

# Recent Developments in the Japanese Tax System

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# Economic and Fiscal Policy of Abe Administration

Three-pronged strategy, aimed at overcoming prolonged deflation and increasing employment and income (Cabinet Decision Jan. 11, 2013)



Aggressive Monetary Policy



Flexible Fiscal Policy



Growth Strategy for Promoting Investment

⇒ New growth strategy to be formulated in mid-2013



## Aggressive Monetary Policy

- ▶ “Joint Statement” of the Government and the BoJ (Jan. 22, 2013)
  - Introduction of “Price Stability Target”
    - 2% in terms of the year-on-year rate of change in the CPI
    - Aim to achieve this target at the **earliest possible time**
  - Introduction of the “Open-Ended Asset Purchasing Method”
    - BoJ’s Asset Purchasing Program with no termination date
    - For some time, 13 trillion yen of purchase per month
    - Total size of the Program will be increased by about 10 trillion yen in 2014



## Flexible Fiscal Policy

- ▶ Emergency Economic Measures for the Revitalization of the Japanese Economy (Cabinet decision on Jan. 11th)
  - Total Size: 20.2 trillion
  - Of which, government expenditure: 10.3 trillion

Approved in the FY2012 Supplementary Budget
- ▶ FY2013 Budget (Cabinet Decision on Jan. 29<sup>th</sup>)
  - 3 Priority Areas: Reconstruction and Disaster Prevention Measures, Wealth Creation through Growth, and Security of Life and Regional Activation.
- ▶ FY2013 Tax Reform (approved by the Diet on Mar. 29<sup>th</sup>)

“Budget  
for 15  
months”

# FY2013 Tax Reform

## 1. Tax Measures for Creation of Wealth through Growth ⇒ p.7

-- consisting of a part of  Flexible Fiscal Policy

## 2. Implementation of the Comprehensive Reform of Social Security and Tax ⇒ p.8

-- consisting of a part of comprehensive tax reform

2011 law: corporate tax rate 30% ⇒ 25.5% : enforced 2012~

2012 law: consumption tax rate 5% ⇒ 8% ⇒ 10% : enforced 2014/2015

2013 law: reform of individual income tax and inheritance tax

## 3. Measures to Support Reconstruction from the 2011 Earthquake

## 4. Measures to Facilitate Tax Payment

## 1. Tax Measures for Creation of Wealth through Growth

- ▶ Incentives for Private Investment, Employment, and Income
  - Enhanced depreciation / tax credit for investments in production facilities
  - Raising maximum deductible amount of tax credit for R&D
  - New tax credits to promote wage distribution: 10% of increased payment
  
- ▶ Measures for SMEs
  - Expand special measures for tax deductible expenses on entertainment and social expenses for SMEs: 100% deductible up to 8 million yen
  
- ▶ Human Resources Development
  - Exemption of up to 15 million per donee for gift tax on gift money for education in a lump sum to children or grandchildren

## 2. Implementation of the Comprehensive Reform of Social Security and Tax

### 2013 law: reform on individual income tax and inheritance tax

#### ▶ Individual Income Tax

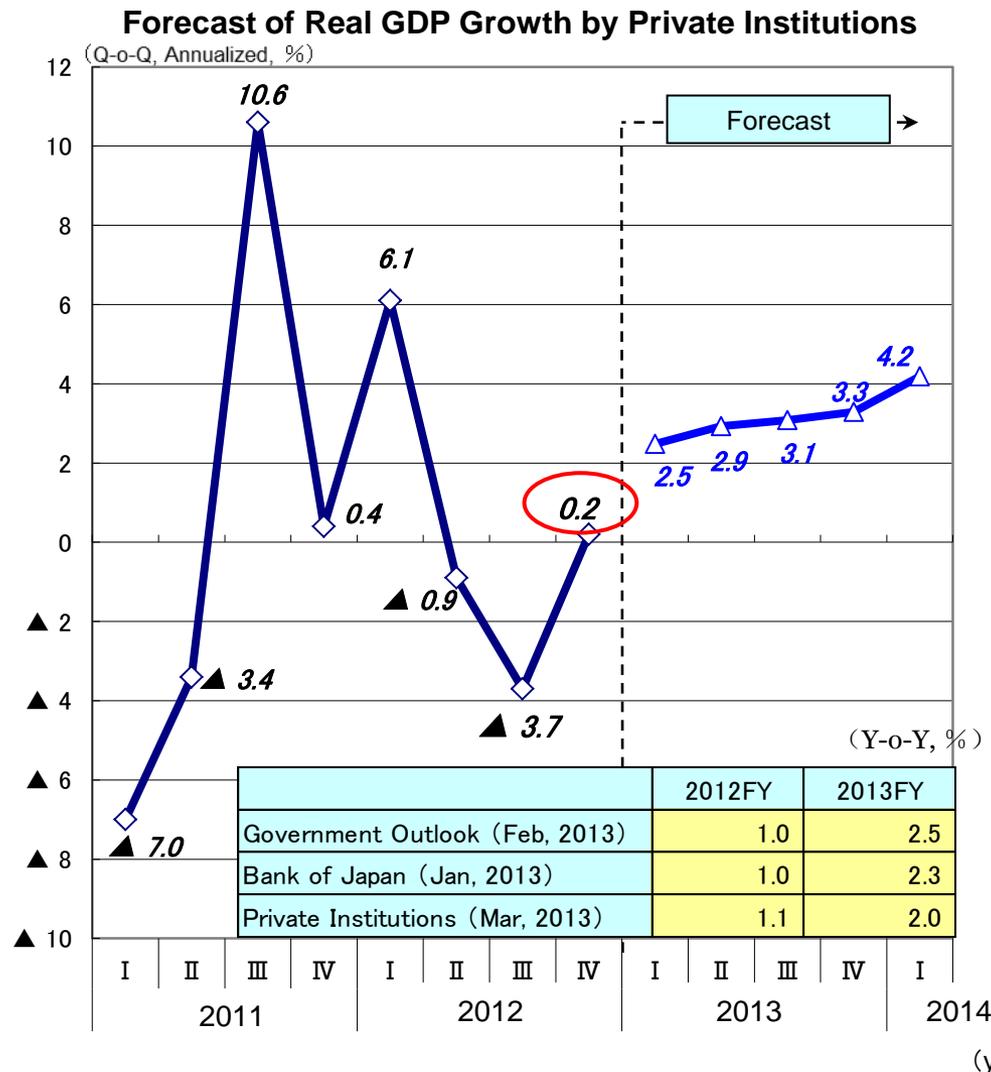
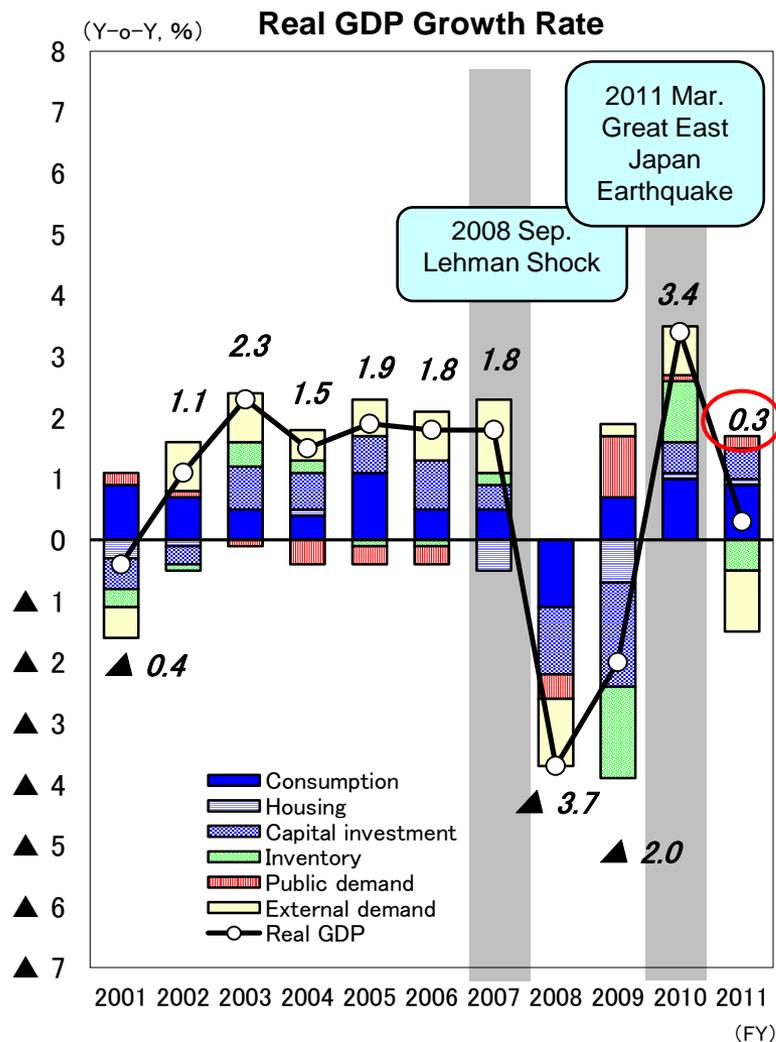
- Top rate of personal income tax: 40  $\Rightarrow$  45% for taxable income above 40 million yen
- Expanding the unification of income tax on profits from financial instruments, while abolishing reduced tax rate on profits from listed stocks (10  $\Rightarrow$  20%)
- Introducing “Japanese Individual Savings Account (ISA)”: nontaxable for financial investments up to 5 million yen for 10 years

#### ▶ Inheritance Tax

- Expanding tax base by reducing basic deduction: deaths subject to tax: 4  $\Rightarrow$  6%
- Top rate of inheritance tax: 50  $\Rightarrow$  55%

# Current Situation and Outlook of Japanese Economy

--- Shows signs of picking up recently, although weakness is seen in some areas.



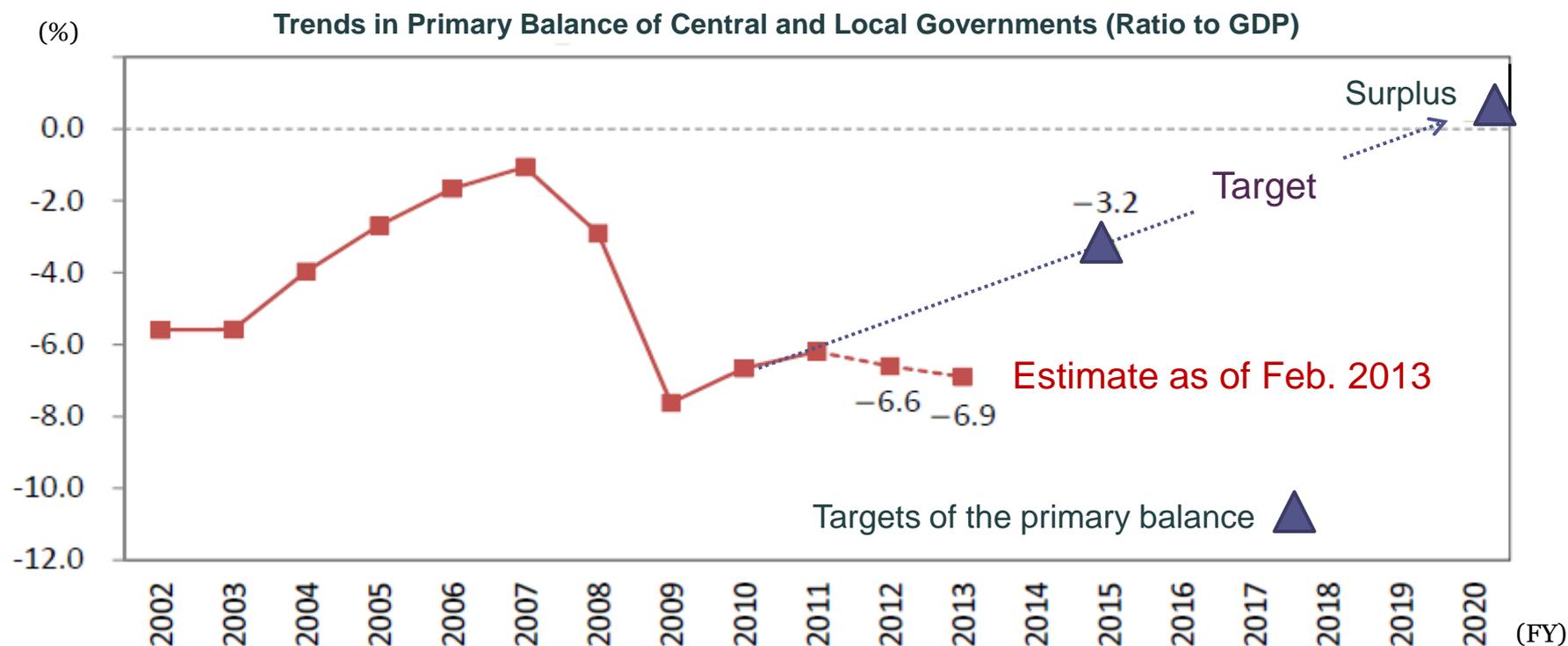
# Fiscal Consolidation

While the priority is to overcome deflation and to increase employment and income, another important agenda to be addressed is Fiscal Risk.

## Fiscal Consolidation Targets

- ▶ The new Abe administration has pledged to maintain the Fiscal Targets originally set in 2010, which are to:
  - halve the primary deficit-to-GDP ratio of central and local governments from FY2010 by FY2015, and
  - achieve a primary surplus of central and local governments by FY2020.

FY2013 initial budget succeeded in reducing primary budget deficit vis-à-vis FY2012 initial budget (▲ 24.9 ⇒ ▲ 23.2 trillion yen). However, the renewed fiscal stimulus (FY2012 supplementary budget) worsened the total balance.



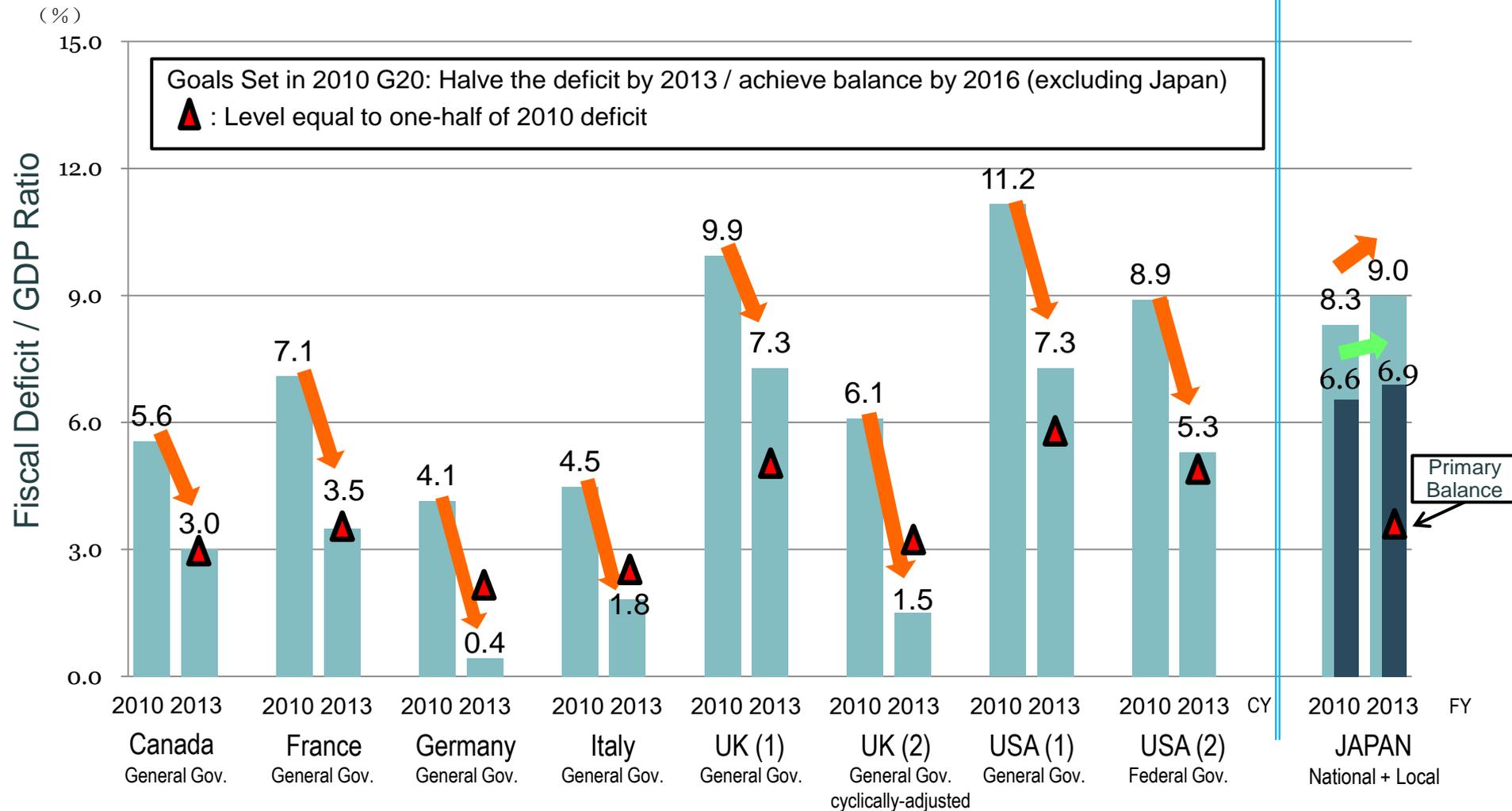
1/ FY2002-2011: Cabinet Office “Annual Report on National Accounts,” FY2012-2013: Projection by Cabinet Office.

2/ Expenditures and financial resources for recovery and reconstruction measures are excluded from the above figures.

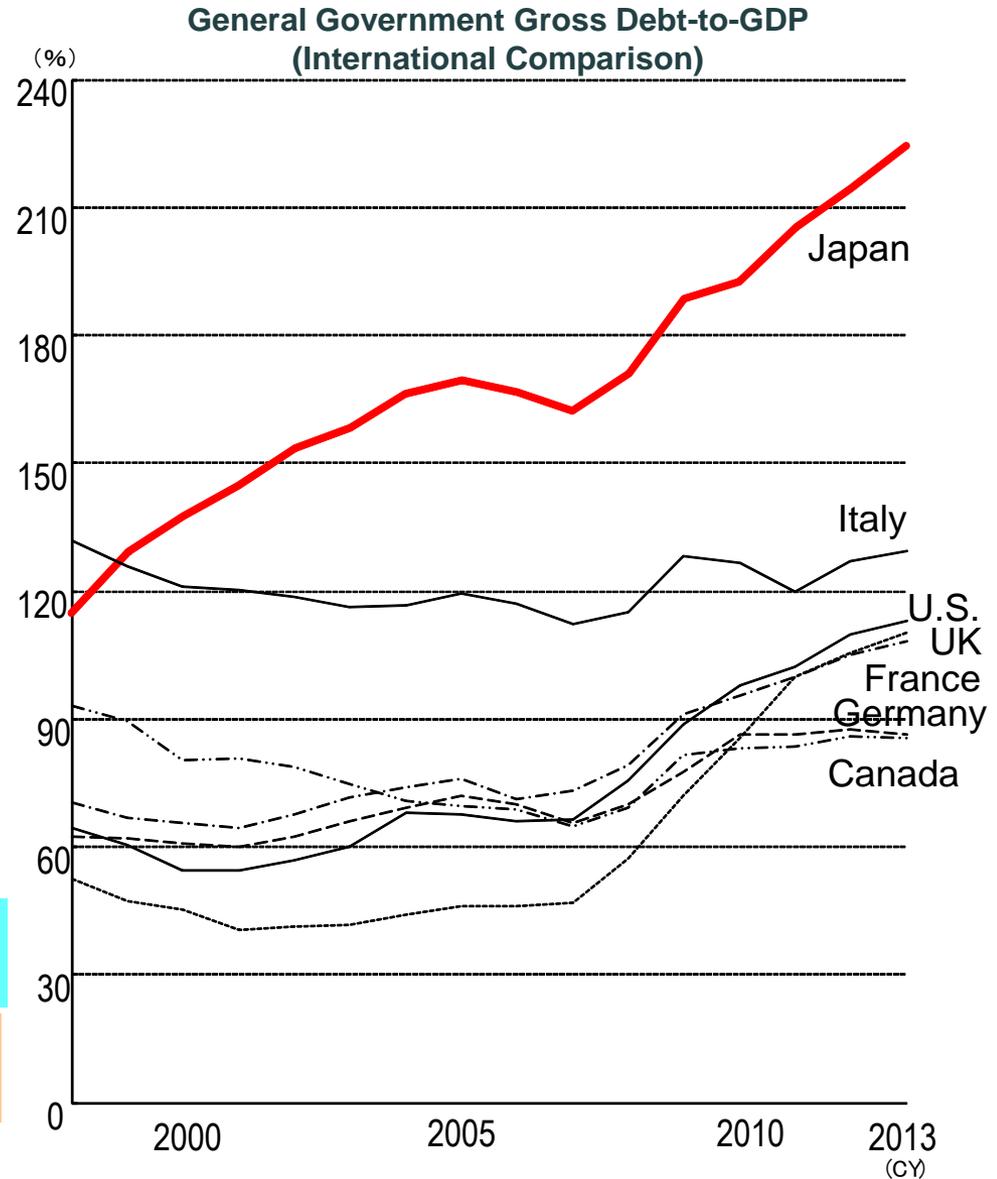
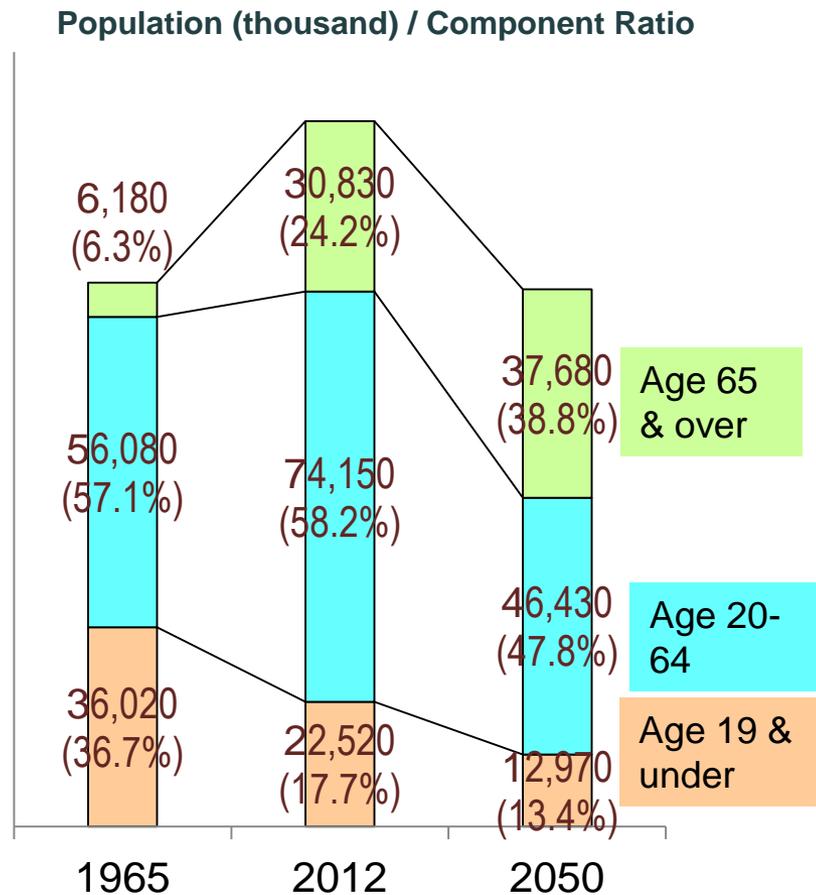
3/ The above primary balance is on SNA basis, assuming most of the FY2012 Supplementary Budget is implemented in FY2013.

Source: Document of Cabinet Office submitted to the 5th Council on Economic and Fiscal Policy (28, Feb, 2013)

Other countries are working on the goals set in the G20 2010 Toronto Summit. Japan also needs to deliver the required adjustments in a timely manner.



The debt level can hinder the potential for growth and the fiscal capability to cope with the aging society.



## Policy Issues for the Meantime:

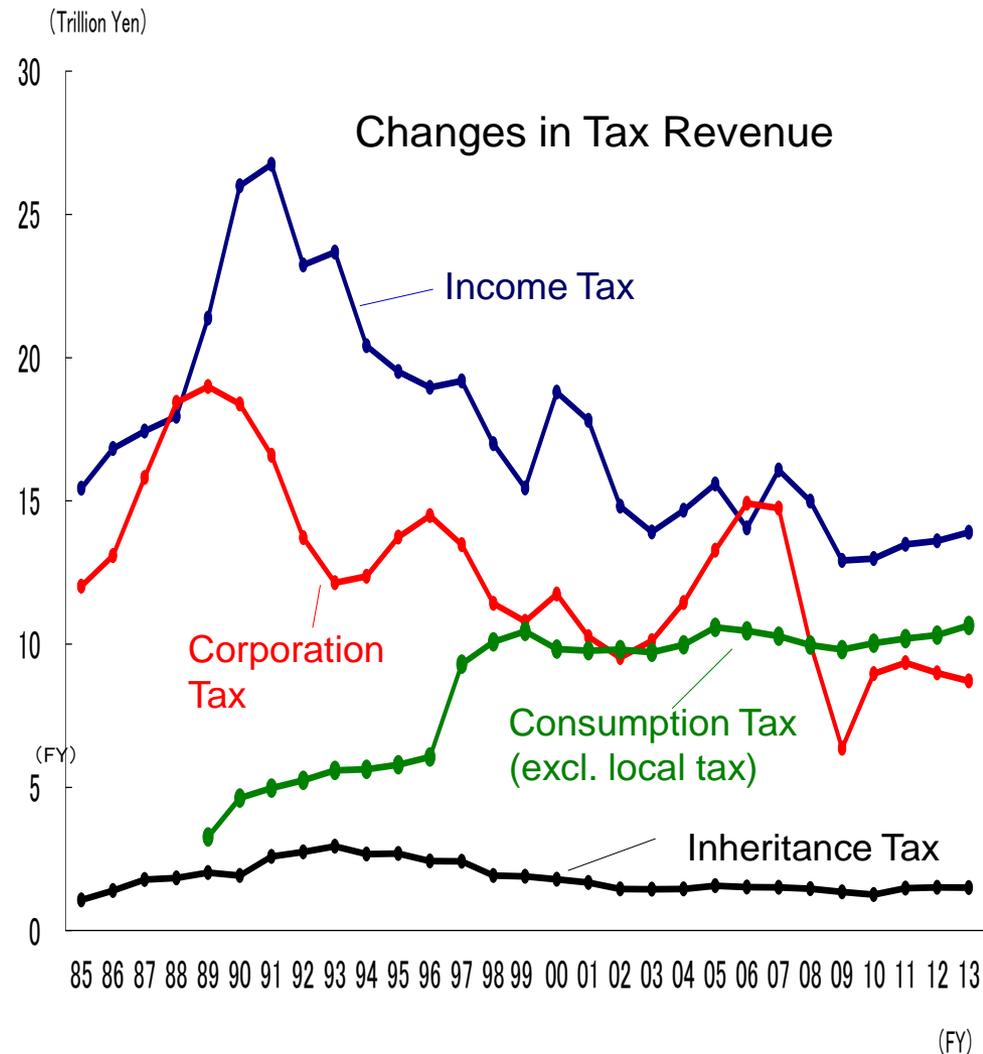
- ▶ The renewed Medium-term Fiscal Consolidation Plan for Current Targets, which will be formulated in mid-2013.
- ▶ The implementation of planned increases of the consumption tax rate

### Reform of Consumption Tax (stipulated in 2012 law)

- Staged increases of the consumption tax rate
  - From April 1<sup>st</sup>, 2014      5% → 8% (national: 6.3%    local: 1.7%)
  - From October 1<sup>st</sup>, 2015    8% → 10% (national: 7.8%    local: 2.2%)
- Revenues from 5% increase will be used to finance social security
  - In the former Noda administration, it was discussed to distribute:*
    - 1% for the enhancement of the social security system
    - 4% to finance the lacking resources of current system (which will contribute to fiscal consolidation)

## Rationale for the Reform on Consumption Tax

- ▶ Two Policy Purposes:
  - Securing stable financial resource for the increasing social security expenditure
  - Achieving fiscal consolidation targets
  
- ▶ Characteristics of Consumption Tax
  - *Stable revenue source* - not easily affected by changes in economic environment or population structure.
  - *Little distortion* on economic activities
  - *Equal burden* - not concentrated on working generation
  - *Large amount of revenue*

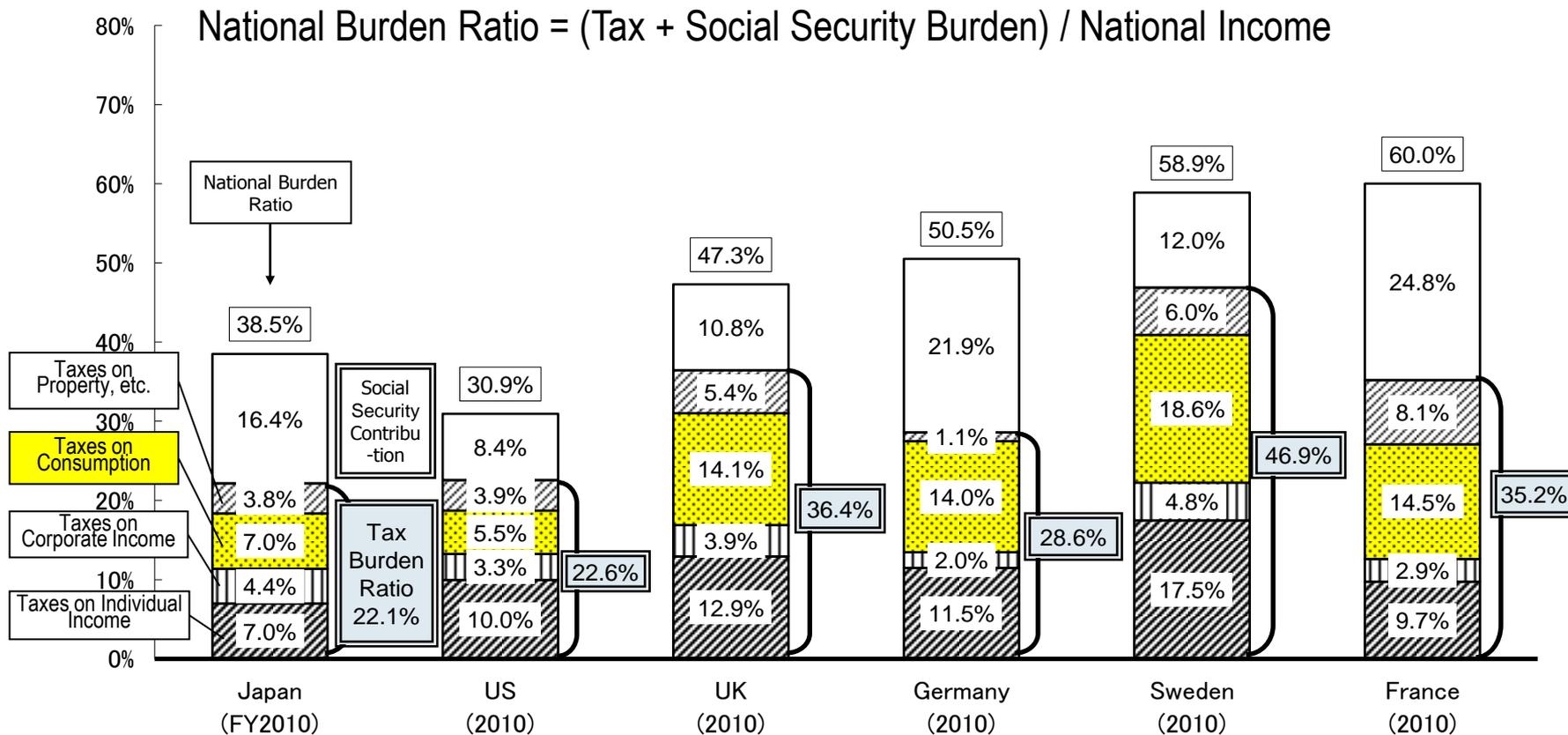


(FY)

For Reference:

## International Comparison of National Burden Ratio

$$\text{National Burden Ratio} = (\text{Tax} + \text{Social Security Burden}) / \text{National Income}$$



[ Percentage of elderly population over 65 ]

[13.1]

[16.6]

[20.4]

[18.2]

[16.8]

Source: Settlement of FY2010 for Japan; OECD "Revenue Statistics 1965-2011" and "National Accounts" for other countries.

## Implementation of Consumption Tax Rate Reform

Governmental actions legally required prior to the scheduled dates of rate hikes:

1. Consideration of the economic situation
  2. Consideration of low-income earners to address distributional effects
    - 1) Two options are legally required for consideration as a **permanent measure**:
      - i. Refundable tax credits
      - ii. Multiple tax rates
    - 2) Simplified benefits will be implemented when the consumption tax rate is raised to 8% as a **provisional and temporary measure** until permanent measures are introduced.
- ※ In order to level the distortionary effect on housing investment, measures including the expansion of the tax credit relating to housing loans have already been introduced in 2013.

## 1. Consideration of the Economic Situation

### Article 18 of the 2012 Law

1. As raising the consumption tax rate would be implemented on the condition of improvement in economic situations, the government shall take comprehensive and necessary measures to overcome deflation and revitalize the economy in order to swiftly bring it to a state of preferable growth, aiming for a 3% increase in nominal and 2% increase in real economic growth on average during FY2011–20.
2. Prior to the scheduled hikes of consumption tax rates stipulated in the law, the government shall check various economic factors, consider economic and other situations comprehensively, and take necessary measures, which may include a suspension of scheduled rate hikes. This procedure will be done in light of economic conditions prior to scheduled rate hikes, and it will require a flexible response to any violent change in the economic and fiscal conditions.

⇒ The decision will be made half a year prior to the scheduled date (fall 2013)

## 2. Consideration for low income earners: Two options for permanent measures

### Refundable Tax Credits

- Comprehensively considered on the premise of **the operation of the Social Security and Tax Number System** (Jan. 2016).
- *Issues:* **Capturing income and property information**  
**Feasibility of implementation, etc.**

### Multiple Tax Rates

- Ruling parties (LDP/Komeito) decided to work with an aim to introduce multiple rates when the tax rate is raised to 10%.
- The following issues will be comprehensively considered, and the final decision will be made by December 2013 with content from parties of interest.
  - Issues:* **Determination of goods and services covered** by reduced rates
  - Necessary budget**
  - Issues regarding administrative burden on SMEs**

*The coming several months are a vital period for Japanese economy.*

*Whether we can:*

- Overcome deflation and put the economy on right track through the three-pronged policy, and;*
- At the same time, address fiscal risks by delivering fiscal consolidation in a timely manner.*

Thank You

*Note: The opinions expressed in this presentation do not necessarily represent the views of the Japanese government.*