Chapter 2 Toward the Tax Reform for Vitalizing the Economy

[Section 1 Burden Structure of Individual Income Tax]

(1) Trend of Individual Income Tax System in Major Countries

- Most countries have simplified their tax rate structures or made their taxes flatter since around 1980, but some also have moved to make the rates more progressive or to raise the top tax rate.
- In Japan, the maximum tax rate was lowered and the tax rate structure was simplified in the 1980s and 1990s.

(2) Burden structure since the 1980s

- Since the 1980s, the tax burden has been dramatically reduced, mainly for middle-income earners.
  1) The redistribution function of individual income tax weakened.
  2) Tax revenue has been decreased considerably.
  → The income tax burden in Japan is low both historically and internationally.
- Current state of the burden structure
  1) Marginal tax rate of individual income tax by types of households
  → The marginal tax rate increases with the rise in employment income due to (i) the increase in the applicable rates of income tax and income inhabitants tax and (ii) the changes in the rate of deduction for salary income.
  2) Large number of taxpayers in the lowest bracket
  → As much as 80% of the tax payers are applied the minimum bracket of the income tax rate schedule (10%).
  3) Large number of non-taxpayers
  → Since the minimum taxable income was raised by expansion of deductions, the proportion of non-taxpayers has been on the increase (one out of five employment income earners).

(3) The tax burden through the life-cycle and by generation

- Due to the tax cuts since the mid 1980s, the effective tax rate for a given point in the life cycle is basically lower for younger generations.
- Since employment income (income amount) increases for higher age groups, the average tax rate also increases accordingly.

(4) Actual state of deductions: Issues and Analysis

- Existence of tax deductions

→ Narrower tax base + lower tax rate → Lower proportion of tax revenue to the total amount of wages.

→ Considering the future aging of the Japanese population, the tax base will become even narrower with the increase in the amount of social security premiums.

- Actual state of personal deductions

1) The real deduction amount based on the Consumer Price Index has stayed more or less the same since the latter half of the 1980s. The amount of special exemption for dependents has been increased significantly in recent years.

2) The impact of the abolition of various deductions would be larger for higher-income earners in that they would have a higher tax burden.

3) The estimated amounts of tax revenue loss as a result of the personal deductions are approximately 2.1 trillion yen for the basic exemption, approximately 1.2 trillion yen for the exemption for a spouse and the special exemption for a spouse, and approximately 1.8 trillion yen for the exemption for dependents, etc.

4) If the various deductions were abolished, the minimum taxable income would become lower, leading to some of those who had not paid income tax (non-taxpayers) becoming taxpayers.

- Actual state of the elderly-related deductions

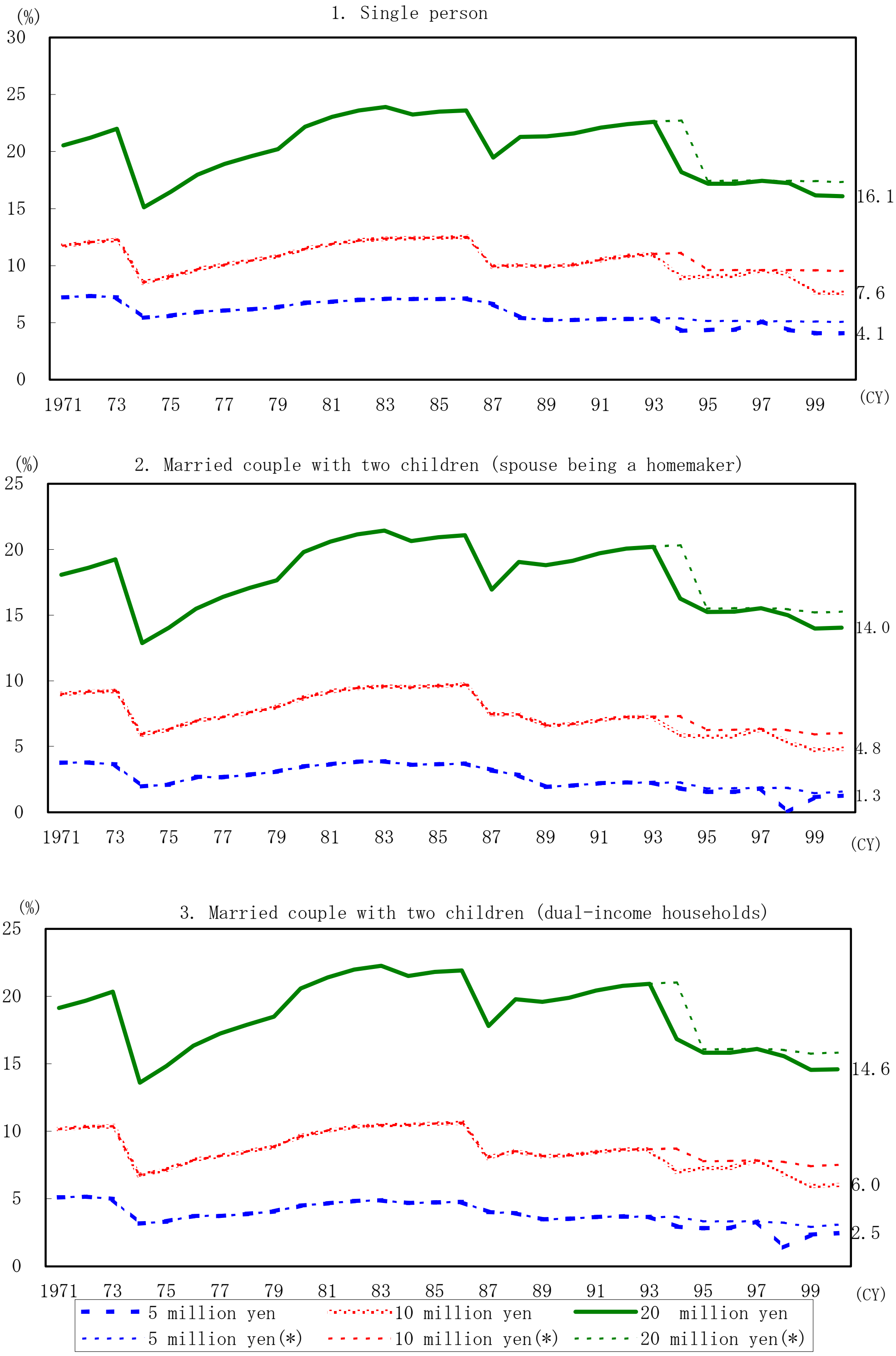
1) The minimum taxable income for recipients of public pensions (couple households) is 1.5 times as much as that of people currently earning wages.

→ A significant difference in tax burden ("lack of intergenerational equity") is observed between working generation and the elderly.

2) It has been pointed out that the current deductions are making the tax burden for the elderly persons with incomes other than pensions extremely low.

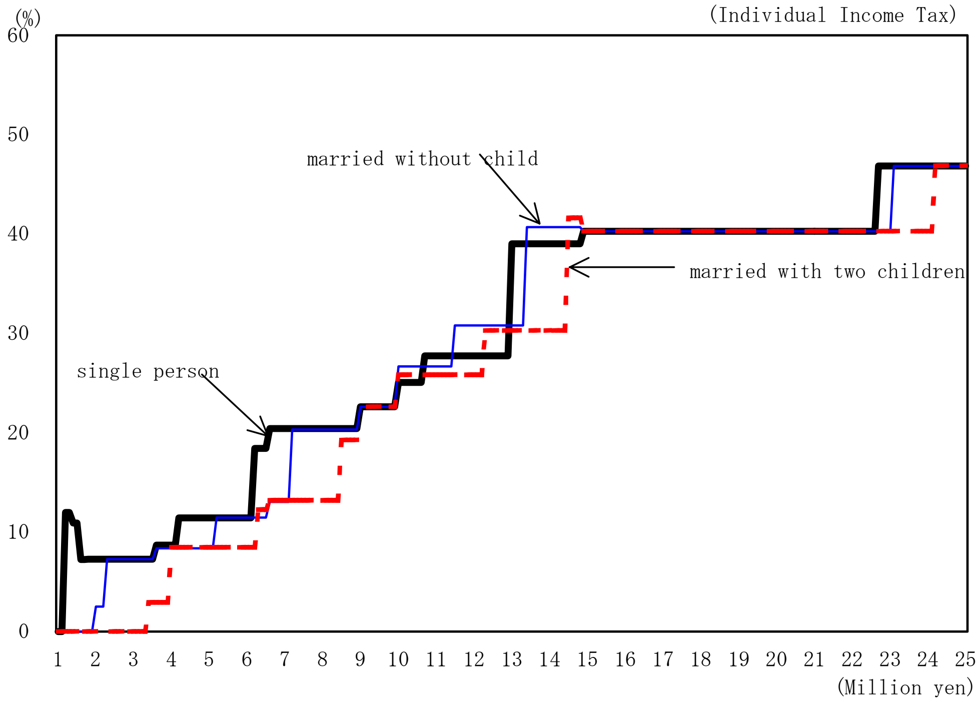
3) The estimated amount of tax revenue loss as a result of the elderly-related deductions is approximately 1.9 trillion yen for the income tax and income inhabitants tax combined.

The Real Effective Tax Rate by Employment Income



Notes 1. Effective rate = (income tax)/(employment income)
2. In the case of married couples with two children, one of the children is subject.

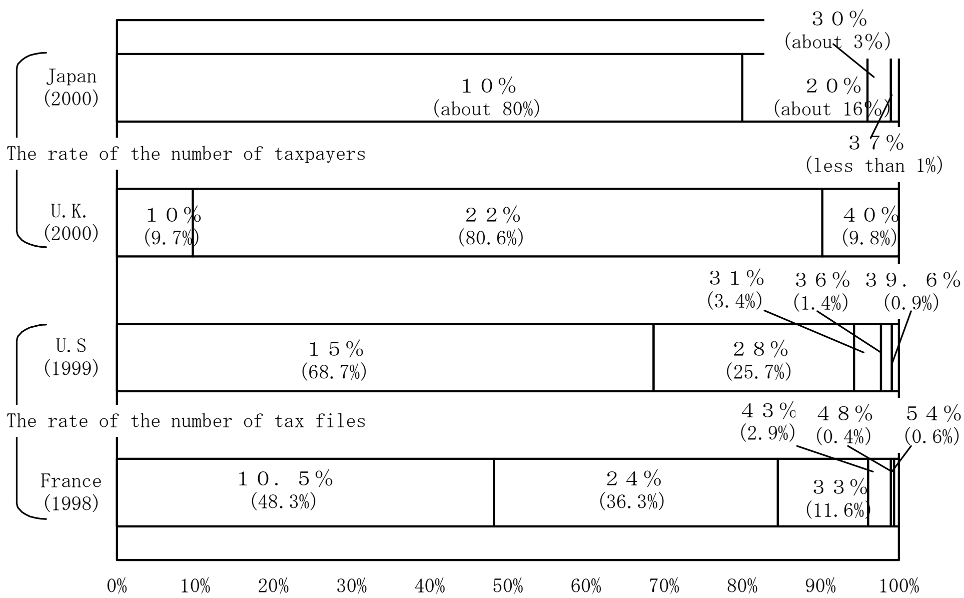
Marginal Tax Rate, by Types of Household(income tax and inhabitants tax combined)



Notes. 1. (marginal tax rate) = (increase of Individual Income Tax) / (one-unit-increase of employment income)
2. Individual Income Tax is total of Income Tax (National Tax) and Individual Inhabitants Tax (Local Taxes).

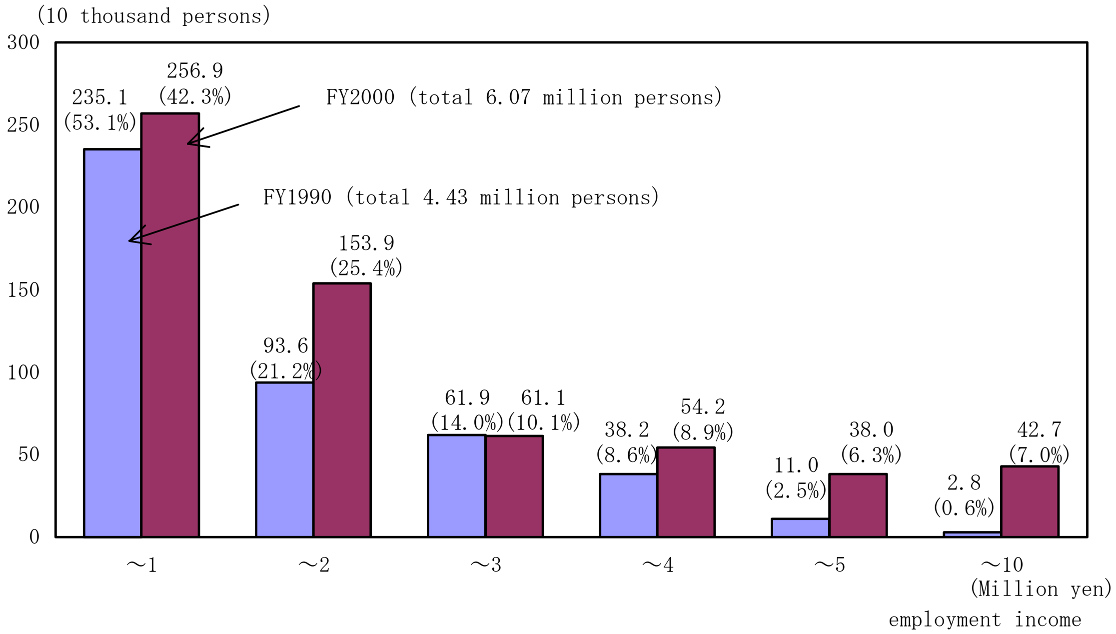
International Comparison of the Ratio of the Number of Taxpayers (or Tax Files) by Marginal Tax Rate Bracket

Large number of taxpayers are in the lowest bracket.



The Number of Non-Taxpayers of Income Tax by Salary Class

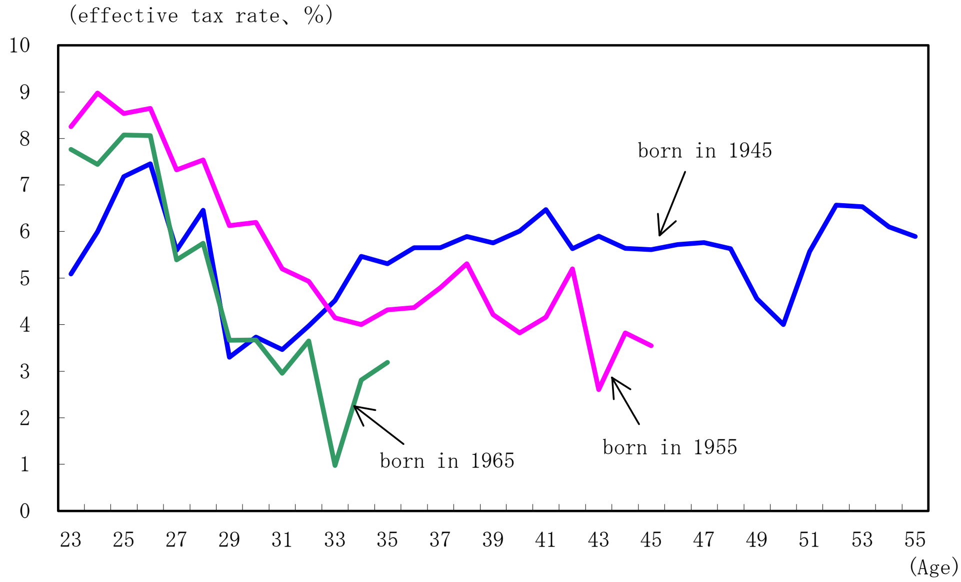
The more the proportion of non-taxpayers, the more employment revenue.



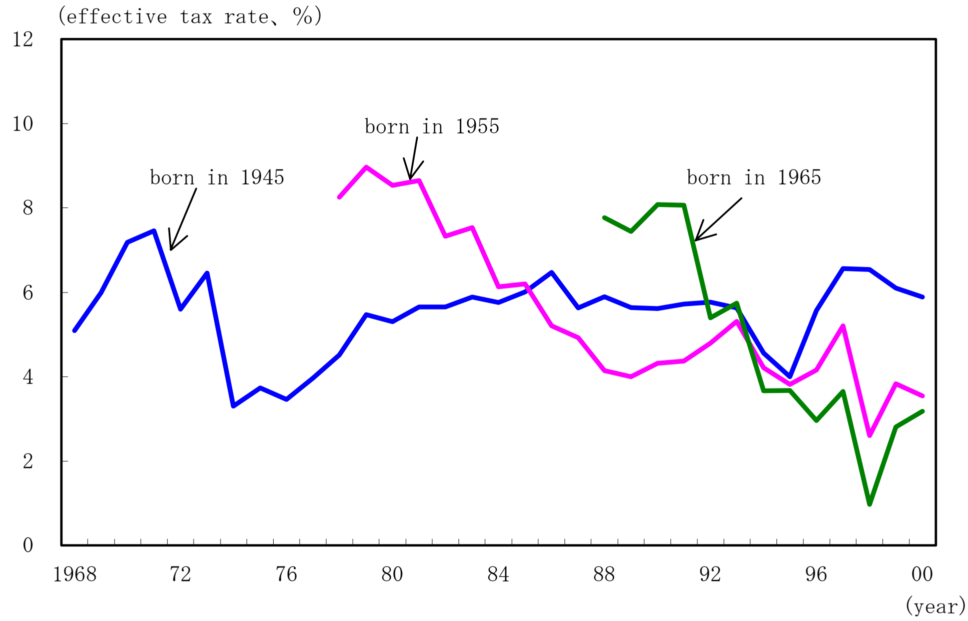
Simulation of the Effective Tax Rate of the Individual Income Tax Through The Life-Cycle by Generations

The effective tax rate of the individual income tax has been falling due to tax cuts since the mid 1980s.

（1） comparison by the same age
Decline since the mid-1980's by several tax reduction

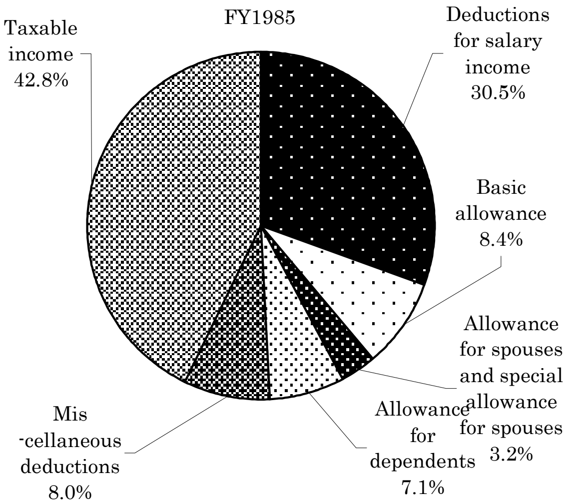


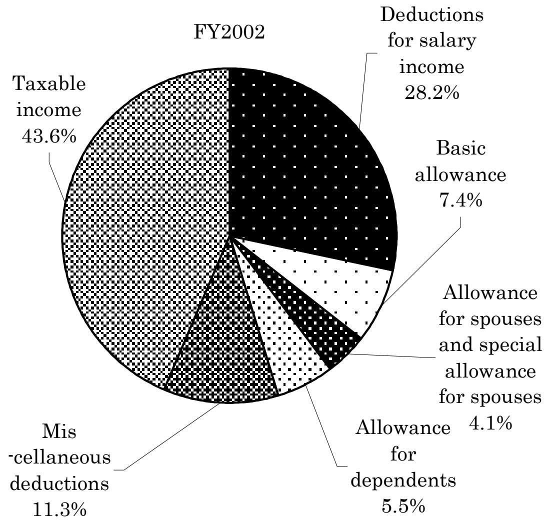
（2） comparison by the same year



Note. (the effective tax rate) = (individual income tax)/(employment income)

The Ratio of Deductions and Allowance on Earned Income





	(trillion Yen)			(trillion Yen)
gross employment income (A)	147.5	1.5 times	gross employment income (A)	222.8
taxable income (B)	63.1	1.5 times	taxable income (B)	97.0
tax revenue (C)	9.5	1.1 times	tax revenue (C)	10.1
(C)/(A)	6.4%		(C)/(A)	4.5%
(C)/(B)	15.1%		(C)/(B)	10.4%

[Section 2 Burden of Corporate Income Tax]

(1) Trends of Corporate Income Tax Systems in Major Countries
- Since the 1980s, most countries have broadened tax bases in their corporate income tax and lowered their effective tax rates.
- Japan also carried out drastic reductions of the tax rate twice, in FY 1998 and FY 1999.
- Against the background of changes in the economic structure, the rate of corporate income tax has tended to be lowered from the latter half of the 1990s as part of attempts to encourage economic activity and to review the overall corporation tax system.

→ The effective rate of corporate income tax in Japan is at the same level as that in the United States.

(2) Current state of the burden of corporate income tax as seen from companies

-Take note of ”rates of tax burden after the application of the tax effect accounting” which corresponds to the tax payable by pretax income.

→ Although the Corporate Income tax rates in Japan are in principle the same, there are considerable differences in the “rates of tax burden after the application of the tax effect accounting” by companies.

- Current state of the burden of corporate income tax

1) Burden of corporate income tax as seen from macroeconomic data

→ The “rate of tax burden on corporate income”, has been on a downward trend in other countries since the 1980s. However, the tax burden rate as seen from macroeconomic data in Japan (about 45%) remains to be higher than that in major western countries (40% or lower),though differences in tax deduction systems by countries need to be borne in mind.

2) Tax burden to corporate income on companies based on microeconomic data

Model companies were assumed in the five sectors of industries (Electronics, Steel, Automobile, Information Service, Retail). Their financial statements were calculated by taking the simple average of those of the five top-sales companies of each sector. Then, estimates of the burden of corporate income tax was made for cases where the model company was assumed to conduct business activities in other countries (Japan, United States, United Kingdom, France), with the same business content and the same financial statements, by making a number of assumptions.

→ The “burden of corporate income tax (rate/amount)” for the model companies was higher in Japan in all sectors.

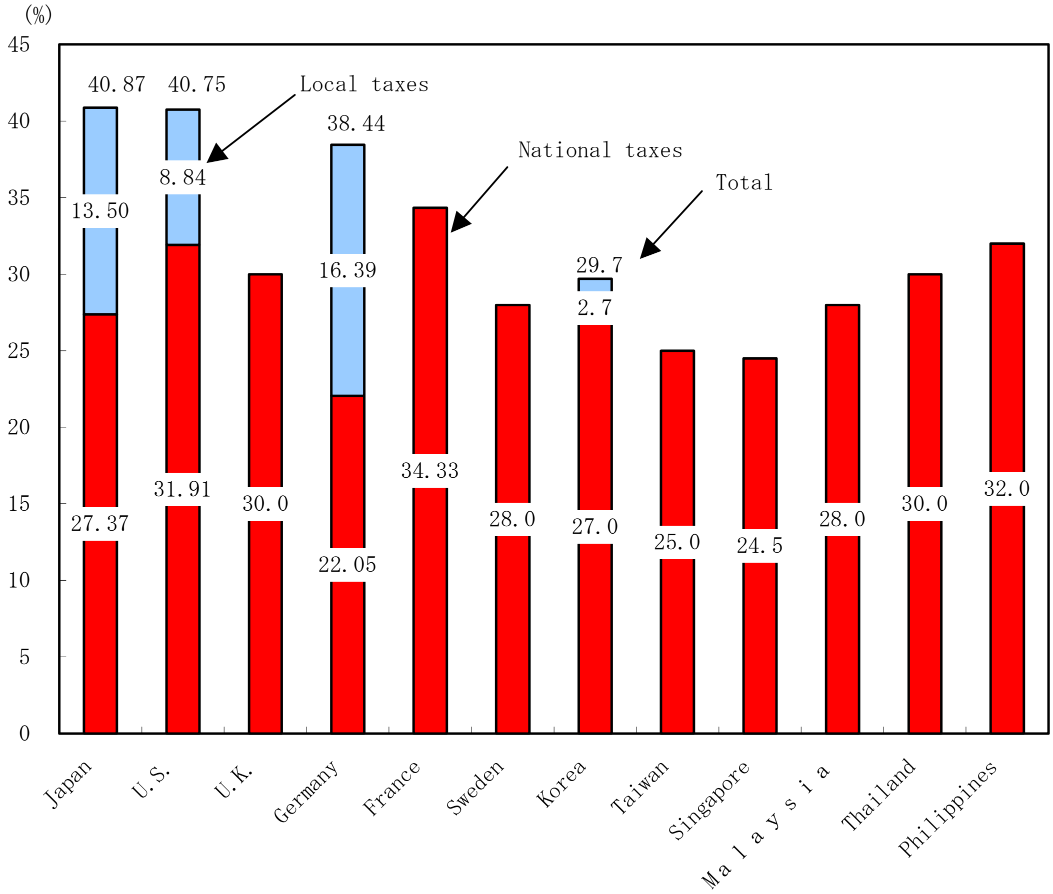
→ The main factor that affected the results of the estimation was the setting of profits and losses in the process of assessing the taxable income,and the adjustments, such as tax credits and additions, after the assessment of the amount of tax.

(3) Simulation of the impact of corporate income tax using an Applied General-Equilibrium Model

- Changes in capital cost due to changes in corporate income taxation will have an impact on the overall economy through impact on resource allocation etc.
- If the amount of capital stays the same, the changes will only promote reallocation of resources between industries and will have hardly any impact on the overall production volume.
- If the capital accumulation mechanism is considered, the changes will promote not only reallocation of resources but also an increase in income, saving and investment, and capital stock as a result, and the impact on the overall production volume and real GDP will be much larger.

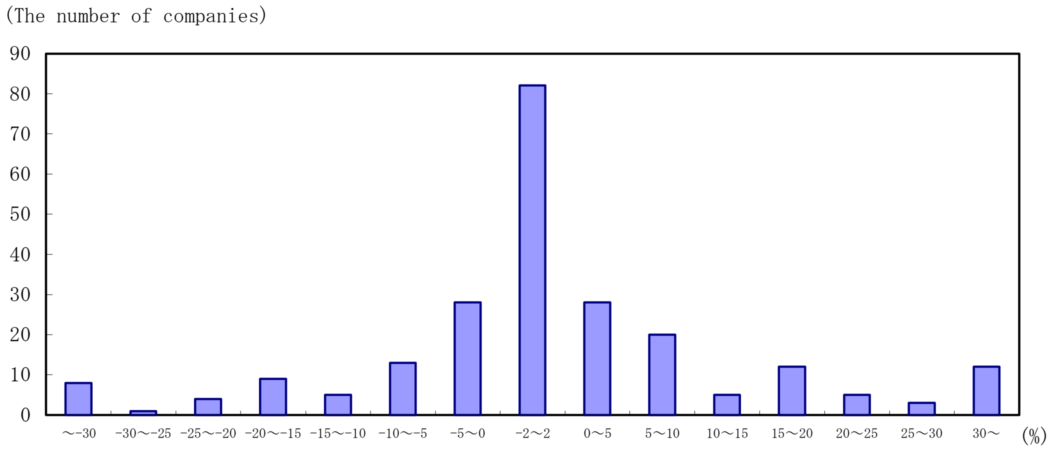
International Comparison of the Effective Rate of Corporate Income Tax

The effective rate of the corporate income tax of Japan is higher than Asian countries.



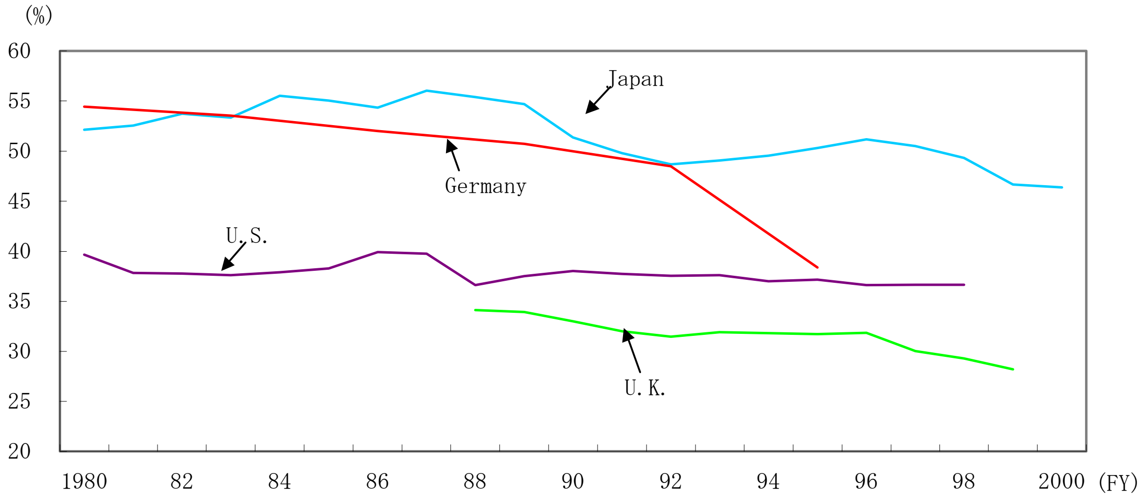
Deviation Between The "Rate of Tax Burden after The Application of The Tax-Effect-Accounting" And The "Effective Statutory Tax Rate".

There are considerable differences in the sense of tax.

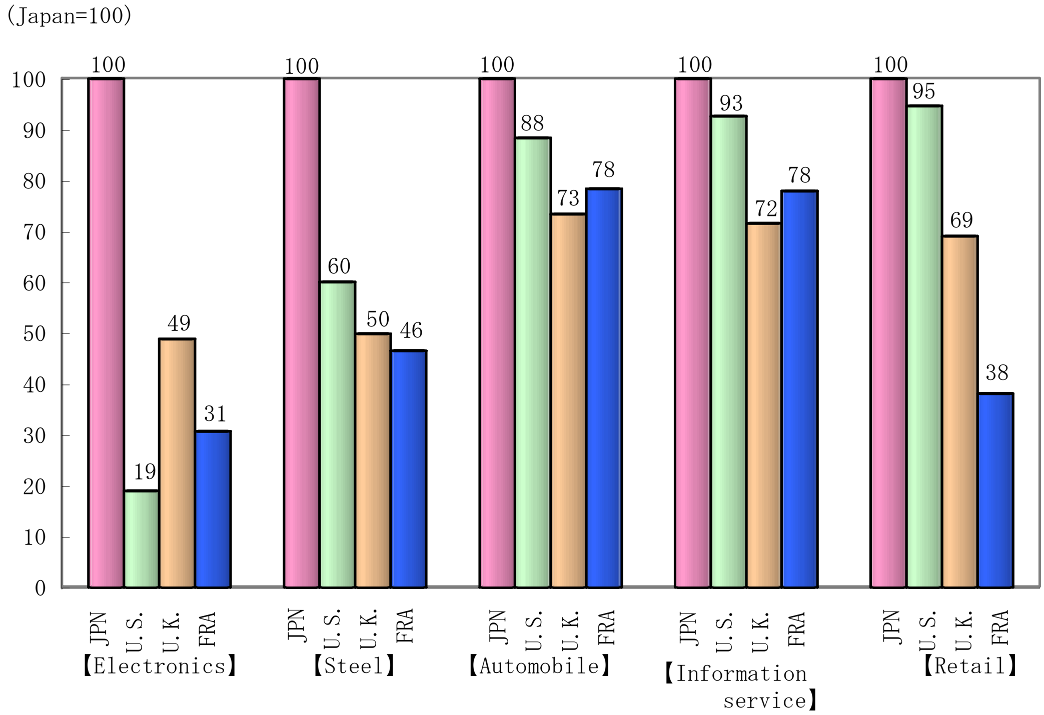


Note. Differentials between the effective statutory tax rate and the rates of tax burden after the application of the tax effect accounting.

The Rate of Tax Burden on Corporate Income



International conparison of Estimated Tax Burden of Corporate Income in Each Industry



Note. 1. The figures indicate the ratio of the tax amount in each country to that in Japan.