backbone of municipal finances. The Local Finance Commission does not have a staff large enough to perform these duties. Qualified personnel in accounting, engineering, appraisal of property, compiling and making statistical studies of an unusually complex nature and the like are required immediately in greater numbers. Effort should be made to recruit such personnel from other agencies of the government in order that the Commission can effectively carry out its assigned duties and responsibilities.

c. Tax Maps

Unless an accurate listing is kept of all real property and improvements in a municipality, some of that property will generally escape assessment. We recommend immediate preparation of large-scale property identification tax maps by all municipalities, with an adequate staff to maintain them on a current bases. Later, the

municipalities should refine their assessment process by developing and maintaining land value maps, land use maps, soil capability maps, and the like.

3. Value-Added Tax

The value-added tax is to replace the enterprise tax based on profits, in 1952, as the chief source of tax revenue for prefectures.

a. Shifting the Tax to Consumers

A common complaint is that the value-added tax, not being restricted to profits, will bear unfairly on those firms with a large labor element. But this complaint seems to assume that the value-added tax is supposed to be borne out of profits, like the present enterprise tax. Instead, the value-added tax is supposed to be passed on to purchasers in higher prices; it is a type of sales tax.

b. Depreciation on Assets in Existence January 1, 1952

In our report last year we recommended that value-added be computed by deducting from sales all purchases from other business firms, including purchase of machinery, buildings, etc. We concluded, therefore, that no deduction of depreciation should be allowed, since this would produce a double deduction of the same item.

Further study has convinced us that this recommendation, and the resulting law, are unfair to concerns that finish a capital equipment program shortly before the tax takes effect. They will be spending relatively little in the first years of the tax for capital equipment, hence will have little to deduct in computing value-added. A newer competitor, on the other hand, may be getting substantial deductions, since he will be spending large amounts for new equipment.

To avoid this injustice, we recommend that the law be amended to allow firms to deduct, in computing value added, depreciation on all property owned by them as of January 1, 1952 (the date when the value-added tax takes effect), and, in addition, be allowed to deduct, as under the present law, the amounts spent on acquiring buildings, equipment, etc., on and after that date. On such buildings, equipment, etc., purchased on and after January 1, 1952, no depreciation could be deducted; to allow this would be to grant double deduction.

c. Depreciation Option for Assets Obtained After December 31, 1951

Business concerns that keep an extensive set of double-entry books complain that it would be much simpler for them to compute value-added if they could deduct depreciation on all present and future buildings, equipment, etc., and not deduct at all the expenditures on acquiring those objects. They could then compute their value-added by summing their profits as computed for national-income tax purposes, their payrolls, and their interest and rental payments. Their gross income for the value-added tax should not include sales of such depreciable assets.

There is no objection to a business firm employing this concept of value-added if it does so consistently. We therefore recommend that the law be amended accordingly, to give the taxpayer this option.

d. Value-Added Deemed to be Certain Percentage of Sales

The present law provides that for the first year of the new tax certain businesses may use as the tax base, not value added, but specified percentages of gross sales for the year.

While there may have been some need for such transition provisions if the law were to take effect at once, the fact its application has been postponed to January 1, 1952, materially lessens the necessity. Such provisions are dangerous, in that they tend to become permanently embedded in the law, although inserted at first as temporary measures; and thus discrimination in favor of certain taxpayers takes root. We therefore recommend in general that Article 74 of the present law be repealed or substantially restricted in scope.

e. Differential Rates

The present law sets the standard rate of the value-added tax at 4 per cent, except that for a long list of businesses, chiefly live-stock breeding, fishing, professional activities, and personal-service businesses, the standard rate is 3 per cent. The maximum rates are set at 8 per cent and 6 per cent, respectively.

We do not think there is a justification for such a rate differentiation. If the tax is to be shifted forward to consumers by raising selling prices and fees, there is no reason why it should be imposed at a lighter rate on these businesses than on others. There is no proof that it will be harder for livestock breeders, or dentists, or tax consultants to shift the tax to their customers than it will be for the steel mill, the retail shop, or the pottery manufacturer to do so.

We therefore recommend that all businesses subject to the value-added tax be taxed at the same rate.

f. Rate-Regulated Enterprises and Government Corporations

To maintain competitive relations between the private and government railroads, the JNR should also pay the value-added tax, under rules for computing the

profit element of that tax to be set by the Local Finance Commission. These corporations, government as well as private, cause the prefectures certain costs of government, and should pay their share. Although at first sight prefectural highway expense might appear to be stimulating competition with the railroads rather than aiding them, actually these expenditures are needed by the railroads in order to enable freight and passengers to get from farms, houses, and factories to railway terminals.

F. Intergovernmental Fiscal Relations

1. Equalization Grant

We have recommended above that the equalization grant be increased to approximately 130 billion yen for 1951-52, from its present level of 105 billion yen. We also recommend that the law be amended as indicated below.

In general, it appears that the Local Finance Commission has done excellent work in interpreting and administering the law with the twin aims of strengthening local autonomy and equalizing the financial resources of rich and poor areas as nearly as possible with the limited fund available.

However, if it is to achieve these aims fully, the equalization grant law must have the following characteristics.

First, the equalization formula must leave the localities with full incentive to operate efficiently. If a locality can save money by improving its methods of administration, the saving should be available for reduction of local taxes. Likewise, if a locality slips into wasteful expenditure, it should find itself faced with the necessity of raising its own tax rates, not able to dip further into the equalization fund.

The present equalization formula fulfills this requirement, and will continue to do so, probably, for the next few years. But the formula does not completely bar the growth of certain incentives to overexpansion of functions. The law should therefore be changed, sometime in the next year or two, to eliminate such incentives. Methods of doing so are suggested in a technical supplementary memorandum to be released shortly.

Second, the equalization formula must not put pressure on the local units to be lax in the collection of their own taxes. And it must not induce them to put low values on the tax base, thus getting low assessments of tax as under the real estate tax. On this point the present law can be improved substantially.

Third, the equalization fund must be economized; it is so small in total that none of it should be wasted by being given to the wealthier communities, on the specious argument that every locality ought to get at least some of it. The truth is just the opposite: an equalizing fund is supposed to equalize, that is, bring the poorer localities up toward the level of average or normal services without undue tax strain; hence the fund should be distributed only to those poorer localities. The Local Finance Commission has so interpreted the law, where the law was not specific, as to produce about as much equalization as is possible, and the result is a fairly good degree of equalization. But the law should be amended so as to improve the distribution of the grant still further.

Fourth, the method of computing the total basic financial need and total basic financial revenue should indicate how large the equalization fund would have to be if full equalization were to be achieved. This would give the Diet something to aim for, even though the goal could not be reached immediately. It would also make the calculations more understandable to the local officials.

"Full equalization" does not mean bringing the poorest localities up to the level of the richest. It means merely bringing them up to the point where they can render a reasonable minimum of service at a reasonable maximum of tax effort — a kind of average concept. The richer localities would still be able to supply their inhabitants with more services, some of them even with low tax rates.

2. Disaster Rehabilitation Expenses

When a typhoon, earthquake, or other natural disaster strikes a locality in Japan, the heavy damage to roads, public buildings, farm-land irrigation systems, etc., and the necessity of repairing the damage promptly will subject the local tax system to an undue strain unless some method is found for sharing the burden with the national government, or evening out the burden over a series of years.

Prior to this year, the national government granted public works subsidies to assist localities in rehabilitating property damaged by natural disasters, on a sharing basis. For major types of public property, the grant was two-thirds of the cost.

This was more than adequate for the richer localities, while it left the poorer localities still under severe financial strain.

Our report recommended that the subsidy be increased to 100 per cent of the cost. This was done, except for damages not exceeding 150,000 yen on any one item. Damages within 20 meters of each other are counted as a single item. This new plan was enacted only for a year. Unless some action is taken, the disaster grants will return next year to the old matching basis for rich and poor localities alike, and the success of the revised tax system will be imperilled in many prefectures and municipalities.

Further consideration since last year has convinced us that a better solution can now be found. The 100 per cent grant poses an unduly large administrative task for the national government to be sure that rehabilitation costs are not inflated; it tempts the localities to be lax in keeping costs to a minimum; and since the localities must pay all of the extra cost of building a better bridge, dike, etc., than the one that was destroyed, it removes incentive to rebuild in a way that will avoid future disaster damage.

We believe that an acceptable plan should (a) transfer to the localities enough responsibility for payment to make feasible the granting to them of almost complete freedom in the design and execution of rehabilitation work, and at the same time (b) give assurance that no local government will have to bear more of the total outlay for disaster rehabilitation and related improvements than it can properly afford. We believe we have designed a plan that meets these tests; we shall submit it in a supplementary memorandum to be released shortly.

3. Promotional Grants

In addition to the equalization grant, and the disaster rehabilitation grants, there are the promotional grants, designed to stimulate local action along certain specified lines.

We suggest that the promotional grants be restricted to an amount calculated as a percentage of the excess of the amount spent over a certain minimum, such a minimum being set low enough so that practically every locality will be surpassing it of its own accord. This

again is an economizing device, making a given amount of national grant go further. This point is developed in a supplementary memorandum.

4. Priorities of Tax Claims

The priority issue on tax claims will arise where the properties of taxpayers have been seized or attached by two or more levels of government (national, prefecture, municipal) and where properties of bankrupt taxpayers are available to settle partially the tax claim of two or more levels of government.

The municipality and the prefecture should be given greater protection in the application of a tax priority rule than the national government. The national government can more easily absorb the losses that occur: it has much greater borrowing power to carry it over a period of poor tax collections.

Article 2 - 2 of the National Tax Collection Law and Article 15 - 3 of the Local Tax Law is now interpreted to give priority to the tax claims of the government that seizes or attaches the property of the taxpayer first in time. Thus, if the municipal tax administrator is the first to attach the property of the delinquent taxpayer then the tax claims of the municipality will have priority over the tax claims of the other governments that attach later. This is merely tax priority based on seizure in order of sequence. This favors the municipality over the prefecture, and the municipalities and the prefecture over the national government. The local tax administrators are in a better position to know against whom seizure must be used if they are to collect their taxes. We recommend that the order of attachment or seizure continue to govern in a determination of the priority of tax claims among the various levels of government except in the case of claims for property taxes which will always have priority over all other taxes because of the recommended change that the liability be in rem as well as in personam.

Where the taxpayer has become bankrupt and owes taxes to two or more levels of government, a tax priority rule must determine the order of satisfying those tax claims. Again recalling the background against which these priorities must be determined, it appears that the claims of the municipalities and the prefectures should be preferred over the claims of the national government. It is therefore recommended that the property tax and the inhabitants' tax of the municipalities and the value added tax

of the prefecture be given priority over all other tax claims. The assets should be prorated as to those tax claims if the assets are insufficient to discharge the total claims based on those three taxes. Any assets remaining should be prorated among all other tax claims of the municipalities, the prefectures and the national government.

5. Local Finance Commission and Local Autonomy Agency

The success or failure of the new system of local finance depends largely on the skill and speed with which the newly formed Local Finance Commission is able to discharge the many duties laid upon it.

The Commission is at present badly understaffed. It needs a large increase in personnel. The present staff has been working overtime, with a good deal of skill, to meet the most immediate problems facing the Commission, namely, the distribution of the equalization grant and of the local borrowing quota. But other, equally important tasks are in turn becoming urgent, notably the assessment of certain properties under the tax on land, houses, and depreciable assets.

There is probably no more important step toward local autonomy to take at this moment than the addition of a large number of capable personnel to the staff of the Local Finance Commission.

Carl S. Shoup, Chairman
Shoup Tax Mission

E'13,3,1,1

連絡局 地方課長

北連調經第三七七號

昭和二十五年九月二十二日

北海道連絡調整事務局長 林

外務大臣 吉田茂 殿

政務局 經濟課長

調整課長

シャウプ勧告に對する反響報告の件

今回發表せられた第二次シャウプ勧告は當地方に於いても本二十二日の各新聞に相當詳細にわたつて報道せられ各方面の注目を惹いているが、本二十二日附北海道新聞は早速本件に關する社説を掲載しているので、何等御参考迄其の要旨左記の通り報告する。

記

一 勧告は國税の減税を犠牲にして平衡交付金を增額すべきであると

記帳済

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の見解を示しているが、之は明年度予算案を閣議で決定するに當つて、地方予算の檢討を並行的に行わなかつた政府に對し重要な警告を與えたものと考えなくてはならない。

「併し其の反面勸告は地方財政の歳出面については觸れるところがない。平衡交付金の增額は更に地方予算の歳出面を愼重に檢討したうえで決定されるべきであることを主張したい。

「減稅の具體的内容について猶檢討の余地の殘されているものがある。農民、漁民に勤勞控除が設定されることは當然のこととして望ましいが、中小商工業などの自家勞働所得に對し同樣の措置がとられないことは明かに片手落ではないかと思われる。

「軽減措置について、勸告には五萬圓から拾五萬圓までの階層をできるだけ救濟すべきであるとのべているが、基礎控除が最低生活を保障しない限り最低稅率を引下げることは當然の政策と考えられる。

「一九五一―五二年会計年度における對日援助費の打切りが檢討されている折柄、明年度の稅制改正及び予算を通じて、これまでのところ何等の性格も見出せないことは甚だ悲しむべきことと言わねばならぬ。

THE EQUALIZATION GRANT

In recommending an equalization grant last year, we had in mind two major objectives: providing adequate financial resources for alo local governments in the less prosperous areas, and leaving these local governments free to determine for themselves the amount and character of the services which they wish to provide.

To this end the equalization grant was to be calculated in a manner that insofar as possible is independent of the manner in which local governments choose to levy taxes or apportion their expenditures, and which will provide small grants or none at all to localities having other resources adequate to their needs, and provide relatively larger grants to poorer localities.

Present Procedures

The equalization grant law as finally enacted in response to this recommendation was necessarily somewhat general in its provisions, and capable of several alternative interpretations. Actually, the manner in which the law is being applied by the Local Finance Commission appears likely to produce a final result that accords admirably with the aims that we originally set up. However, the procedures that are being followed are quite complicated and difficult for the local governments to understand; moreover the severe shortage of staff and the severe pressure of time in the Local Finance Commission plus the lack of some of the needed data have required the use for this first year of a number of short-cut procedures. This has led to some misunderstandings on the part of local government officials, and to some fear that an undue amount of discretionary authority over the distribution of the grant has been lodged with the Local Finance Commission. In order to allay these fears, improve the understanding of local officials concerning this important element of their finances, and lay the groundwork for a simplification and rationalization of the procedures, it seems appropriate to present here a summary of the present procedure as we understand it.

The law specifies that 10% of the equalization grant shall first be set aside as a "special grant" and that the remaining 90% shall be allocated in proportion to the excess, in each local body, of "basic financial need" over "basic financial revenue". The special grant is to be allocated on the basis of such special factors as cannot be incorporated in a general formula, or such emergencies as happen after the regular grants has been allocated.

"Basic Financial Revenue" is defined in the law as seventy percent of the revenue that would be obtained from the standard taxes at the standard rates. This use of only seventy percent of the standard revenue for computing the grant insures that at least some incentive will remain

to each locality to assess its taxes fully, unless it is willing to put its current rates above the standard rates. If 100 percent of the standard revenues were used, then for a community that actually imposed taxes at the standard rates there might be a temptation for example to overlook property or to underassess depreciable assets, since, if this practice is not observed by the LFC and allowed for in distributing the grant, the reduction in taxes would be made up by the equlization grant. To be sure, in principle the Local Finance Commission may compute the equalization grant on the basis of what could be obtained with some standard degree of efficiency in assessment, but, for the first year at least, the pressure of work on the Local Finance Commission is such that it can hardly be expected to undertake any detailed appraisal of the completeness with which the various local bodies assess property, although some attempt has been made to get the governors of prefectures to do something along these lines. A similar temptation would be even more serious in the case of the prefectures where there is great variation from one place to another in the degree of enforcement of such taxes as the entertainment tax and the enterprise tax and where there is no intermediate level of government that can be called upon to perform an appraisal or auditing function. As it is, every local body will have a net gain of resources, after considering the effect on the equalization grant, of at least 30 yen for each 100 yen they collect in taxes, even assuming that the Local Finance Commission makes no attempt to allow for failure to assess and collect the standard taxes with full vigor. In any event, the current grant is based not on actual collections but rather on estimates; actual collections will affect the grant only as they affect estimates for future years, at least unless the law is changed (as we suggest below) to provide for an adjustment of the grant for a given year in the light of the actual yield or assessment of taxes for that year.

The basic financial needs for each local body are computed by taking number of units of the various kinds of standard services performed or normally required in each local jurisdiction, and multiplying these numbers of units by its corresponding unit cost, and summing the products. It should be noted that the number of units of service is not in most cases a measure of services actually performed, but rather the number of units for which the service in question should be performed. Thus in many cases the unit consists of the population, or area, or the part of the total population or area falling in an appropriate category. In some cases, such as education, the measure, number of pupils, is a direct measure of the service, but in such cases the local body cannot influence the number of units of service by its own action to any great extent, if at all.

In determining units of service the Local Finance Commission has given some care to defining units of service in such a way that they shall be beyond the immediate control of the local body, lest the local body be given an incentive to wastefully increase such units of service as a means of increasing its share. In the equalization grant, there remains some cases, however, where for the longer run at least a more independent measure of the need of a community for a given type of service

should preferably be found. In particular this appears to be the case for roads: using the actual condition and extent of the road network of a community is an inadequate measure of the needs of the community for road maintenance and construction, and indeed if continued as at present would have a serious tendency to induce an uneconomical pattern of expenditure by local bodies. For the first year, however, the need for a measure that can easily be computed and administered appears to be paramount. The LFC is amply justified in using the measures it has adopted and if their use is confined to the first two or three years of the equalization grant system and in particular if the intention to shift to new measures is adequately publicized, their use should have no appreciable adverse effects.

The number of units of service are thus obtained for each category of service for each local body, on the basis of data specific to that body. "Unit costs", however, are obtained on an overall basis. To arrive at unit costs, which should perhaps better be termed "standard unit expenditures", the Local Finance Commission secured detailed data on budgeted costs from a group of local units selected to represent adequately the various conditions as to climate, population density, degree of industrialization, etc., to be found in Japan.

An average budgeted expense per unit of service was then computed for each of the sample bodies. From the sample were then selected those local bodies differing primarily with regard to some particular factor that is deemed to influence the cost of some items of expenditure: thus for police expenditure, deemed to be influenced by the amount of snowfall, units are selected with about the same population, etc., but differing as to snowfall, and the average budgeted police expenditure per unit is plotted for each local body against its snowfall. A curve is then fitted (apparently typically a parabola) to this scatter of plotted points (apparently by the use of a least squares method, where this seems to produce satisfactory results), and thus a normal value is obtained for the per unit police expenditure for varying amounts of snowfall. Comparing this with the overall average per unit cost produces an adjustment factor reflecting the effect of various degrees of snowfall on the cost of police.

Adjustment factors may similarly be obtained for degree of urbanization, or population of the local unit, or other factor deemed to have a substantial measurable influence on the cost of the service in question. Actually, only four general factors have been considered, namely the (1) scale on which the particular service is supplied, (2) population density, (3) climate, and (4) the degree to which the service in question is performed inside or outside a city. In addition, an adjustment factor is derived to reflect the extent to which varieties of service are supplied that differ in some respect from a standard of variety. Thus the cost of an industrial course in a high school may be considered to be 1.30 times that of an ordinary course, and an adjustment factor for the kind of units of service rendered is obtained by multiplying each variety by a corresponding coefficient, adding the products and dividing by the

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number of units to get a weighted coefficient for type of service.

The basic unit cost for each type of service is then multiplied by such of these five adjustment coefficients as are applicable in order to get the adjusted unit cost for any given locality.

In obtaining the basic unit cost, however, certain overall adjustments are applied to the original data. To begin with, whenever a given expenditure is in part defrayed by some specific subsidy, or source of revenue specifically allocated to such a service, the part so defrayed is excluded in computing the basic unit cost. Thus in effect only those expenditures that are to be defrayed from the equalization grant and tax revenues are included in the computation of basic financial need and the unit costs used in computing it. Moreover, in order to insure an overall approximate correspondence for the nation as a whole between the computed estimate of financial needs and the resources available from the equalization grant and from taxes, the Local Finance Commission has endeavored to adjust the average unit expenditures corresponding to items of expenditures that it deems to be most readily curtailed, to such extent as may be necessary to bring the estimated aggregate of the local financial needs into agreement with the sum of the estimated local standard revenues and the regular portion (90%) of the equalization grant.

In making this adjustment, as in making a further adjustment to be described below, the LFC has to be sure to exercise a considerable degree of discretionary authority. Indeed it might appear superficially that in making the decision thus to cut the standard unit expenditures for certain types of services, the LFC has acted to discourage specifically the corresponding types of expenditures on the part of local bodies. However, the tendency, if it exists, is purely an advisory one, and it remains true that by and large no local entity would actually increase or diminish its share of the equalization grant through deciding to provide a lower or higher expenditure per unit on the type of services for which the LFC thus reduced the standard unit expenditure. The most that could be said in this connection would be that the LFC by doing this would channel relatively less of the grant to those communities having a relatively high requirement for those types of services that the LFC considered to be most flexible and for which the standard unit expenditure has been cut by the LFC to a level below that prevailing in the sample local bodies. But even this would not provide a positive incentive for communities to divert their outlays away from such services.

On the other hand, this reduction in standard unit expenditures does have the effect of cutting the financial needs of the wealthy and the poor communities by approximately the same percentage; the difference between needs and revenues is therefore reduced by a larger percentage for wealthy than for poor local bodies and the equalizing effect of the grant is thus made more pronounced than it would if the grant were distributed in proportion to a margin between needs and revenues computed without any such curtailment of the computed needs.

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It may be noted that the discretion thus exercised by the LFC is authorized only for one year, and only by a rather broad interpretation of a quite obscure clause in the law. For fiscal years after 1950-51, unit costs "shall be fixed by this Law", but this is apparently merely a declaration of intention that an appendix shall be later added to this law. Apparently it is expected that detailed provisions, along the lines laid down by the Local Finance Commission, will be enacted into law before the computation of the 1951-52 grant begins.

The above curtailment of standard unit expenditures deemed by the LFC to be non-essential, made under its general authority to determine unit costs for the first year, is not specifically required by the law. However, the law does provide that costs shall exclude the portion financed by the local tax revenue in excess of the basic financial revenue: i.e., by the 30% of the standard tax revenues that is not included in the basic financial revenue. If this exclusion were computed for each local body separately it would have the effect of nullifying the incentive provided for the full collection and assessment of the standard rates, and moreover if it were to refer to all taxes and not only the standard taxes it would to a large extent deter local governments from imposing any taxes beyond the standard taxes. However, the LFC has applied this provision so as to reduce the standard unit expenditure by the same amount for all local bodies, to an extent that will for the nation as a whole result in the reduction of the standard expenditures by the amount in the aggregate equal to the required 30% of the standard tax revenue. The standard unit expenditure is thus not materially affected by the amount of taxes that any particular local body collects, and local governments retain an adequate incentive for pressing for full collection of their taxes and especially for fully assessing the tax base for the various local taxes.

However, in the view of the Local Finance Commission, this reduction of the standard unit expenditures or unit costs to correspond with the use of only 70% of the financial revenue is also vitally important as a means of avoiding a certain amount of psychological constraint upon the alllocation of expenditures in local budgets that might result if this reduction were not made. If the equalization grant were computed in the straightforward manner by setting up a standard budget at the levels actually expected to prevail in practice, and subtracting the full amount of the standard revenues, it is felt that there would be a strong tendency for the local governments to take this standard budget as a directive, so that the exercise of local autonomy would be considerably inhibited, if not actually restrained. In the procedure actually followed, local bodies find that after they have provided in their budgets for the standard unit expenditures at the reduced levels employed in computing the equalization grant, they still have an amount left equal to about 30% of their entire budget, and the Local Finance Commission apparently feels that when the computation is done in this manner the local governments will feel considerably freer to use this amount as they see fit according to local circumstances and not according to some overall national averages.

However, this is not the end of the adjustments. The figures upon which the LFC operates are approximations, and while they have done their best to assure that the total of the equalization grants computed by the various localities on the basis of the unit expenditures thus furnished by the LFC will about equal the fund available, there will remain a certain margin of error, and the LFC expects that, when the returns from the municipalities are in, the aggregate of the amounts claimed will be slightly more or less than the stipulated total. At this point the LFC expects to apply the formula stipulated in the law and adjust each grant upward or downward by a constant percentage to obtain the budgeted total. But it is expected that this adjustment will be relatively small and will not materially affect the overall picture.

The one point where the administrative discretion exercised by the LFC in all this process is likely to materially and explicitly affect the shares of the various local bodies is in the division of the grant between prefectures and municipalities. As between the several prefectures, and also as between the several municipalities, the variation in the proportion of expenditures devoted to the "less essential" purposes for which the LFC decreased the standard unit expenditure is relatively small, so that the choice by the LFC of the items to be cut made relatively little difference in the overall picture. But as between municipalities as a group and prefectures as a group, the two types of governmental units engage between prefectures on the one hand the municipalities on the other would be substantially affected by whether the LFC chose to cut the standard unit expenditure for a service generally provided by municipalities or one generally provided by prefectures. Indeed at this point the LFC made a specific and explicit decision as to how much of the grant was to go to prefectures and how much to local units, before beginning to adjust the standard unit expenditures. This apportionment was based upon the changes made in the tax sources, and the amounts of subsidies previously going to prefectures and local units that were incorporated in the subsidy. But although this apportionment was thus based on somewhat objective criteria, there was no basis for it specified in the law, and while the results are quite defensible, there is still rather more opportunity than is altogether desirable for feelings to arise that the result was left to depend unduly upon an arbitrary decision by the LFC.

Points at which the present method of distributing the equalization grant can be improved.

1. The use of the 70% of the standard revenues as the basic financial revenue diminishes the degree of equalization obtainable with a grant of a given size, or if the size of the grant is increased to obtain a given degree of equalization, local autonomy suffers through reducing the amount of local needs that are obtained from local resources. Thus the local tax revenue for 1950-51 is estimated at 190 billion yen and the regular portion of the grant at 95 billion yen, allowing total expenditures of 285 billion yen to be financed from these sources. The

70% rule gives 133 billion yen for the basic financial revenues, and the corresponding cut in the expenditures covered is from 285 billion yen to 288 billion yen (by subtracting 30% of 190 billion yen), or 20%.

Now if a wealthy community has standard needs of 100 million yen and standard revenues of 100 million yen, then without the application of the 70% rule, it will get no grant. On the other hand, if the 70% rule is applied, basic financial revenues become 70 million yen and financial needs are cut 20% by the use of the lower average unit expenditures to 80 million yen, so that it becomes entitled to a 10 million yen share in the equalization grant, or at least to a proportional amount depending upon the total grant available. Conversely, for a poor community having needs of 100 and revenues of 20, without the 70% rule it would be entitled to a grant of 80, but with the 70% rule the basic revenues become 14 and the adjusted needs 80, so that the grant is cut to 66. Only for the average community where the revenues cover just 2/3rds of the needs does this adjustment make no difference. To be sure, this 70% provision provides an incentive for local bodies to assess and collect their taxes rather than relying on the equalization grant to make up any deficiency in tax resulting from slack collection and assessment efforts. And indeed it is difficult to realize the equalization principle fully and at the same time preserve such incentive unless some method can be found for measuring financial resources independently of the assessments or collections of the local body.

2. The distribution of the equalization grant is based on estimates of revenue (i.e. collections) for the year for which the grant is to be made. These estimates have been made in various ways, but in most cases they have been made by the municipalities, or by the prefectures for themselves, or by the prefectures for the municipalities. In general the staff of the LFC has been entirely too small to do any substantial amount of estimating of revenues of individual units in addition to its other duties. And indeed for the LFC to make such estimates, and to some extent for even the prefectures to make estimates of municipal taxes, would often be a wasteful duplication of effort.

In some cases the estimates are on a fairly objective basis, as for the property tax on land and houses. In others the estimates are made independently, but on a fairly arbitrary basis, as is the case with the manner in which the governors of the prefectures have apparently been asked to apportion among the various municipalities an aggregate estimate of the yield of the income portion of the inhabitants tax. And in some cases the tax is estimated on the basis of the yield of the previous year for a comparable tax. In other cases it appears that the objective standards now used for the estimates may cease to be applicable, as is the case with the property tax, or will become subject to possible rigging by the localities concerned motivated by a desire to increase their share of the equalization fund.

No easy way out of these difficulties seems available. On the whole, however, it would seem desirable to recompute, after the end of

the fiscal year, a revised basic financial revenue, and a revised qualization grant share based on it, and have any difference between this revised share and the share actually paid added to or subtracted from the first payment on account of the grant for the succeeding year. The revised basic financial revenue would be computed by taking, for each tax for which no reasonably accurate and independent estimating basis can be found, the actual assessed tax base for the fiscal year for each local body, applying the standard rates, multiplying the result by the average collection ratio for this tax for the country as a whole, and multiplying finally by 70%.

Taking the assessment for each local body times a uniform collection ration for the whole country will give each local body an incentive to achieve a good collection ratio. As for achieving a full assessment, the 70% formula will mean that each local body will gain 30 yen in overall revenues for each additional 100 yen of tax assessed at the standard rate; this in most cases should be adequate to produce full assessment, particularly as for most of the local taxes, especially the inhabitants tax, the property tax on land and houses, and the electricity and gas tax, the tax base is determined independently and there is little room for argument as to the amount of tax due. Nevertheless, the LFC should have the authority and the duty to check on the efficiency with which the local bodies assess the standard taxes and to make appropriate upward adjustments in the basic financial revenues whenever it appears that the local body has been unduly lax in assessing a tax. Indeed, if the equalization grant continues to depend in considerable measure upon the tax bases assessed by the local bodies, this review of the degree of completeness of these assessments may become an increasingly important function of the LFC in subsequent years, and one that can contribute substantially to the quality of local tax administration as well as to the equity of the apportionment of the equalization fund. (It may be noted that quite generally in the United States a similar function is carried on, though often for a somewhat different purpose, by bodies generally designated as "State Board of Equalization"). However, it may be possible to modify the equalization grant formula in such a way as to make this procedure largely unnecessary, at least for the purpose of the grant.

3. The manner of computing the needs of a locality, while satisfactory as an initial expedient, leaves much to be desired. The more or less arbitrary downward adjustment of the standard unit expenditures by the LFC does have the advantage of increasing the equalizing effect of the grant, but it should be possible to preserve this effect by other means, provided that the law is suitably amended. It has the disadvantage of being a complicated operation, entailing an unnecessary amount of discretion on the part of the LFC. The effects of this operation are likely to be misunderstood, leading either to a feeling that the LFC is setting up standards which the localities can deviate from only at the peril of impairing their share in the grant, or to a feeling that the discretion is greater in its practical effect than is actually the case, or merely to a general misunderstanding and suspicion of the whole process of distributing the grant through making it too complicated to understand. More seriously, as long

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as the standard unit expenditure figures deviate from actual expenditures, the resulting aggregate excess of needs over revenues will be an artificial one that furnishes no direct standard for determining the aggregate amount to be set up for the euqlization grant in the national budget. Indeed, the present procedure may tend to create an impression that the existing size of the grant, whatever it may be, is the correct one.

Initially, of course, all the LFC has had to go on has been the budgeted figures, particularly in the case of new services or services transferred to a local jurisdiction. Eventually, the standard unit expenditures should be computed so as to reflect the actual expenditures of the localities generally, adjusted so as to exclude, for the nationwide average, such part of the expense as is defrayed by specific fees or grants, and, if the 70% or a similar provision is retained, such part of the expense as can be considered to be defrayed by the 30% of revenues excluded from the basic financial revenues. Both of these adjustments would, as now, be a uniform percentage of any given unit expenditure for all prefectures or for all local bodies. But the adjustment on account of the 70% provision should preferably be made either uniformly for all types of expenditure, or according to some rule specified by law, rather than at the discretion of the LFC. Actually, of course, the discretion exercised by the LFC in this first year is conferred by a provision of the law applicable only to 1950-51, but as the law must in any case be amended to determine what is to be done next year, it seems proper to note that this procedure, quite justifiable as a temporary expedient, should not be incorporated in the more permanent provisions.

Differential adjustments should also be made, as now, for such factors as climate, population density, and the like; insofar as possible these adjustments should be based on a comparison, by correlation analysis or otherwise, of the actual expenditures of as large as possible a sample of local bodies with differing characteristics. For a time, it may be necessary to make adjustments based on other data selected on a more or less subjective basis by the LFC, but eventually both the general level and the specific differentials in the unit expenditures should be determined by the general average level of expenditures resulting from the individual decisions of the various local bodies as to how much they will spend in the aggregate.

This does not mean that incentives for economy on the part of individual local governments will be at all impaired by the fact that the national government would in effect be underwriting whatever level of expenditure the local governments on the average choose to adopt. To be sure, if all local governments decided to increase their expenditures by say 10%, the indicated equalization grant would be increased to that if it were budgeted in full by the national government no additional local taxes would be needed. But any particular local government, if it increases its expenditures, will scarcely affect at all the national average level on which the standard unit expenditures are bases, and thus will increase its equalization grant hardly at all; practically all of this increase in expenditures would have to come from local taxes or other local resources. Similarly

if a local body can by increased efficiency or the elimination of non-essential services decrease its outlays, practically all of the benefits can be retained in the form of diminished local tax rates, or otherwise. Thus each individual locality has adequate incentive to operate efficiently and to balance any proposed increase in services against the additional tax burden that it will need to impose on its own citizens if the increase is undertaken.

There are, however, minor exceptions to this principle arising from the manner in which the units of service are computed. In principle, the number of units of service should be a measure of the need of the community for a given service, not of the degree to which this need is actually satisfied. In particular, the measure chosen to reflect the need for a particular service should insofar as possible be unaffected by the action of the local body in meeting the need or by other actions taken by the local body. In general this principle has been well recognized by the LFC and insofar as the law permits has been implemented by the LFC in its regulations. For example, the need for police service is measured not by the actual number of policemen in service, but by the number that the national law requires the local government to supply. Thus if the local government decides that it needs more than this standard number, this will not affect the equalization grant.

In some instances, however, the need is measured in a way that will be affected by local action, at least over a period of years. The measures selected may be acceptable as a temporary device, by reason of the pressure of work on the LFC, and the facts that to a large extent these measures of need reflect actions taken by local bodies before the equlization program was clearly anticipated in detail, and that the measures will be modified local action only fairly slowly. Thus the area and character of existing roads and bridges has been taken as a measure of the need for highway maintenance, and the number of schools and the number of classes has been included as an element in the measurement of educational expense. These quantities have in general been given their present values largely as a result of decisions made without reference to their effects on the equalization grant, and their use for only the first two or three years of the grant will thus have no ill effects. But if the equlization grant retains its present form, this may not continue to be true. If a local body were to consider that its standard needs and hence its share in the equalization grant would be increased if it constructed new roads, it might be led to an undue expenditure on new roads through the consideration that the equlization grant would then be increased by an amount sufficient to pay for their maintenance. Or a local body may become reluctant to convert gravel roads to hard-surfaced roads, considering that the reduced maintenance cost would not benefit the local treasury but would be absorbed by a reduction in equalization grant. Similarly the formula for educational needs may induce a local body to scatter its facilities in a large number of school buildings, and to have smaller and more numerous classes than would represent the most advantageous use of school funds. Indeed, the use

of the number of pupils as a measure may induce undue concentration of local efforts on increasing enrollment, as by special efforts to improve facilities at levels where school is no longer compulsory so as to keep students at school longer, to the possible detriment of elementary school facilities.

Not all of these pressures are inherently undesirable, to be sure. But where special inducements are deemed necessary in order to encourage certain types of action on the part of local governments they should preferably be created deliberately through a promotional grant (such as is outlined in the next section) or other special device, rather than left to arise accidentally through mechanical imperfections in the equalization grant. As soon as possible, therefore, these mainpulable measures of need should be replaced by measures that are not affected by local action.

Admittedly, this may not be easy. It is difficult, for example, to produce a measure of highway and road needs that is not to some extent dependent upon the existing highway network, particularly for units as large as the prefectures. Possible actual highway outlays can be subdivided into those performed within the limits of each city, town, and village, and standards of outlay devised that depend on such items as area, density of population, vehicle traffic, and terrain, which can be computed for each local unit and built up to a prefectural total. Or a national highway planning commission might be set up that would determine as equitably as can be the road and highway net work that should be used as a normal standard in each area.

With regard to education, the problem is probably not so acute. A pressure towards smaller classes may not be altogether undesirable. But the LFC is not the technically competent authority to determine how much pressure should be put on localities to reduce the size of classes. To be sure, factors beyond the control of the local body, such as the sparseness of its population, often determine the number of classes among which a given number of pupils must be distributed, and the actual number of classes may be the easiest way to measure this factor. But local bodies are also often free to choose for themselves whether to have larger and fewe classes or more and smaller classes and the equalization grant should avoid exerting an accidental influence on this decision. Accordingly, as soon as other measures of the degree to which the distribution of the population affects educational needs can be derived, the use of number of classes as a measure of educational need should be dropped. Indeed, it would seem possible to use number of schools, or perhaps the distribution of schools by size and by the grades included, as a measure of differences produced by geographical factors.

In principle, also the number of schools needed by a community should be derived from the districution ofpopulation rather than the actual number of schools. But since it may be quite difficult to devise a simple and

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equitable formula for this purpose, and since in practice cases where consideration of the effect on the equalization grant would actually influence the pattern of school construction are likely to be rare, this measure may well be left. Similarly, for grades where attendance is compulsory, there is no objection to using number of pupils as a measure of need. But for high schools, where attendance is voluntary,it may be preferable to use the number of children of appropriate age groups in the community, rather than the number of children in attendance, as the proper measure of need, provided that due allowance is made for pupils in private schools. If there is a desire to give encouragement to local bodies to provide higher education facilities this can better be done through a promotional grant, where the conditions can be properly stipulated, and the amount of stimulus determined directly, rather than in a haphazard fashion through a casual feature of the equalization grant.

Methods of achieving full equalization without impairing incentive for full assessment and collection of taxes.

Full achievement of the equalization principle calls for the measurement of the financial needs of the various localities independently of the manner in which the particular locality actually meet these needs, and for the measurement of financial resources independently of the extent and manner in which the locality actually exploits these resources. The first of these requirements has been fairly well met, with the exceptions noted above that are capable of correction. It is somewhat more difficult to estimate what the financial resources of a community are in a way that is not affected by how effectively a locality assesses its taxes. This difficulty is the main justification for the insertion of the present 70% provision. However, by this provision a partial incentive for the localities to assess taxes fully is preserved only at the expense of impairing the degree of equalization achieved.

Complete and literal application of the equalization principle would require the LFC or some other independent agency to appraise separately the effectiveness of the assessment procedure of each local body, at least for those taxes for which independent and accurate estimates of potential yield are not available. The equalization grant would then be based on the assessment that would be obtained if the assessment of these taxes were at some standard level of effectiveness. This is not only a partial duplication of expenditure but at best will give rise to considerable friction if it is done effectively, and to considerable inequity if it is not. If possible, other methods of approximating the financial resources of local bodies should be used that do not involve either reliance on locally determined assessments or the necessity for appraising the level of such assessment. Eventually, indeed, it may be possible to use a figure for financial resources based on such general indications as income produced in the local area, or income received by residents, or the like. But for the time being such general statistics are inadequate, and figures must be used that are more closely related to the actual assessments.

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Fortunately, however, two of the major municipal taxes are assessed on tax bases that are determined largely independently of local action. The income part of the inhabitant's tax is based on income as determined by the national government, while the base for the electricity and gas tax is determined very largely by the utility companies, with little opportunity for evation. Furthermore, the base used for the standard inhabitants' tax under option (a), namely the national income tax, is progressive, and represents a relatively higher proportion of the standard financial revenue for the wealthier communities than for the poorer ones. Thus if we can manage to place more weight on this income tax base in computing the equalization grant, we can simultaneously increase the equalizing effect of the grant and diminish the dependence of the grant on the completeness of local assessment.

For example, we could set up a hypothetical tax system consisting of a surtax of 30% of the national income tax, a property tax at 0.8% on the assessed value determined by the local bodies, and the actual yield of the electricity and gas tax. The total revenue for this hypothetical system for the nationas a whole would be about the same as they yield of the present standard municipal rates, but would be somewhat higher for the wealthy units than for the poorer local governments. If now the equalization grant were distributed on the basis of the excess of financial needs over this hypothetical revenue, the result would be an overequalization, in that poor communities would find that the grant plus the taxes at standard rates would more than cover their basic financial needs, while some of the wealthier communities might find that their grant plus the revenues from standard rates would fail to cover their needs. Some degree of overequalization may indeed be on the whole more desirable than not, as it would permit the poorer communities to reduce their property tax rates and perhaps other taxes somewhat below the standard level and thus attract capital and eventually overcome their disadvantages, while the wealthier communities might have to levy taxes at higher than standard rates.

However, if no overequalization is wanted, or if a smaller degree is desired than that produced by a formula such as the above, the degree of equalization can be diminished to the desired level by the application of an adjustment similar to the 70% adjustment now provided. Thus, for example, the final equalization grant formula might become, after reducing needs by 20%, or 57 BY in the aggregate, and the hypothetical tax revenues by 30% to correspond:

Grant equals 80% of standard financial needs,
less the sum of:
21% of national income tax of residents
0.56% of assessed value of property
70% of the electricity and gas tax assessment

Under this formula, or a similar one, full equalization can be achieved, with minor exceptions in the case of localities having large income tax bases relative to property than is generally the case for local bodies of the same overall relative tax-levying capacity; but such variations are not likely to be substantial enough to require adjustment. The income tax part of the formula is determined from assessments by the national tax office, and is not affected by the actions of the local body to any substantial extent. Similarly the utility tax assessment is fairly immune to such influence. The degree to which variations in property tax assessment affect the equalization grant would be much smaller than with the present formula. Such a formula also has the advantage of avbiding the psychological hazards of presenting the local bodies with a standard budget, as feared by LFC, since there is room for standard unit expenditures to be cut an average of 20% below the average leval for the nation . Similar formulas could be devised, if desired, with even greater cuts.

It should be emphasized that the coefficients set forth above are purely illustrative and are not necessarily recommended specifically. We suggest that the LFC make studies to determine what coefficients will give a result that will produce full equalization, or perhaps a slight degree of overequalization, as between wealthy communities that are more or less average among such communities with respect to the relative reliance on different tax sources, and poorer communities that are similarly typical in this respect. Equalization may be somewhat imperfect as between communities that differ substantially from this normal or average relationship, but the differences should be of minor importance on the whole compared with the vital importance of preserving proper incentives among local bodies for the full assessment and collection of their taxes and for proper economy in disbursement.

It should also be noted that the percentage of the national income tax that is used in the formula may well be one that differs appreciably from that typically used by the municipalities in computing their tax and indeed is likely to be one that

the municipalities cannot be permitted to be used in assessing an actual tax. For if municipalities were actually to impose a tax at say 30% of the national tax, the combined impact of the national and local taxes on the higher incomes might well be such as to produce an undesirable degree of impairment of the incentive of taxpayers, and perhaps also such as to drive taxpayers to an excessive amount of evasion. Indeed it is to be expected that for next year many municipalities will find it necessary, as a result of the decrease in the national tax rates, to use option (b) or option (c) to a considerable extent in the actual computation of their taxes.

To be sure, if local governments are left free to determine their own rate of property tax, there may be a temptation for them to assess property generally at a low percentage of its fair market value, say at 80%, keeping the tax revenue the same by increasing the rate applied to this reduced assessed value, thus increasing the amount of the grant by the above formula. Actually, it does not appear that this difficulty would be serious low as suggested above, i.e. 0.56%.

If such a tendency to lower assessment standards under the property tax does appear troublesome, serveral remedies are available. The most straightforward one is for the LFC to undertake to check on a sampling basis or otherwise, the level of assessment practiced by each local government, and where it is found to be unduly low, to adjust the equalization grant accordingly. Another one would be for the valuation of property, as distinguished from the assessment of the tax, to be carried out by some agency more or less separate from the municipalities. For example this valuation could be performed by the prefectures, or perhaps by associations of municipalities. In the latter case it might still be necessary for the LFC to check the practice of their associations, but this would probably be less burdensome than an attempt to check the level of assessment for each local body independently. Or the valuation might be performed on a national basis by the LFC itself, although this might be considered to entail an undesirable degree of centralization.

Another possibility would be to restrict local autonomy to the extent of fixing the rate of the property tax for all localities, and denying them the freedom to change this rate. This would mean that if a local body were to attempt to increase its share of the grant by undervaluation of property, it would not be able to recoup the revenue directly by raising the rate of the property tax. If the rate were say 1.6%, the locality would lose 16,000 yen of property tax revenues for each million

yen of undervaluation, but would gain only 5,600 yen of equalization grant. To be sure, a locality bent on jimmying the equalization grant might figure that it could recoup the lost revenue by raising the income tax rates, but in most cases this would not be considered worth while, particularly since if this were done in any overt manner it would be likely to come to the attention of the LFC with a resulting correction of the assessment for purposes of calculating the grant.

Another method of minimizing incentives for underassessment is to introduce assessed valuation on the needs side of the formula as an element in the computation of the needs for certain services such as fire protection, disaster rehabilitation, police service, the promotion of industry, or the like. Undervaluation would then have the effect of reducing standard financial resources so that the net effect on the grant might become negligible.

Finally, it might be possible to eliminate the property assessment from the formula altogether, by increasing the weight given to the utility tax factor, or herpahs by introducing some other figure into the formual that would give a generally similar result.

Thus, there are many ways of checking the adverse effects which the equalization grant might, if improperly applied, have on local tax assessment and collection offorts. Which of them are to be employed can be left to be determined according to the way in which the inter-governmental fiscal relationships and local tax practices develop.

The problem is perhaps a little more difficult in the case of the prefectures, where none of the major prescribed tax bases can readily be estimated in an independent manner. Perhaps here it may be better to get even further away from an attempt to measure the yield potential for the various prefectures of a specific standard tax structure, and compute the grant on the basis of some more generalized measure of revenue yielding capacity. For example the standard financial resources of the prefectures might be taken as some fraction of the aggregate of the standard financial resources of the local units within it (but not if the prefectures are given the job of determining property values nor in any event in the case of Tokyo-To). Or a formula involving the assessments of various taxes within the prefecture by the national government might be devised, similar to the one suggested above for municipalities. Or, since the prefectures are relatively few in number, the LFC might undertake to review the effectiveness with which the various prefectures assess their various taxes and adjust the grant accordingly. However, this latter alternative may be considered to involve an undesirable amount of discretion on the part of the LFC.

LOCAL TAX ADMINISTRATION PROBLEMS

MUNICIPAL PROPERTY TAX

1. NATURE OF LIABILITY

The liability for the municipal property tax is now personal in nature and not in rem. On the day the property tax accrues (April 1st of each year?) the registered owner of real property and the improvements thereon and the owner of depreciable property become liable for the tax. Even though the real property or the depreciable property may be transferred before the taxes are paid, the transferer continues to be liable for their payment. The local government cannot proceed legally against the real property or the depreciable property to collect the taxes that are unpaid on the transferred property unless the transfer was collusive for the purpose of evading taxes or the property was transferred by way of inheritance. Except in those two instances the local government must seek out the transferer and by law collect only from him.

Our visits to local tax offices demonstrated that this legal remedy was not always followed in so far as real property and the improvements thereon were concerned, but that the local tax administrators proceeded to collect from the transferee even though he was not legally liable. Every local tax administrator interviewed insisted that the transferee of real property was morally liable and that they never had any difficulty collecting the unpaid municipal property taxes from him.

The municipal property tax is now a very important revenue source in municipal finance. It might reasonably be expected that more transferees of real property in the future would likely be called upon to discharge their so-called moral liability for unpaid municipal property taxes. These tax payments by transferees resemble very closely the contributions that once were so prevalent in Japanese tax administration. Taxation must be based only on law and not on so-called voluntary contributions. A system of contributions results in a highly arbitrary and capricious method of municipal finance. This feature was condemned in our original report and apparently has now been largely eliminated. These payments by transferees therefore deserve our careful study because they are not in accordance with law.

It

It also seems clear that municipalities may have difficulty in many cases in proceeding personally against the registered owner of reality for the municipal property tax who after tax day transfers such reality. Such registered owner may never have been a resident of the municipality or he may have moved to a distant town with no other property in the municipality from which the taxes can be collected.

Two factors would seem to make transferees resist their so-called moral liability in the future. First, national and local tax administration is improving rapidly; such administration is based on the legal liability and not the moral liability of taxpayers. Second, the increase in 1950 of the rate of the municipal property tax will make the payment of a so-called moral obligation more significant to the taxpayer and probably will therefore find him less inclined to pay the larger amount.

It seems therefore that municipalities will likely encounter more resistance from transferees when they are asked to pay taxes because their transferers did not discharge the tax liabilities against the transferred real property or improvements. But those same municipalities have been rendering and will continue to render many direct valuable services to such properties, such as fire and police protection, without any payment therefore unless some legal method is available for the municipalities to proceed against the transferred properties. Furthermore, the collection of the municipal property tax must be assured because it is now the backbone of municipal finance.

Theory also supports the in rem liability. Many services rendered real properties by the municipalities relate directly to the property and because of the services enhance the value of such reality. This enhanced value continues in the hands of transferees. Also, if the liability is in rem the transferee can easily determine whether there is any municipal property tax liability and for that reason is on notice if there is any unpaid liability.

These reasons appear to compel the conclusion that the liability for the municipal property tax as applied to real property, and the improvements, should be in rem. We therefore recommend that the law be changed. Although we recommend the

continuation

continuation of the in personam liability, it is not believed that this personal liability should continue after the in rem liability has become thoroughly established in the tax system. It would appear unwise at this time to try to shift at once from the personal liability solely to the in rem liability. For that reason, during a temporary period, both in personam and in rem liability will apply to real property and the improvements thereon. However, it is our opinion that the personal liability for the municipal property taxes should always exist as to all property other than real property and the improvements thereon. In this instance the property easily may be moved outside the taxing jurisdiction, and if the liability is solely in rem the municipality may not be able to collect the property taxes against such property. It is therefore essential that the personal liability be preserved in order that the local governments may be able to collect their property taxes.

The land and house ledgers are now required to be kept in the respective municipalities. An up-to-date record will therefore have to be maintained as to the status of the municipal property tax to each parcel of land in the municipality in order that prospective purchasers can easily ascertain if any property tax liability exists against the property. Prospective purchasers can therefore require either that the purchase price be adjusted or that the seller share all property taxes prior to the transfer of the property. This will protect both the purchaser and also the municipality and it will do much to improve its administration.

The following are the major revisions that will have to be made in the laws in order to carry out this recommendation:

1. Article 369 of the Civil Code which provides for priorities of mortgages.

2. Articles 175 and 176 of the Civil Code pertaining to real rights, especially Article 176 which allows transfer of real rights by mere declaration of intention. This amendment is necessary only if the lien system is extended to movables.

3. Law No. 24 of 1899 which provides for registration of immovables. It will be necessary to add an article providing for registration of tax liens.

4. Article 5 of the Land Ledger Law, Law No. 30 of 1947, will have to be made more inclusive. This article enumerates what property shall be registered, but leaves detailed implementation to Cabinet Order by which necessary additions could easily be provided.

5. Article 5 of the House Ledger Law, Law No. 31 of 1947, enumerates the type of registration of houses. This article can also be supplemented by Cabinet Order.

6. Articles 47 to 52 of the Bankruptcy Law, Law No. 70 of 1922, and amendments thereto, set forth the priority of various claims in case of liquidation. Priority of property tax liens will have to be determined in this law.

7. Paragraph 3 of Article 15 of the Local Tax Law to prevent priority of national tax claims in all cases.

8. Article 3 of the National Tax Collection Law and Article 15, paragraph 5, of the Local Tax Law which provide that in case there is a notarial deed certifying that property was pledged and hypothecated one year prior to the final data of payment of either national or local tax, those claims will be superior to tax claims. These articles should be amended to allow property tax liens priority.

2. Procedures for Attachment or Seizure

Under the National Tax Collection Law the national government has an established statutory procedure for attachment or seizure. The Local Tax Law does not contain similar provisions, it contains only a reference to the national attachment procedure. It would seem desirable to have the Local Tax Law provide the same detailed statutory procedure instead of merely referring to the appropriate provisions of the National Tax Collection Law. Local tax administrators and local taxpayers find the cross references in the Local Tax Law to the national tax laws to be confusing and, to say the least, highly inconvenient. It appears desirable to eliminate such cross references and to provide in the Local Tax Law all of the detailed statutory provisions.

3. Priorities of Tax Claims

Where there are several levels of government and each has its own sources of revenue, the priority of the various tax claims of each level of government becomes an important problem

of inter-governmental fiscal relations. The priority issued will arise where the properties of taxpayers have been seized or attached by two or more levels of government and where properties of bankrupt taxpayers are available to settle partially the tax claims of two or more levels of government. The priority rules do not have to be the same in both cases.

As a general rule the municipality and the prefecture should be given greater protection in the application of a tax priority rule than the national government. The national government can more easily absorb the losses that occur in these instances because the revenue receipts of the national government are many times those of any municipality or prefecture. Also, the national government has almost unlimited borrowing power from the Bank of Japan or from private sources. This flexibility at the national level is in direct contrast to the rigidity at the municipal and prefectural level. In fact, in many instances the municipality or prefecture may be prohibited by law from borrowing. And even if they can, their credit standing is far different from that of the national government. These facts have to be borne in mind when decisions are made as to the priorities among the various levels of government.

4. Attachments or Seizures

Article 2-2 of the National Tax Collection Law now gives priority to the tax claims of the national government in connection with property of taxpayers that the National Government has seized or attached. Article 15-2 of the local tax law gives priority to the tax claims of the municipality with respect to property of the taxpayer that the municipality has seized or attached. It is understood that these two provisions are interpreted so as to give priority to the tax claims of the government that first in time seizes or attaches the property of the taxpayer. Thus, if the municipal tax administrator is the first to attach the property of the delinquent taxpayer, then the tax claims of the municipality will have priority over the tax claims of the other governments that attach later. This interpretation merely means that tax priority is based on seizure in order of sequence. Admittedly this priority favors the municipality over the prefectural and national government and the prefecture over the national government. This is true because the local tax administrators are in a better position to know against whom seizure must be used if their taxes are to be collected. For this reason,

reason, the national tax administrators have requested that assets of a taxpayer that are attached by more than one level of government be pro-rated among those governments on the basis of the total tax claims, irrespective of the order of seizure. The interpretation of the two provisions of the national tax collection law and the local tax of the two provisions of the national tax collection law and the local tax law which tends to favor the municipalities is the application of the tax priority rule as to attachments or seizures seems warranted and should be enacted into law. We therefore recommend that the order of attachment or seizure govern in determining the priority of tax claims among the various levels of government.

Where there is a private claimant in addition to the tax claims of the national or local governments the existing statutory rules as to attachment differ somewhat. If property on which a mortgage has been outstanding for more than one year is attached for tax claims then under Section 369 of the Civil Code the claim of the mortgagee must first be satisfied from the sales proceeds. With respect to the remaining proceeds the national government has priority over the local government, irrespective of the order in which the governments may have requested participation in the distribution of the proceeds from the sale.

Also, if a private claimant has attached personality or has a mortgage on the attached property which has been outstanding for less than one year, the tax claims of the various levels of government take priority over the private claims; but there again Section 15-3 of the local tax law provides that the tax claims of the national government shall take priority over the tax claims of the local governments. It is recommended that where such private claims also exist against property attached for the payment of taxes the national government and the local governments must prorate the assets that are available for distribution in relation to their total filed tax claims. Elsewhere in this report it is recommended that the liability for municipal property taxes be changed so that it will be both in rem and in personam. It was there indicated that several laws would have to be amended to carry out that recommendation. Under that recommendation all municipal property tax claims would have priority over the tax claims of the national government and the prefectures, and the claims of mortgages, even though the mortgage had been outstanding for more than one year.

Except

Except for this change, the claims of private persons will not be affected as a result of our recommended changes in tax priorities.

5. Bankruptcy

Under Article 15-3 of the Local Tax Law the tax claims of the national government are given priority over the tax claims of the local governments in connection with the distribution of the assets of a bankrupt taxpayer. Under these principles the existing bankruptcy rule should also be changed. It is recommended elsewhere that the claims of the municipal government for property taxes should have priority over all other governmental and all private claims. Any assets which thereafter remain would be prorated among the national and local governments in relation to the tax claims that were filed by them in the bankruptcy proceeding.

Inhabitants Tax

The inhabitants tax, which is partly a per capital tax but chiefly a tax on net income as assessed for the national personal income tax, is the largest of the three main local levies (the other two being the tax on fixed and depreciable assets and the enterprise tax). The municipalities levy this tax, and retain all the proceeds for their own use.

(a) Base of the Text: Options One, Two and Three

For the 1950-51 fiscal year, the tax (aside from the per capita element) must be a percentage of the amount of national personal income tax -- 18 per cent. For 1951-52 and succeeding years, however, the municipalities may shift to either of two other alternative bases. They may levy the tax as a percentage of the taxable income, not the tax (taxable income is the net income after deduction of the basic exemption, the allowance for dependents, and the earned income credit). Or, they may levy it as a percentage of what is left of the taxpayer's taxable income after subtracting the national personal income tax: the "disposable taxable income". The municipalities are free to levy whatever rate they choose, so long as it does not exceed 20 per cent of the national tax (Option one), 10 per cent of the taxable income (Option Two) or 20 per cent of the disposable taxable income (Option Three).

This year, the national income tax is much lower than last year, owing to the rate reductions and exemption increases voted by the Diet last winter. Consequently, even under the maximum rate of 20 per cent, Option One under the inhabitants tax will, for many municipalities, yield too little revenue. The inhabitants tax is based on the national income tax of the preceding year. This year, Option One is yielding substantial sums since it is based on the heavy national personal income tax of 1949-50.

Almost all municipalities will therefore need to look ahead to 1951-52 and be making up their minds which option they want to move to -- Option Two or Option Three. We offer no advice on this point; the purpose of the options is to allow the municipalities to make their own decisions.

If

If the maximum permissible rate under Option One were raised from the present 20 per cent to say, 25 or 30 per cent, some municipalities might be able to get sufficient revenue from Option One next year. It may prove advisable within a year or two to raise the maximum in this manner, if the nation and municipal tax combined are being administered without much difficulty and seem not be deterring work and incentive unduly. At present, however, it would be unwise to raise the combined national and local income tax to the levels that would be reached under such a program.

(b) Current Year Basis?

As noted above, the inhabitants tax is a percentage of the tax (or the taxable income, or the disposable taxable income) under the national income tax for the preceding year, not the current year.

An objection to this kind of base is that collection of the inhabitants tax does not take place until the year after the income is earned. Consequently, the taxpayer may not have the money on hand to pay the tax, or he may have moved into another municipality. Moreover, he may pay the tax but feel aggrieved, if his economic status has worsened.

These defects could be largely overcome by collecting the inhabitants tax on the income or national tax of the current year. The taxpayer would pay tentative installments during the year, just as under the national tax.

Also, it might be possible to withhold the tax from employees, as under the national tax.

Numerous technical problems arise under withholding of the inhabitants tax: for example, as regards those who work in one municipality and commute to work from another.

However, we believe that the plan of collecting on a current basis rather than a past year's basis, including withholding, is sufficiently promising to deserve some experimentation by those municipalities that feel that they can deal with the administrative difficulties involved. We therefore recommend that the Local Tax Law be amended to permit any municipality to impose the inhabitants tax, on a current basis, and to require employers in such municipalities to withhold the tax on wages and salaries on their employees.

In

In the year of transition from the past-year basis to the current-year basis, there will arise the question of whether the taxpayer should pay two years' taxes in one year, or be forgiven one year's tax. If in 1951, for example, a certain municipality moves the inhabitants tax to a current-year basis, the taxpayers will be paying, in 1951, (a) the last year of tax under the old plan, based on 1950 taxable income (or national tax paid) and (b) the first year of tax under the new plan, based on 1951 income. If this is considered to be too much to ask of the taxpayer, and he is therefore excused from paying the tax on his 1950 income, he gets a whole year's tax relief. We do not propose any particular formula for deciding this issue, but merely note that it is a technical problem that must not be overlooked.

(c) Per Capita Tax

The Local Tax Law corresponds with the suggestions in our report last year that the maximum rates of the per capital element of the inhabitants tax be set at 1,000 yen in cities of population 500,000 or over, 750 yen in cities with population 50,000 up to 500,000 and 500 yen in all other cities and in all towns and villages. In addition, the law specifies standard rates of 800, 600, and 400 yen respectively.

Our statement last year was in the form of a suggestion, not a definite recommendation. Further observation this year has convinced us that the per capita element would play too great a role in the inhabitants tax at those maximum rates, and we therefore recommend that they be reduced to the present standard rates. Although the maximum rates may seem trivial to mose individuals who are self-supporting, there seems still too much chance they would cause real hardship in some cases.

(d) The National Tax Dividend Credit

Under the national personal income tax, a dividend credit of 25 per cent is subtracted from the national income tax as computed on the taxpayer's income including dividends received from corporations. This is allowed because the national government imposes a 35 per cent tax on corporations.

But

But municipalities levy no inhabitants tax on corporations other than a small per capita tax. Consequently, the municipal inhabitants tax, if computed under Option One, should be a percentage of the national tax as computed before subtraction of the 25 per cent dividend credit. Correspondingly, the definition of taxable income, for the use of Option Two, should be income inclusive of dividends received. Option Three should be based on income, inclusive of dividends, minus national tax as computed before subtracting the dividend credit.

The wording of the present law may need to be changed, or elaborated, to make these points clear.

(e) Failure to Reach 35 Per Cent of Corporate Profits

The present national personal income tax law, in agreement with the recommendation in our report last year, allows the individual taxpayer to subtract from his national income tax, as computed on his entire income, 25 per cent of the amount of dividends included in that income if received from corporations subject to the 35 per cent income tax. Thus double taxation of corporate income is avoided.

However, our recommendations on this point overlooked the fact that the local income tax (the inhabitants tax) fails to reach all of the corporate profits; the part that goes to the national government as corporation tax of course never gets to the individual and so is never reached by the inhabitants tax. Yet there is no reason why the corporate profit should not be fully subject to the inhabitants tax, in the hands of the individual.

The ideal solution to this problem would be to amend the national income tax law and require the individual taxpayer to add to the dividends that he had received the 35% tax which the corporation had paid on that dividend income and to permit the shareholder to take 35% of that total amount as a credit against his individual income tax. The municipalities could then simply use the national tax figure in the determination of the inhabitants tax under option A, B or C. But we stated last year that until the accounting had developed further and the new tax system had become stabilized we did not believe that the dividends paid credit should require the shareholder to gross up the dividends received by the 35% corporation tax. We therefore have

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have to suggest an interim alternative to be used until such time as this grossing up procedure can be adopted under the national tax law without undue confusion. During this period it would seem that a tax of 10% on dividends under Option A or a tax of 5% under options B or C of the inhabitants tax in addition to the tax as now levied would correct the existing defect in the inhabitants tax. It would be hoped that this measure would be only temporary and that the national tax would be amended at the appropriate time so that the ideal system could be instituted in determining the liability of the inhabitants tax.

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ADMINISTRATION OF THE NATIONAL INCOME TAXES

A. Overall Aspects

1. Current Progress in Tax Administration

The last year has produced a steady and significant improvement in the procedure and personnel for the administration of the national income taxes. Energy, diligence and imagination have been applied by the officials in charge of administration and their endeavors have met with considerable success. The development of the administrative organization and procedures necessary to the successful operation of the income taxes is proceeding over a wide area. This simultaneous advancement of many programs is a difficult task, and its completion will require a considerable period of time. But the basic foundations appear to be carefully and thoughtfully planned. The work on these foundations indicates that the erection of a sound administrative structure is a goal capable of achievement if the same skill and intensity of effort is maintained in the years ahead.

It must be kept in mind that the present administration inherited many handicaps. One is the large amount of bitterness and anti-tax feeling on the part of taxpayers that have been carried over from the difficult inflationary period. Another is the huge delinquency backlog that arose under the former rate structure. A third is an inexperienced tax personnel which, moreover, has recently been deprived of its previous props of a formal goal system and collection drives. An appraisal of the current progress must take account of the retarding effect of these handicaps and of the potentialities of the present system for improvement when these handicaps are diminished. The present period is one of transition from almost a strong-arm method of collection interspersed with bargaining over the tax amount to a modern system of income taxation.

An income tax always presents a formidable challenge to the administrators. Significant reliance on the income tax necessitates sound administration. Developments over the last year offer considerable encouragement in this respect. They indicate that a fiscal program which relies heavily on income taxes is still warranted in Japan as far as the possibilities of successful administration are concerned. This view assumes that the top level of the tax administration will possess in the years ahead the

energy,

energy, imagination and forcefulness now exhibited. It also assumes that those officials who, as a result of continued contact with United States personnel, are familiar with present problems and their possible remedies will be permitted to continue in their task of reforming Japanese tax administration.

2. Cooperation of the Japanese Citizen

The prime factor in the successful administration of the self-assessed individual and corporation income taxes is the voluntary, whole-hearted cooperation of the taxpayer. Unless there is a basic will be comply on the part of the great bulk of the citizens, administration of the income tax will fail. Prerequisite to such a basic willingness to cooperate are an understanding by the public of the underlying social aspects of the tax and a high degree of confidence in the officials who administer the tax. Understanding of the tax can come through education of the public respecting the fiscal needs of the Government, the important role played by the income tax, and essential aspects of its structure. Confidence in the tax officials is probably more difficult to achieve. It clearly requires the existence of an income tax administration which, as respects its personnel and procedures, is worthy of that confidence and trust.

The officials in charge of the income taxes are earnestly striving to achieve efficient and equitable administration of these taxes. They are also attempting to instill in their subordinates the necessary respect for the rights of the taxpayer. Their efforts merit the cooperation of the citizens. The taxpayers should approach their responsibilities under the income tax with the assumption that the administrators of that tax as a group are worthy of their confidence. They should be willing to assume that the Government's aim is proper administration of the tax and should offer their cooperation in the achievement of that objective. At the same time, they should be alert to weaknesses in tax administration and be willing to call them to the Government's attention. But the basic approach of the citizen should be one of confidence in the tax administration.

Mutual confidence and respect between the tax official and the taxpayer is the key to the success of the income tax in Japan. The steps taken so far indicate that this mutuality of confidence and respect is possible of achievement.

3.

3. Development of the Tax Administration Agency

The Tax Administration Agency, as distinguished from the Regional Bureaus and Local Tax Offices, is the directing force in the administration of the income taxes. It is important that the Agency firmly control and coordinate all of the aspects of tax administration. Its directing authority must be clear and must be exercised. Of course, flexibility in Bureau and Tax Office operations is desirable and tax administration must not be hampered by an unreasonably rigid structure. But the complexity of the task of tax administration requires a clear recognition of the governing authority of the central organization and a willingness on the part of such organization intelligently to exercise that authority.

The Agency should continuously examine its procedures to see that they are adapted to such necessary control and supervision on its part. It should allocate to itself those operating functions who effectiveness requires a centralization of the activity. It should make sure that supervisory controls are both available and exercised with respect to those functions which can best be handled on a decentralized basis. It should at all times have the personnel and drive necessary to overall leadership and guidance.

4. Continued Contact with Tax Administration in the United States

Under the circumstances it is inevitable that the Japanese tax administration should exhibit many of the characteristics of tax administration in the United States. Given such similarity the development of Japanese tax administration will be significantly aided by continued contact with its United States counterpart. Such contact can best be achieved in the future through frequent trips to the United States on the part of Japanese tax officials. As administration progresses in Japan, the problems of detail in procedures and structure will gain in importance. Observation of the detailed workings of well-established tax systems in other countries and discussions of what are clearly common problems for the tax administrator regardless of his geographical location should contribute much to the improvement of the Japanese system. Visits of American officials at a later date after the system has been in operation for a sufficient length of time, may, in turn, assist the Japanese in maintaining the necessary perspective, despite a daily preoccupation with detail.

5.

5. Participation by Professional Groups in Tax Matters

Professional groups in Japan appear to be awakening to their responsibilities in the achievement of a successful tax system. Lawyers seem to be taking a greater professional interest in tax matters, as is evidenced by the conduct of tax institutes. There is a newly-created Japanese Institute of Certified Public Accountants, which can do much to further participation in tax matters by the certified public accountants. The universities are considering courses in the legal aspects of income taxation. The Japan National Tax Association has been in operation for a year.

It is imperative that these professional groups steadily increase their interest in tax matters. In this regard, tax institutes, tax committees of the several Associations, tax publications, and the like would all be valuable. The application of trained minds with different professional backgrounds is bound to have a beneficial effect on the tax structure in Japan. The existence of professional people sufficiently versed in tax matters to cooperate with the tax administrators in developing tax procedures, as well as to represent individual taxpayers, is a necessary ingredient of a successful tax system.

6. Major Administrative Problems

The overall administrative task is that of strengthening administrative procedures at every point. There are, however, certain areas to be highlighted. Thus, the elimination of the delinquency backlog and the creation for the future of improved collection results are a major concern. Another major problem is improvement in the accuracy of the reassessments, which in turn requires improvement in investigative activities. Both of these problems are linked with the task of reallocating personnel and other resources to achieve maximum productivity. The remainder of the discussion deals with the details of these and other administrative problems.

B. Procedures for the Determination of the Income and Tax Liability of the Taxpayers

1. Taxpayer Returns

a. Simplification

Voluntary compliance by taxpayers is still hampered by the complexity of tax return forms and accompanying instructions, though there have been improvements in this area. Such complexity

is

is in part forced by the substantive provisions of the law, and certain of these provisions, such as the co-living family rules, require reexamination in this light. But continued attention should be paid to the details of the return forms and instructions so that all unnecessary difficulties may be eliminated.

b. Final Return

1) Time of Filing

Personal returns are now due one month after the close of the taxable year. This period is adequate in many cases to permit proper preparation of the return. It is probably desirable to fix the filing date at two months after the close of the taxable period.

c. Provisional return

1) Use of Last Year's Income

The requirement that the taxpayer in the provisional return declare at least last year's income (in the absence of permission to declare lower) is designed to spread income tax payments throughout the year, in contrast to the bunching that formerly occurred after the close of the year. Despite handicaps, such as the existing delinquency of the 1949-50 tax, it appears to be achieving a greater spread of tax payment than previously existed. In the July 31, 1950 preliminary returns, the legal requirement respecting use of last year's income received about 90% compliance, e.e., that percentage of income required to be declared was so declared. This was estimated by the Ministry of Finance to represent about 80% of the proper tax liability. In part this percentage was obtained as a result of the Tax Offices' sending each taxpayer individual notification of the amount to be declared. The percentage is being increased through a follow-up in August and September by the Tax Offices as respects those taxpayers who either filed too low or who did not file. Two factors, however, prevent a spread of tax payment commensurate with this percentage of 90%. First, only 56% of the declared tax was actually paid at the time of filing. This figure will also be increased as a result of Tax Office activity in August and September. Second, the notifications of the amounts to be declared were based on 1949-50 reassessments and such reassessments were too low compared to true income. The Ministry of Finance estimates the 90% declared represented only 80% of true income. These factors are considered elsewhere. Their correction would permit the provisional return to achieve its purpose. It is, therefore, desirable to continue the requirement that last year's income furnish the minimum amount to be declared. Individual taxpayer notification by the Tax Office of that figure should be continued.

Allowing

Allowing a request for permission to file a lower amount should be continued. It would seem proper for the tax offices in the absence of books and records to deny such a request unless the taxpayer can concretely demonstrate that a material change in his situation had occurred. Where the taxpayer keeps adequate books and records, the degree of change need not be so marked. It is inadvisable to have the conferees participate in the consideration of such petitions, as they do not warrant such extensive review or the use of the time of these officials.

2) Collection of Delinquent Tax Under Provisional Return

As is pointed out under Collection, it is important that immediate action be taken in the case of delinquencies in declared tax on the provisional return. Such enforcement of the requirement of one-third payment is necessary if the objective of spreading tax payment throughout the year is to be realized.

3) Separation of Filing Date and Payment Date

Consideration should be given to moving the filing date for the provisional return one month earlier, to May 31, and keeping June 30 as the payment date for the first one-third of the declared tax. This would give the taxpayer a month in which to obtain the funds to meet such payment. The presence of such a payment target date might induce greater payment compliance than is obtained under the present system, in which a last minute calculation of the tax due may find the taxpayer without funds to meet the payment simultaneously required.

4) Relationship between Provisional Return and Final Return

A strong educational campaign is undoubtedly needed to impress on the taxpayer that the use of last year's income on the provisional return does not carry over to the final return. We should understand that the amount declared on the provisional return is only an estimate, and that the use of last year's income is a device to place a floor under such estimates. This campaign should be integrated with the overall campaign urging the reporting of the true income on the final return.

5) Simplification of Provisional Return Form

The present provisional return form is approximately the same as the final return form. It may be possible to simplify the provisional return form for some taxpayers. Thus, a simple return form could be devised for those taxpayers who desire merely to declare last year's income. The more complete return form would be available for those taxpayers who wish to declare more or less than last year's income.

d.

d. Blue Return Form

1) Factors Militating against Its Use

In the corporation field, the blue return form has been chosen by 47.2% of the taxpayers. But its use by individuals so far is almost negligible: 4.4% overall; 3.2% for farmers; 4.2% for business people. In some areas the percentages are higher, under the impact of educational activity by taxpayer groups.

Some of the deterrents to the use of the blue return form can be eliminated. Thus, the felling among taxpayers that minor bookkeeping errors will deprive them of the blue return privilege can be shown to be unfounded in actual practice. The Tax Offices should show reasonable leniency in this respect in the case of taxpayers proceeding in good faith. The belief in many cases that the blue return bookkeeping requirements present an unneeded complexity warrants reexamination of those requirements. Thus, the permission, apparently now existing, for farmers and small businessmen to use a single-entry system should be made clear both in law and in practice. Also a clear and simple statement of the requirements under such a single entry system should be made available. It may also be possible to tailor these requirements to the type of business or farming activity involved. In addition, it should be made clear that the actual posting in a ledger of sales and purchases invoices is not necessary if those invoices are carefully filed. As respects minor expenses and petty cash amounts, an overall statement might be permitted in place of detailed vouchers. The tendency of some Tax Offices to discourage the use of blue returns could be met by alleviating the worries of these offices respecting such use. Thus, the fear that the blue return may be seized upon as a weapon by taxpayers desiring to understate their income could be countered by an improvement of investigative techniques. In addition, tax offices could be made to understand that not every blue return need be investigated but that only some returns, selected by standards as a guide, need be checked.

2) Incentives to Increased use of Blue Return Forms

It is desirable to strive for increased use of the blue return. Hence, in addition to the negative steps of eliminating conditions militating against filing the blue return forms, attention must be paid to positive incentives. The influence exerted by the present standards offers a problem in this regard. It is probable that the present standards operate to produce, on the white return forms, office reassessments that are below the true income. While the standard rates of profit on gross income are high, the Tax Offices estimates

estimates of gross income are low, and the combination generally produces a reassessment net income lower than the true income. Hence, a taxpayer filing a white return form has a good chance of being reassessed below the net income that would have resulted from his filing accurately on a blue return form. While this could be corrected by weighting the standards in favor of the blue return form, i.e., by using standards in reassessing the white return forms that are pitched above the average, such a step is at odds with the effort accurately to estimate net income. The latter effort requires that the standards be closer to average net income. This difficulty cannot readily be solved. At best, the tax offices must be diligent in seeing that office reassessments on white return forms approximate as closely as possible true income so as not to prejudice those taxpayers filing blue return forms.

It has been suggested that the use of blue returns be encouraged by offering taxpayers a monetary benefit in the form of a tax discount, such as 5% or 10% of the tax, or possibly freedom from reassessments in any case where 90% of true income is returned. Such incentives would seem undesirable since they undercut directly the goal of having tax liability computed by the application of the legal tax rates to the true income. Incentives in the form of permitting only blue return taxpayers to obtain certain deductions which are dependent for their effective administration on correct bookkeeping would appear appropriate. Thus, present law permits loss carryovers and bad debt reserves only to those who file on blue return forms.

2.

2. Investigations.

The Japanese tax officials are engaged in a major effort to shift reassessment procedure from one based on office reassessment to one based on voluntary compliance reenforced by actual investigations. The success of the income tax in large part depends on the extent to which this shift succeeds. For 1949-50, 18% of the self-assessed returns were investigated. The target for 1950-51 has been placed as high as 50% for business returns, though a figure closer to 30% would probably be more realistic. While the ultimate goal is vital, it is equally important that the shift to greater reliance on actual investigations does not proceed more rapidly than is warranted by the strength and experience of the investigative personnel. The taxpayers must be brought to a position of confidence in the investigative system. Placing too great a strain on the investigators at this period is clearly undesirable. The percentage of cases investigated should depend on the full utilization of an investigative personnel spending sufficient time per case to accomplish a satisfactory result in each case.

The selection of the cases to be investigated should be carefully determined. Presumably a reduction is warranted in the amount of gross income (or corporate capital) above which all returns are automatically referred to investigators. Beyond this, it is desirable to concentrate on business income, since apparently greater accuracy has been obtained in the office reassessment of farm income. Standards could be used to indicate the returns most in need of checking. In addition, within each income class and category of taxpayer, a number of cases should be selected at random. The percentages of each class in such a sample audit should be carefully chosen for the purpose, and the results should be analyzed each year to determine the soft spots in taxpayer compliance.

This planned increase in investigative activity will require additional investigators, as is discussed under the heading of Personnel. Also, it should be accompanied by increased requests to private organizations and professional groups interested in tax matters for assistance in educating taxpayers to file more accurate returns. All the mass

information

information media, the business organizations, and the tax professions should lend their support to this task.

3. Conference Procedure

a. General Procedure

The use of conferees is just commencing and the procedures they should follow have not been definitely formulated. It is imperative that this phase of tax administration be soundly developed. The conferees are intended, apart from the top supervisory officials, to be the group possessing the best overall knowledge of the tax laws, sound practical judgment, and the greatest ability in the tactful handling of taxpayers. They are the group to whom the taxpayer who is dissatisfied with his reassessment and the action on his protest must turn as the final step in the administrative process. The conferees must respond to the challenge of their position by approaching these appeals with as balanced and objective an attitude as is possible. The procedures respecting their function must be such as to facilitate prompt and fair decisions.

It is suggested that the following procedure be considered: When a protest against reassessment is decided against a taxpayer, he should be given the reasons as fully as possible; the reasons would be in writing in the case of blue return, orally in the case of a white return. In each case the Tax Office file would contain a written statement of the reasons for the action taken. The taxpayer desiring to appeal to the conferees would be required to state in writing his reasons, the grounds on which he relies and request a hearing, which would be automatically granted. After a sufficient number of trained conferees are available, experience should indicate whether only one conferee or a team of two or three conferees would normally hear the case. The conferee should not do any actual investigating of the facts himself, but should utilize the information contained in the taxpayer's office file, the taxpayer's written appeal and the oral statements at the conference. Where vital information is lacking, he can ask the taxpayer or the Tax Office to supply it, as

is

is appropriate. Care should be taken, however, not to prolong unduly the consideration by the conferee. He must be satisfied with a reasonable amount of knowledge and decide as best he can on that basis. If the taxpayer has no books and records, the conferee should satisfy himself as to the overall apparent reasonableness of the reassessment, i.e., considering the known condition of the taxpayer's business, does the reassessed income appear reasonable? If so satisfied, he should place the burden on the taxpayer to demonstrate a lower figure. Where reliable books and records are present, and certainly where the case has been investigated, the issues should be sharper and therefore handled accordingly by the conferee. The taxpayer should be permitted to have a tax representative present at the conference if he desires, assuming that such representative is qualified to practice before the tax administration; participation by the representative should not be discretionary with the conferee.

A conferee should be able to settle a case. Many tax issues, both of fact and law, are not capable of precise resolution and therefore fair settlement shapped by the strength of the conflicting contentions is necessary. But a conferee should not compromise a case. That is, if he is satisfied as to the taxpayer's net income, his duty is to apply the rates of tax regardless of the resulting tax burden. It is not the function of a conferee to temper his decision because of sympathy for the taxpayer, or because the proper amount of tax may constitute a heavy burden or be difficult of payment. The collection of the tax is not his function. It is his responsibility to determine as best as he can the true income of the taxpayer and then apply the existing rates. While, as stated above, "true income" is often the result of a settlement of conflicting contentions, it should not be based on a desire to alleviate the tax burden of a taxpayer temporarily faced by financial difficulties. The compromise of tax liability because of financial inability to pay the legal amount if a function of the collection staff.

It is desirable that the decisions of the conferees should be post-reviewed by the Agency. The number of cases will determine whether this post-review can cover all cases or a representative selection. Such post-review would permit the Agency to see that there is reasonable

geographical

geographical uniformity in the conference activities and that the decisions are being correctly determined. It will also disclose matters in which clarifying Agency rulings or instructions are necessary. It is desirable that such post-review should not disturb the result in the particular case, but instead operate to advise the conferee that the Agency disagrees with his decision for stated reasons and that he should guide himself accordingly in the future. Whether this concept of post-review can be applied at once is uncertain. It may be proper in the initial years while conferee experience is being developed to permit the Agency on post-review to reverse a materially erroneous decision by a conferee. In addition to post-reviewing conferee decisions, it may be desirable to post-review the cases in which reassessments based on investigations have been closed by agreement with the taxpayers. Such post-review, which could be on a sample basis, would indicate the extent to which investigators are properly checking returns and the correctness of Tax Office and Bureau action in handling protests.

It appears that at present the Agency must report to the Account Audit Board the decision in every settled case, and the documents in all corporate cases. In addition, the Account Audit Board spot-checks the settlements to ascertain whether they are in accord with the substantive income tax statutory provisions. These procedures appear to be quite wasteful and to introduce an overlapping jurisdiction in tax cases. Consequently, as soon as an adequate post-review system is established in the Agency, the Account Audit Board should have no jurisdiction to review the administrative decision in any particular tax case and the Agency should not be required to report the results of its decision to the Account Audit Board.

b. Appeal to the Courts

The conferee's decision, in form a recommendation to the Bureau or Agency head, as the case may be, is in effect the final administrative action on the taxpayer's case. The taxpayer's next step, if he still wants to contest the result, is a suit in the courts. The handling of such a suit is discussed under the Judicial Consideration of

tax

tax cases. It is a refund suit because payment by the taxpayer is a prerequisite to litigation. Moreover, payment is legally a prerequisite to protest to the tax office and appeal to the conferee, though in practice this requirement is probably not rigidly enforced. For the time being it is apparently desirable to enforce these requirements. As the collection machinery improves, it may be possible progressively to dispense with the requirement of payment, at first for the protest, later for the appeal to the conferee, and finally perhaps for litigation in the courts.

C. Collection of the Tax

A tax system, otherwise equitable, may be administered in such a way that it becomes extremely unfair and highly arbitrary. This is particularly true of the Japanese tax system if collection of the self-assessed income and corporation taxes is not consistently maintained at high levels. Thus, declaration by taxpayers of their true incomes and determination of their proper taxes do not alone bring about an equitable and fair tax system; there must also be payment of the taxes in full. A collection rate that is very irregular and low will eventually cause the collapse of the voluntary tax system.

Furthermore, during periods of irregular rates of collection, budgeting by the Government is extremely difficult. Estimated collections of past delinquencies invariably enter into the calculation of revenues and therefore further complicate an already complex problem. Also, pressure to meet the delinquency goal set in the budget will often result in considerable individual hardship, unwarranted compromises, and further pyramiding by delinquent taxpayers of their tax liabilities. As the individual or total aggregate delinquency increases it becomes more difficult to place collections on a current basis. This vicious spiral only continues to increase in intensity and unless effectively checked eventually reach as such proportions that its destructive power cannot be arrested.

Various

Various reasons are given for the low rate of tax collection, among them always is the tight money market. An analysis of this reason clearly demonstrates that it is invalid. Employees subject to withholding have paid their taxes; yet the self-assessed taxpayer, who is often in a comparable financial situation, has not voluntarily complied and his taxes are now in arrears. Some have used that tax money to increase their standard of living; others have used it to increase their inventories or to buy fixed assets; and others have used it for still other purposes of their own choosing. The underlying reason for the low rate of collection seems clearly to be the lack of savings to pay taxes. Taxpayers subject to withholding are forced to save the required amount to pay their taxes; some other taxpayers save systematically through individual or association discipline. All these who have so saved pay their taxes. To a certain extent the two payments under the provisional return represent a form of forced savings to pay taxes. But savings to pay taxes have not been adequate in the past to provide taxpayers with the required funds to discharge their tax liabilities on their provisional returns or on their final tax return. Administrative reasons prevent, at this time, the use of a more frequent form of forced savings, say monthly provisional returns.

For these and other reasons the collection of the self-assessed income and corporation taxes in Japan must be carefully watched. Every effort must be made to achieve a tax collection goal for each year approaching one hundred per cent. The collection problems in Japan now have two aspects. First, the collection of the large existing delinquency of 73 billion yen as of July 31, 1950, requires immediate and drastic action. Second, the collection of future taxes necessitates long-range planning so that better procedures will be developed and additional collection personnel will be trained to deal effectively with the problem.

It appears that neither the existing delinquent taxes nor future taxes can be collected unless the Tax Offices maintain a collection force that will exert consistent and

frequent

frequent pressure upon the individual taxpayers. This pressure can only be exerted by frequent contact with the taxpayers so that savings will be periodically deposited throughout the taxable year for the payment of taxes.

The second aspect of the collection problem is more significant in the long run than in the short run. Here we will be concerned with suggesting new procedures and practices that are required to bring about the maximum rate of collection of the self-assessed income and corporation taxes. The intensive collection drive in 1950 should develop an able collection staff that could then be reassigned to the various tax offices throughout Japan in such manner that their services would be used most effectively. In this way the 503 offices would begin the calendar year 1951 with a well-trained and well-qualified collection staff.

Individual taxpayers find it extremely difficult to save adequate funds to meet their final self-assessed individual income tax liability. Some improvement in collections has resulted from the requirement that taxpayers report their final reassessed income of the previous year as their estimated income in their provisional returns unless approval is obtained from the Tax Office authorizing them to declare a lesser amount as their income. One third of the estimated tax is due at the time of filing the provisional return. Most taxpayers, however, have not set aside adequate savings to pay their taxes. As noted above, failure of taxpayers to save adequate funds to pay taxes is one of the major administrative problems that must be solved in some way, either by compulsory means or by some new voluntary procedures. The large delinquencies demonstrate conclusively that many taxpayers desire to borrow from the Government at a rate of 14.6 percent by not paying their taxes rather than from a bank at a rate of 10 to 15 percent or in the black market at a rate of 10% per month. In fact, some of these taxpayers may have great difficulty in securing a private loan at any interest rate.

1. Provisional Return

Our first attention should be directed at the provisional self-assessed individual income tax returns.

Collections under the provisional self-assessed income tax returns have tended to concentrate toward the second and third payments. The collection rate on the first one-third of the tax due on June 30th (extended to July 31st in 1949 and 1950) has not been satisfactory. The provisional return data demonstrate that some taxpayers are not filing, others are not reporting their true income, and others who may be reporting substantially their true income are not paying promptly.

It may be desirable to have the provisional return filed one month earlier, on May 31st, while the first one-third payment is made on June 30th as the law now requires. Consideration should be given to this earlier filing date if it appears that the one month's notice of tax liability will increase the savings of taxpayers so that they will be able to make the first payment in full of their tax liabilities under their provisional returns.

Every effort should be made to acquaint the Japanese people with the filing requirements under the law. The needed improvement in the collection rate should be obtained by increased voluntary compliance, if possible. The low rate should not be allowed to continue for the first payment; collections should be spread rather evenly over the three payment periods. If the result cannot be secured by improvement in voluntary compliance then compulsory measures may have to be resorted to by the tax administrative agencies. Attachments or seizures are now being effected under ordinances but they should be permitted by law on the properties of those taxpayers who fail to pay one-third of their tax at each of the three payment dates of the provisional return. Public sale of the seized property does not seem warranted until after the due date of the final return. Generally, however, attachments should be resorted to only where voluntary methods have failed. Too frequent attachments by tax administraters tend to remove the public stigma that should be associated with these proceedings. The attachment process should represent both a legal and moral sanction to bring about taxpayer compliance.

2. Attachments and Seizures

When the administration of the self-assessed income tax is stabilized, attachments or seizures are not generally necessary. Taxpayers voluntarily file their returns and pay their taxes in full. But where large numbers of taxpayers fail to file voluntarily, then these drastic procedures have to be used, otherwise the administration of the tax system would become inequitable as among taxpayers. The attachment and public sale procedure represents an effective sanction in bringing about voluntary compliance by all taxpayers. During the period of low compliance, resort to attachment has to be too frequent for any stigma to be associated with its use against delinquent taxpayers. During such times taxpayers freely allow their property to be attached because so many others are also having their property attached. For attachment to be a real sanction, its effectiveness must be based on both its legal and moral effect. Through attachment and public sale, collection can legally be made. But today, attachment has almost no moral effect because it no longer brings public condemnation. Its frequent and injudicious use has been largely responsible for this result. The properties of a taxpayer subject to attachment should be reviewed by the Ministry of Finance to determine if the items are those that should be subjected to such legal process, or whether additional items should be added to the exempt list. The attachment process should be judiciously used. Such judicious use will assist in improving voluntary compliance and will likewise make it less necessary to resort to attachment. As resort to attachment decreases and the tax system becomes stabilized, the attachment process will once again become an effective moral sanction in the administration of the self-assessed income tax.

3. Tax Posters

It has already been indicated that every effort must be used to increase voluntary taxpayer compliance in the payment of the self-assessed income tax and the corporation income tax. The appropriate effective technique to increase compliance may vary from region to region or even within a region. One method that would appear fruitful in increasing voluntary taxpayer compliance is the awarding of posters to individual taxpayers who have paid in full their self-assessed income taxes, or to corporations that have paid their income taxes in full. The system should be so designed that the poster

will

will be displayed at the taxpayer's shop or place of business. The effectiveness of tax posters will depend largely on the reaction of the public. Thus, posters will be effective in areas where the delinquent taxpayers will be condemned and will be at a competitive disadvantage to taxpayers who deplay the poster, assuming that they have the same merchandise and sell for approximately the same prices. It would not seem that tax posters would be effective if instituted immediately in very low compliance areas. But as these low compliance areas improve, the use of posters can be introduced and should assist materially in the collection of taxes. Tax posters would then be introduced in various areas at such times as the posters would prove effective and eventually throughout the whole of Japan.

4. Installment Payments for Reassessed Amounts

Individual and corporate taxpayers that are reassessed usually find it extremely difficult to make immediate payment of the entire reassessed amount because of the pyramiding of current and reassessed taxes. Taxpayers often do not have adequate funds to discharge such large tax liabilities in full. Allowing payment of the reassessed amounts in installments therefore deserves careful consideration.

D. Judicial Consideration of Tax Cases

1. Present Status

The volume of income and corporation tax cases, civil and criminal, pending in the courts is very low. As of September 15, 1950, there were, as respects Civil cases, 76 cases pending in the District Courts, and 5 in the High Courts. As respects criminal cases as of August 15, 1950 there were 132 in the District Courts, 59 in the High Courts and 34 in the Supreme Court. Income tax litigation is in its infancy at the present time. This situation thus affords the courts an excellent opportunity to deal effectively with existing cases and to plan carefully the procedures necessary to the disposition of a larger volume of cases in the future. It must be recognized that the courts have a vital role in the income tax picture. They constitute the impartial arbiters between the citizen taxpayers and the bureaucracy charged with tax administration. They must deal evenly with excessive demands by the officials and with underpayment and evasion by the taxpayers. The

effectiveness

effectiveness with which they discharge their functions largely determine the extent to which the tax system is kept in balance. In this regard the available evidence indicates an awareness on the part of the Japanese judiciary of the responsibilities thus placed upon it.

2. Prompt Disposition of Cases

It must be remembered that, with the few constitutional questions to one side, the legal issues (as distinguished from the factual issues) in tax cases are issues of statutory interpretation. The courts are required to determine the meaning of legislative provisions. Such problems are difficult, for by hypothesis the legislative language is unclear and ambiguous on some point of statutory interpretation. Once the interpretation is decided by the court the legislature can then readily consider the effect of the decision. It can conclude that the meaning thus given to the language achieves a desirable result and therefore allow the legislation to stand as interpreted. Or it can decide that the interpretation given to the legislation brings about an undesirable result and therefore proceed to change the statute. The important point is that the judicial decision provides a basis for going ahead with tax administration — taxpayers, tax officials, procurators, and lower court judges are told what the statutory language provides and can act accordingly, subject to any change by the Diet. Any undue delay in the judicial decision in such cases simply makes it impossible for these groups to move forward with any feeling of certainty.

3. Judicial Specialization in Tax Cases

Tax litigation generally presents issues that are more difficult than the average legal question. The intricacies of tax legislation are largely responsible for this result. In addition, since the issues involved are common to a great many taxpayers situated in all parts of the country, it is essential that there be uniformity of decision as quickly as possible so as to avoid geographical diversity in the application of the tax laws. These factors, coupled with the need for a prompt disposition of tax cases, indicate the necessity of special judicial procedures in tax cases. If a large volume of civil tax cases existed, the best solution would be a Civil Tax Court, created as a part of the judicial branch of the Government, which would have nationwide original jurisdiction in civil tax cases. Such a court, it appears, could constitutionally be created. It would provide specialization and a large

degree

degree of uniformity of decision. Appeals could lie to a panel of the Tokyo High Court, to assure geographical uniformity, with appeal by certiorari to the Supreme Court.

The volume of civil tax cases is of course not such as to warrant creation of a Civil Tax Court at this time. But it is extremely likely that the volume of civil tax litigation will increase and, also, that in the future the number of civil tax cases will far exceed the criminal tax cases. Improved administration will tend to replace issues of fact with issues of law. An increase in the number of lawyers and accountants participating in taxpayer representation will also create questions of statutory interpretation and similar issues. A mature tax system is likely to produce more litigation than a primitive system. For these reasons the possible future need for a Civil Tax Court should be kept in mind.

The present state of civil and criminal tax litigation does call for judicial specialization in the consideration of tax cases. This is apparently felt by the judiciary itself, since there exist in some District Courts and High Courts panels specially designated to hear all of the tax cases. It is believed desirable to extend such specialized panel system to other areas just as soon as tax cases develop in those areas. Such panels would not be limited to hearing only tax cases, since that would be a waste of personnel. Rather, all tax cases would be assigned to these panels and, if the volume of tax cases permitted (as is presumably the case at present), the panel could hear non-tax cases as well. But priority would be given to the tax cases by these panels. There may of course be different panels for civil tax cases and criminal tax cases. The Supreme Court may also want to consider whether all of its non-constitutional tax cases should be assigned to one of its petty benches rather than distributed throughout all of the benches.

4. Handling of Tax Litigation

Every effort should be made to insure the efficient handling of tax cases. Thus, the system of continuous trials seems to have worked successfully where it has been applied, and should be used in all tax cases. Procurators should be careful in assembling and arranging the evidence presented in tax cases, in view of the many factual issues that may be present. Care should be taken in the selection of criminal

cases

cases so that the most serious cases are presented for indictment. Procurators and judges should be kept advised of changes in tax administration, so that they may have an overall understanding of the entire administrative process in the tax field and thus obtain the necessary perspective. The budget for the judiciary should be analyzed to see that it is sufficient to support the proper handling of tax and other cases. And for other obvious reasons as well, it is important that all measures needed for the maintenance of an efficient and respected judiciary should be pursued.

E. Personnel and Office Operation

One of the most serious problems in the administration of the self-assessed income and corporation taxes centers around personnel. The accelerated rate at which personnel has been increased since 1946 has brought in many new tax officials who are both young and ill prepared. To a certain degree in-service training the somewhat overcome their lack of preparation. But the goal system which was maintained officially in Japan until the fiscal year 1949-50 gave them a distorted picture of their new duties and responsibilities. That system also created a hostile tax-paying public which in turn lowered the morale of the new recruits. At the same time, however, a new, modern tax system was introduced into Japan, requiring well qualified personnel to initiate the program and to set successfully its course of administration. Despite these handicaps great progress has been made in initiating the new tax system by the few able and experienced tax administrators and the new personnel.

Adequacy of personnel, the effective utilization of personnel, the mass transferring of the key personnel of all tax administrative agencies and the seniority system of promotions are probably the more serious problems that deserve immediate attention.

1. Adequacy of Personnel

To determine accurately whether existing personnel is adequate would require a study of the present use of personnel at the numerous tax offices, regional bureaus and the Tax Administration Agency. Such a study would require the concentrated effort of an efficiency group for several months. Adquate time and the staff were therefore not available. The study made within the time permitted did clearly demonstrate that existing personnel as now utilized is not adequate. It is, therefore, imperative that the existing personnel remain at its present level even if the overall budget requires a general reduction in government personnel. To economize now by reducing the personnel concerned with the administration of the self-assessed income and corporation taxes would be extremely harmful. First, it would certainly represent false economy because a decrease in the staff of the Tax Offices would result in a reduction of tax collections exceeding many times the cost of the discharged personnel; second, voluntary compliance would undoubtedly be adversely affected if the number of tax administrators were reduced.

Certain

Certain functions appear to be in critical need of additional personnel. It is believed that a great part of the personnel can be obtained by transferring existing tax personnel and utilizing them more effectively. In some instances, the transferred personnel can be immediately put to work; in other case, they will have to have some in-service training before they can be effectively used.

a. Collection Division

The most critical shortage appears to be in the Collection Division of the various tax administrative agencies. It appears that additional personnel are required to place the Collection Division in a position where it can keep collections reasonably current. This additional personnel, as indicated in another portion of this report dealing with the existing delinquency of ¥ 73 billion, would be largely used in the first instance in intensive drives to clear up the delinquencies in those large industrial centers where the rate of collection and voluntary compliance are both very low. After the tax drives were completed, some of the additional collection personnel should then be transferred to other Tax Offices so that their services would be most effectively used.

b. Conference Group

The conference group system has just begun to function. Two hundred experienced men were selected from the tax administrative agencies and 400 inexperienced persons were selected based upon competitive examinations, from the outside. One experienced and two inexperienced men preside at each conference. In that manner the inexperienced men are receiving their in service training. The work of the conference group should steadily increase; if so, the present personnel even when used most effectively does not appear adequate. It is, therefore, recommended that some additional personnel be selected for the conference system and assigned there for in-service training. Experienced and well trained conference personnel will then be ready for the heavy and important administrative burden that eventually will be imposed upon the conference group.

c. Supervisors

Of the 60 supervisors authorized for the Agency, 53 have been appointed and are now functioning. They serve an important function in checking the efficiency of the various Tax Offices and Regional Bureaus. Such work requires an investigation of many detailed matters, much of which could be done by less experienced and junior men under the direct supervision of one of the present supervisors. The senior supervisors could then devote their time and attention to more important matter, much of which is not now examined because of limitations of time. It, therefore, appears desirable to increase the number of supervisors by 60 junior supervisors who will work under the direct supervision of the 60 senior supervisors.

d. Investigation Section

There are now approximately 1,000 agents in the investigation section. They are now authorized to check all individual self-assessed income tax returns disclosing a gross income of three million yen or more or where the capital of the corporation is three million yen or more. This jurisdiction includes about 12,000 individual self-assessed income tax returns and 15,000 corporation income tax returns. The present plan is to increase the jurisdiction of the investigation section so that the one million yen for individuals be decreased to 700 thousand yen and the three million yen in both instances for corporations be decreased to two million yen. This will then place 40,000 individual taxpayers and 45,000 corporations under the jurisdiction of the investigation section. The returns of these individual and corporate taxpayers should have closer scrutiny and more frequent examinations than the income tax returns of less substantial taxpayers. Furthermore, the time for filing the final individual self-assessed income tax returns should be extended from January 31st to February 28th and the investigation section should have at least one year within which to conduct their intensive examination of the tax returns for each taxable year. All these activities will require additional personnel. The funds spent for enforcement, however, should be amply rewarded by a large increase in revenue collections and an improvement in voluntary compliance. It would seem that 500 additional investigators would be required by the investigation section for its projected intensive examination of the income tax returns of the 40,000 individual income taxpayers and the 45,000 corporate taxpayers. A staff of 1,500 investigators would

probably be able to examine annually about 50 per cent of both the individual and corporate returns in this group; this percentage should represent the bare minimum of investigated returns in this group if the self-assessed income and corporation taxes are to be reasonably administered.

e. Personnel for Processing Information Returns

Within the past year many new information returns have been required and are now being filed. New information returns are recommended im this report. These information returns must be processed in order to serve the functions for which they were designed. Through the effective use of these returns, taxpayers failing to file returns or underreporting their incomes would never feel secure from reassessment or from criminal prosecution. Adequate personnel should be assigned and adequate office or warehouse space should be made immediately available for this important purpose.

f. Personnel for Notices or Rulings

Taxpayers are in constant need of advice in connection with the interpretation of tax laws and their application to various factual situations. The Agency now issues notices or rulings which are serving a useful purpose in improving compliance and taxpayer morale. But the personnel now engaged in this interpretative and ruling work is not adequate. Provision should be immediately made for the necessary personnel so that taxpayers will be able to get prompt responses to their requests.

2. Temporary Personnel and Overtime Work

It has already been indicated that the effective use of existing personnel would probably demonstrate that there was not an excess of personnel in the tax administrative agencies and that it would be "sen wise and yen foolish" to make any reductions at this time. During this period of reassignment, the existing personnel will be required to work overtime. Also, during certain times, such as the periods immediately preceding and following

the

the filing of returns, some temporary personnel will have to be added if the work of the agencies is to be performed effectively and punctually. The budget should provide an adequate amount for these two purposes; otherwise, the Tax Offices will find it difficult to keep current in their many activities including collections.

3. Effective Use of Personnel

The reduction in the number of self-assessed income taxpayers through increased exemptions and allowances for dependents for the calendar year 1950 has decreased somewhat the workload in the Tax Offices. This decrease has varied, however, from Tax Office to Tax Office. Every effort should be made to transfer immediately the resulting surplus personnel to those offices where the personnel shortage is most critical. Generally, this will involve assigning personnel from rural areas, where voluntary compliance is rather high, to industrial areas where it is very low. If this surplus personnel is effectively used as indicated elsewhere it should bring about a higher rate of collection in the large industrial areas where the intensive tax collection drives are recommended. After the tax administrators have had sufficient time to reassign personnel so that it is used most effectively, a management committee should be appointed by the Minister of Finance. This Committee should make continuous studies in the use of personnel in the tax administrative agencies with a view toward their being used more effectively. The composition of that Committee is important; it should include representatives of the Ministry of Finance, representatives of Industry, and possibly professors of universities who are experts in personnel management. As indicated elsewhere the Tax Deliberation Committee is now studying the office procedures and practices of the tax administrative agencies to determine in what manner they can be simplified and improved. That Deliberation Committee might aid in making these continuous studies in the use of tax personnel.

4. Mass Transfers

The practice of the Ministry of Finance is to make

periodic

periodic mass transfers of administrative personnel. The effect of these mass transfers on the efficiency and morale of the various offices is certainly adverse for a period of one to three months. Generally, the reasons given for such mass transfers are that they are made to prevent graft or collusion and to provide promotions for the tax administrators. Promotions could be made in many instances within the same offices rather than to positions in other offices. Key personnel would then be more continuous in the various offices without sacrificing promotions. Graft or collusion must be prohibited. Mass transfers may have reduced the amount of graft, but certainly they have not eliminated it. Also, it would seem that graft and collusion by tax administrators could be effectively checked even though their tenure were longer than one year. A policy involving the periodic and selective transfer of key personnel would be as effective in preventing graft as mass transfers. This would enable the various offices to have continuity of key personnel. Also, it would bring about greater efficiency in the offices and improve morale throughout the year. It is recommended that the system of transferring key tax administrators on a mass basis be abandoned and that the future transfer policy be based on periodic and selective transfers of key personnel.

5. Promotions Based on Merit and Seniority Rather than Seniority Alone

The promotion of tax administrators appears now to be governed largely by seniority. This factor should be taken into account in determining the promotional policy, but the factor of merit should in most instances be given greater weight. Seniority alone as the governing factor in all promotions will inevitably lead to a sterile administrative organization and with a very low morale. The "dead hand of bureaucracy" would then be controlling. Vigorous, imaginative, and ingenious tax administrators are required for the many complex problems that arise in the administration of a modern tax system. These administrators cannot be selected on the bases of seniority alone. For that reason it would appear desirable for the Ministry of Finance to revise its policy so that merit is the major factor in the promotion of tax administrators.

6. Morale

The past year has seen a great improvement in the

overall

overall morale of the tax administrative agencies. Every office that we visited demonstrated clearly the vast change. Within the past eighteen months, however, new positions have been created in the tax service and personnel assigned to those positions. These include, among others, the conference groups, supervisors, inspectors, investigators and personnel investigators. The morale among these newer groups should be watched and every effort made to keep their morale at a high level because the new functions which they are performing are vital to the modern tax system. A word or two from top officials demonstrating clearly the important role which the newly appointed tax administrators play would do a great deal to improve their morale.

7. Elimination of Corruption

Although not alarming in number, acts of corruption among tax officials and tax employees are cause for serious consideration. Unless prompt, efficient and stern measures are taken now in dealing with all acts of corruption, it may easily get out of hand, and become a major problem.

At present there are two comparatively small organizations dealing with the misconduct of tax employees. One is the Tax Administration Agency Personnel Investigators and the other is the Tax Administration Bureau Personnel Investigators. In the past there has been a tendency on the part of the Agency and the Bureaus to deal rather lightly with employees found guilty of corruption. There have been instances of some employees that were guilty of bribery or embezzlements who have merely been reprimanded or transferred. Usually all criminal acts of bribery and embezzlement should result not only in prompt dismissals from the Government Service, but where warranted, in criminal prosecution.

The Agency Personnel Investigators have introduced some procedures which have considerably improved the disposition of corruption cases. It is still necessary, however, to strengthen and reconstitute the organizations so that they may deal more effectively with the problems before them. Although the Agency and Bureau Personnel Investigators are now operating under a plan of cooperation, it is generally recognized that the present arrangement is not satisfactory. If these two organizations were combined into one unit in the Tax Administrative Agency, it appears that the work of the personnel investigators would show great improvement. It is, therefore, recommended that these two organizations be so combined into one unit under the Agency.

8. Office Procedures

A marked improvement was clearly evident in the office procedures, both in the Regional Bureaus and the Tax Offices.

a. Physical Facilities

We visited numerous Tax Offices throughout Japan and we found the office layouts to be considerably improved over last year. The offices also appeared to be well lighted and kept clean. The renovated and well kept buildings were in marked contrast to the antiquated and ill kept buildings of last year. Also, the space in the buildings housing the tax offices appeared to be used to the maximum.

It was clearly evident, however, in our visits, that the Tax Offices were in urgent need of more space. To illustrate, we found in every case that the reception room for taxpayers at the entrance of each Tax Office was always crowded with taxpayers. In many cases taxpayers had to stand for two or three hours waiting for their scheduled hearing on their income tax reassessments. Several individual hearings were being conducted in a manner that caused a minimum of interference with the other conferences; but the details of the returns of various taxpayers were made to a certain extent available to many other taxpayers. Tax return data should be treated as confidential matter by the government. This cannot be accomplished where hearings are so conducted. Also, adequate space for investigators and inspectors did not exist.

For these reasons, it appears essential that the existing building facilities of the Tax Offices be expanded. This should be done so that an adequate reception room is provided in the entrance to each Tax Office; an adequate number of rooms are provided in each Tax Office for hearings on Tax Office reassessments and for hearings of the conference groups; and an adequate number of rooms are provided for the inspectors and investigators. Over all, these changes in physical facilities may seem rather minor, but such factors are extremely important in developing good will among taxpayers.

b. Office Equipment and Transportation Facilities

Adequate office equipment, such as filing cabinets, carbon paper, binders, is still urgently needed in every regional bureau and Tax Office. Some progress was noted over the equipment of last year, but funds must be obtained for sufficient office.

fice equipment; otherwise the record-keeping demands of the new tax system cannot be met. Transportation facilities continued to be below minimum needs and should receive further attention.

c. Manuals

It was clearly evident that considerable work had been done over the past year or so in the preparation of manuals for investigators, inspectors, supervisors, collectors and personnel investigators. In some instances these manuals had already been published and are now in use. Discussions with tax administrators indicated that they had noted improvement in the efficiency of the personnel that were now using the new manuals. The preparation of manuals should be extended to other areas where the need still exists. Furthermore, the work on the original manuals that are now in use was done under considerable pressure. It is clearly evident that they require revision. In fact, it would appear necessary for adequate personnel to be permanently assigned to the important task of preparing new manuals and revising all outstanding manuals. The increase in efficiency of personnel for whom the manuals were prepared would offset many times the amount of time required to prepare the new and revised manuals.

9. Tax Deliberation Committee

The Tax Deliberation Committee in the Tax Administrative Agency has done considerable work in studying office procedures. The membership of the committee is taken both from the Agency and from the outside. There was considerable evidence that the committee was composed of very able people and that it was doing a great deal of excellent work in the simplification of office procedures. The work of this committee should be encouraged in every possible way. It has been indicated above that the functions of this Committee might be increased to include continuous studies in the use of tax use of tax personnel.

F. Representation of the Taxpayer

1. Professional Groups Representing the Taxpayer

An efficient tax system requires the presence of professional groups competent to represent the taxpayer before the administrative officials. Such representation affords a necessary protection for the individual taxpayer against administrative

administrative ~~error in his particular~~ case. But in addition it serves as an overall check on administrative operation, since the professional groups are capable of informed criticism of the administrative system. The result is a constant and needed spur to in creased administrative efficiency and fairness of decision. It is very important to the success of tax administration in Japan that the number and quality of taxpayer representatives be steadily increased.

There are four professional classes which can be drawn upon for such taxpayer representation - attorneys, certified public accountants, Zeimu Dairichi or tax practitioners, and Keirishi or former type certified public accountants. (There can be no new Keirishi, since for the future the new professional accounting standards must be met). It is believed that all four classes may be selectively utilized to provide taxpayer representatives, under the following general plan:

a. Attorneys and Certified Public Accountants

Attorneys and certified public accountants, present and future, would be admitted to practice before the tax administrative agencies without any examination other than a character examination. Their general professional competence has been proven by admission to their respective professional statuses and no further test of competence is necessary. While specific experience in the tax field may not be present, it is implicit in their professional standing that they will obtain the knowledge necessary for a competent representation of the taxpayer.

b. Zeimu Dairichi or Tax Practitioners

The Zeimu Dairichi group numbers about 3,500, of which about 3,200 are active in taxpayer representation. Presumably only those active in the past intend to continue their careers as tax practitioners. Under these conditions, existing Zeimu Dairichi may be admitted without examination, other than a character examination. But it is appropriate that persons desiring hereafter to obtain the status of Zeimu Dairichi should in addition be required to pass a written examination testing their professional competence.

c. Keirishi

While about 30,000 Keirishi are registered, only 3,000 are active and of these 3,000, about 1200 are also Zeimu Darichi, Existing Keirishi (who are not also Zeimu Dairichi) desiring to represent taxpayers should be required to pass a written examination testing their competence for the task, and also the character examination. The written examination could be the same as that given to new Zeimu Dairichi. There can be no new Keirishi.

d. Identification

Each person so admitted to practice before the tax officials would obtain a card which would state his name and the professional class to which he belongs. There would be a committee in the Tax Agency which would supervise the entire process of admission to practice and of disbarrment for just cause.

The above would be the rules governing admission to practice before the Agency, Bureau and Tax Offices. Representation in the courts would be governed by the Judiciary. Representation of the taxpayer does not necessarily imply an audit of his books and records, although a representative competent to do so, such as a certified public accountant, may have made such an audit as part of his employment. But if the representative assists the taxpayer in the preparation of his return, he should be required so to indicate on the return and sign along with the taxpayer. Any person so signing who has actual knowledge of falsifications in the underlying books and records should be subject to discipline by the Committee. On the other hand, if any changes are to be made in the return of a taxpayer which has been prepared and signed by a taxpayer representative, the tax officials should as far as possible communicate with such taxpayer representative. Finally, it should be noted that a duly qualified taxpayer representative should always be permitted to attend conferences, hearings on protests, and other meetings, on behalf of his client. Such participation should be as a matter of right and not as a privilege to be granted in the discretion of the tax officials.

In this connection it would seem undesirable to establish a new class of taxpayer representative, such as a "Tax Notary" class, authorized to certify tax returns and books and records as correct in accordance with the tax law. This is especially so if persons who are not members of the accounting profession, such as lawyers

and tax practitioners, and permitted to qualify for this position. The auditing of books and records is an accountant's task and should be restricted to that profession. Moreover, certification of a tax return and legally correct is not the proper function of a taxpayer representative. His task is to assist the taxpayer as best he can to file a correct return. But the ascertainment of the correctness of that return is a matter for the tax administration and cannot be delegated to a private group.

2. Compilation of Authoritative Tax Material

The ability of professional groups competently to represent taxpayers is in part dependent upon the accessibility of the authoritative tax materials. It is therefore important that all such materials be arranged and distributed in such a fashion that they are complete, readily available and convenient to use.

This result can best be achieved by the Agency's preparing a loose-leaf tax service containing all the authoritative tax materials. Such a service would include all the statutory provisions, the ordinances, the interpetative rulings and other administrative pronouncements, the court decisions, etc. These materials would have to be properly compiled and arranged and an adequate index prepared. The tax service would be kept up to date through current supplements. Such a service should be sold by the Agency to anyone desiring it, and thus taxpayer representatives could be supplied with the necessary tools. The tax services would of course be furnished to all Tax Offices and Bureaus. They should be sent to all universities offering courses in taxation.

The preparation of such a tax service will require some time and hence the task should be commenced at once. Some of the needed materials is already being distributed by the Agency, so that the first task is one of the compilation and rearrangement of existing material. The next step could well be the indexing of existing material. Such a progressive development of a loose-leaf tax service will be of material assistance to taxpayer representatives pending completion of the final product.

3. University Courses in Taxation

The University Law Schools should institute courses in the legal aspects of income taxation, as distinguished from the

fiscal

fiscal policy and public finance aspects. Such courses would do much to interest attorneys in tax matters and to increase informed criticism of the system. It would of course also bring about needed academic research into the legal phases of taxation. Sufficient funds should be provided in the budget to permit such courses to be given by the Law Schools.

G. Accounting

The profession of certified public accountant in the true sense of the term is slowly obtaining a foothold in Japan. The examination procedure for certified public accountants, under the supervision of the Certified Public Accountants Administration Commission, is proceeding satisfactorily and should not be changed except that problems should be included involving the tax laws. Thus, a panel examination should not be substituted for the present special examination. But several affirmative steps should be taken to hasten the growth of this profession. A modern income tax system, especially as respects corporations and large individually-owned businesses, is greatly dependent for its success on the existence of an able and respected accounting profession. For much the same reasons, it is imperative that modern accounting standards and procedures should be introduced as widely as possible. The work of the Business Accounting Standard Council is encouraging in this regard, and the Council should continue its activities along this line.

The former Article 47 of the Certified Public Accountants law, restricting the auditing and certifying of financial statements to certified public accountants professionally qualified for such tasks, should be restored, but probably in a modified form, as indicated below. This would assist in legislatively reestablishing the concept of a certified public accountant system, as understood in the world at large. Restoration of former Article 47 without change would apparently mean that only new certified public accountants could certify financial statements, thus making it impossible for the Keirishi or former type certified public accountants to so certify. It is probably desirable that both new certified public accountants and qualified Keirishi should be the two groups permitted to certify under the restored Article. The qualified Keirishi could be ascertained by a sreening process conducted by the Certified Public Accountants Administration Commission. Under this policy, however, it would still be permissible in those specific situations where certification is required by law or regulation to restrict the required certification to the new certified public accounts, as for example in the

case of the certifications to be required by the Securities and Exchange Commission. And, of course, the legal and other distinctions between new Certified Public Accountants and Keirishi would be continued, and each class should be clearly identified. The Securities and Exchange Commission should make effective as soon as possible (and not later than say April 1951) a regulation requiring the auditing of the balance sheets and profit and loss statements of corporations having securities listed on the Stock Exchange. Similar auditing of other organizations, such as public corporations, should be encouraged. The Tax Administration Agency should also consider a requirement that large corporations and proprietorships should have their books and records audited in connection with the filing of their tax returns. Such required auditing in the above situations should be done only by new type certified public accountants.

In order to hasten the development of a competent accounting profession, leading persons in the accounting profession should travel to the United States to observe the practices and methods there followed. At the same time, prominent American accountants should be invited to Japan to lecture before the Japan Certified Public Accountant Association, University groups, and others interested in accounting.

GENERAL HEADQUARTERS
SUPREME COMMANDER FOR THE ALLIED POWERS
APO 500

012 (30 Oct 1950)ESS/IR

MEMORANDUM FOR: THE JAPANESE GOVERNMENT

1. Transmitted herewith for the information of the Japanese Government are certain technical memoranda prepared by the Shoup Mission during its recent visit to Japan.

2. I trust the memoranda will prove of help and assistance to the Government in its consideration of the various problems discussed in the memoranda.

W. F. MARQUAT
Major General, U. S. Army
Chief, Economic and Scientific Section

Inclosures: 4

Received: 30 Oct. A.CO p.m.
Shukan : M of Finance
Local Autonomy Agency
Copy : C of L, C of P, Minister
LCO, [redacted], MA, Jikan
LFC. D of CS