A Review of Japanese Sales Taxes with Special Emphasis on the Recently Enacted Consumption Tax

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1. General Background :

The introduction of the sales tax[1], in its modern form, is the most important development in the field of taxation in the 20th century. This kind of tax, confined only to two countries, Mexico and the Philippines, before the outbreak of World War 1, was subsequently adopted by many countries as a temporary measure for solving financial problems created by the war. The Great Depression of the 1930s forced other countries to enact a sales tax in order to combat the deficit produced by the Depression. World War 11 stimulated the further spread of sales taxes in many other countries as the result of exigencies related to financing the war. The sales tax was also adopted by many developing countries in the later half of the 20th century in

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order to generate revenue for financing their enormous developmental activities.[2] Now the sales tax is a major source of government revenue in virtually all countries in the world.

Japan, however, is an exception to this general phenomenon. This country has had almost no experience with a general sales tax. A turnover tax was introduced in September 1948 but it was discontinued after only 15 months. The Shoup Mission[3] recommended a value added tax (VAT) for Japan in 1949 but it was not instituted at that time. Thereafter a VAT was proposed several times in Japan but was never put in operation. Similarly, subsequent efforts to introduce a general sales tax failed. Finally, a 3 per cent consumption tax was adopted on April 1, 1989. That tax, however, severely criticized by many different groups in Japan, now stands at a cross-roads, its continuation threatened.

This paper attempts to trace the development of the Japanese sales tax and to review its present structure.

2. The Turnover Tax:

Japan introduced a turnover type of sales tax, called the *Torihiki-daka-zei*, on September 1, 1948. The tax was levied on the sales of goods at each stage in the process of production and distribution, meaning that the tax was levied on sales by the manufacturer to the wholesaler, the wholesaler to the retailer and the retailer to the consumer. However, small vendors whose monthly gross sales were below 30,000 yen were exempt from the tax. Other exemptions from the tax were exports, sales of staple foods, sales of agricultural, forestry, livestock or marine products by the original producer, sales of

securities, transportation, and certain other less important items. The tax was levied at the extremely low and uniform rate of one per cent. Initially, it was collected primarily by the advance sale of stamps to manufacturers, wholesalers, and retailers who were required to remit the tax. But as this system was opposed by these taxpayers, it was replaced by a system that assessed the turnover tax on the basis of monthly returns submitted by the taxpayers to their tax offices. While in operation, the tax provided about 6 per cent of total central Government revenues.

Even so, the Japanese Government rescinded the tax after only 15 months because, the tax, like all turnover taxes suffered from a number of limitations. Such a tax generates undesirable and unintended effects in the methods of production and distribution and leads to unnecessary increases in the price of taxable goods. The tax sometimes avoids these distortions when the rate of tax is very low, such as one per cent levied by Japan. However, at that tax rate the tax "is not likely to be taken very seriously by either tax administrator or taxpayer ... and thus may decay gradually into a tax that is largely unenforced."[4] But if the rate is raised, the tax leads to distortions. For example, it tends to induce firms to integrate vertically even when other economic considerations do not justify such integration. This integration occurs because integrated firms are able to avoid part of the tax because it is levied on the sales at all stages of production and distribution. Thus, the tax provides an incentive for firms to produce their own materials and parts instead of purchasing them from independent suppliers. Moreover, they then try to sell their products directly to retailers or sometimes even to consumers. The tax puts

those firms which do not want to change their methods of doing business and the small firms which cannot integrate vertically, at a substantial disadvantage.

Furthermore, the turnover tax leads to tax cascading. Under this system the base of the tax at the later stages includes, *inter alia*, tax paid at the earlier stages. Thus the tax is levied on tax. The consequence is that the tax induces a rise in prices that is higher than the amount of the tax. In addition, as discussed elsewhere, tax cascading leads to vertical integration, and makes it difficult to refund the exact amount of the tax levied on exports.

That the turnover tax is not a good tax was clearly perceived by the Shoup Mission which recommended the abolition of the tax. Taxpayers hostile to the tax also argued that it hit too heavily on small vendors who could not shift the tax.[5] It was also believed that turnover tax returns submitted to the tax offices helped the tax authorities in assessing an income tax on the self-assessed businessman, as these returns enabled the tax officials to make guesses as to taxpayer's net income. So, not surprisingly, the taxpayers demanded that the turnover tax be abolished. The tax was repealed in December 1949 without ever being implemented fully.

3. The VAT:

In 1949, the Shoup Mission recommended that Japan adopt a VAT, called the *Fuka-kachi-zei*. It was to be levied at the prefecture level in place of an existing enterprise tax, the *Jigyo-zei*, which taxed business profits.[6]

The base of the VAT was to be the sum of profit, interest, rents

and payroll. The same base could be obtained by deducting from gross receipts the sum of all purchases from other firms including the purchases of capital goods. This tax was similar to the present day consumption type VAT, widely used in the countries of the European Common Market and elsewhere, which excludes from the tax base, *inter alia*, all capital goods purchased from other firms in the year of purchase but makes no allowance for depreciation from the tax base in the subsequent years. However, unlike the credit method[7] being widely used under the present-day consumption type VAT, the Shoup Mission opted for the subtraction method of VAT calculation. Under this method, the value added is deemed the net turnover. It is obtained by subtracting the cost of materials from the proceeds from sales. The negative value added, if any, would be carried forward and offset against value added amounts in succeeding years. Farmers and small enterprises were to be exempt from the VAT. The tax was to be levied at a rate of 4 to 6 per cent.[8]

This tax, the first of its kind, was developed by the Shoup Mission as a way to avoid the undesirable and unintended effects of existing enterprise and turnover taxes.[9] The VAT contained features of both an enterprise tax and a turnover tax. Like the enterprise tax, it was to be levied by the prefectures on the business within their area of jurisdiction. However, the burden of VAT, like the burden of the turnover tax, was supposed to be borne by the final consumers.

The VAT held promise of being superior to the enterprise tax in more ways than one: the base of VAT was broad, it did not discriminate against capital intensive techniques in favor of labor intensive techniques and it simplified tax administration because there

was no need to keep accounts of inventory or to compute depreciation.

Similarly, the VAT might well have proved better than turnover tax on several grounds. For example, because the VAT was levied only on the value added at each stage in the process of production and distribution, tax liability remained the same regardless of the system of production and distribution, meaning that it did not encourage firms to integrate forward or backward. For the same reason, VAT avoided the problem of cascading and made it possible to refund the exact amount of tax levied on exports.

The VAT, however, was subjected to bitter criticism from various groups in Japan who did not care to consider its basic principles. Because the tax was completely new, not only in Japan but in the whole world, the Japanese found it difficult to evaluate. This led to general confusion about the potential benefits of the tax. Labor groups not only complained about the regressive nature of the tax, but also charged that the tax would result in increased mechanization and a consequent decline in employment, because payrolls represented a major element in the base of the tax.[10] Business groups thought that it would be difficult to pass on VAT to consumers.[11] As the tax was opposed strongly by various groups, the introduction of the tax was postponed several times and finally, in 1954, the Japanese decided not to implement a VAT.[12]

4. The Consumption Tax:

a) **Introduction**:- The idea of introducing a general sales tax was suggested again in the later half of the 1970s in order to raise the financial resources required to fund the increasing public expenditures.

The Tax Commission, a permanent advisory body to the Cabinet, recommended the introduction of a general consumption tax in 1977, and made public a detailed draft proposal for such a tax in 1978. Preparations for introducing this tax were scheduled to begin in 1979, and the tax was to be introduced in 1980.[13] However, the proposal was not implemented because of strong public resistance.

After that the Tax Commission proposed several variations of this tax. Finally, the Diet approved a general sales tax, under the name of "consumption tax" (*Shohi-zei*), on December 24, 1988. It began on April 1, 1989. As a result the lead-in time from the decision to adopt the tax to its introduction was rather short specially when compared to similar events in other countries.[14] For that reason, the National Tax Administration in Japan was asked to enforce the tax less strictly during the first half of Fiscal 1989.[15]

The consumption tax is now a part of the national tax system. It has replaced five national commodity taxes : a commodity tax, a playing-card tax, a sugar excise tax, an admission tax and a travel tax.[16] Taxes on liquor and tobacco products were also adjusted when the consumption tax was introduced.[17] Similarly, a stamp tax, a securities transaction tax, a bourse tax and a petroleum tax were all amended slightly.[18] In addition, three local taxes : the electricity tax, the gas tax and the timber tax[19] were abolished. As a result, one-fifth of the revenue from this consumption tax is allocated to local Governments in the form of a consumption transfer tax, which is divided among prefectures and municipalities on the basis of a defined formula.[20] Other commodity taxes based on petroleum products : a gasoline tax, a liquefied petroleum gas tax, an aviation fuel tax and a petroleum tax,

are levied together with the consumption tax.

b) **Coverage** :- The consumption tax is levied on domestic sales and leases or on the rental of goods (properties) and the supply of services, and on imported goods. It is applied to almost all consumer goods and services including such essential goods of daily life as foodstuffs. A very few items including certain medical and welfare services, selected tuition fees, specified securities and stamps, the sale of land, and exported goods are exempt from the tax. It should be noted here that many countries, including the countries of the European Common Market, exempt several items from VATs on the grounds of equity, difficulty of administration, the promotion of tourism and so on, with the result that the coverage of the Japanese consumption tax is broader than the VATs in many other countries. So broad a coverage of the consumption tax resulted, *inter alia,* from the intention of making tax system simple. As a consequence, taxpayers do not have to keep separate records of taxed and untaxed items, and the tax administration does not have to check it ; nor does it, have to be involved in distinguishing between taxed and tax-exempt items.

Such a broad coverage is desirable from other several points of view too. It prevents taxpayers from classifying taxable goods as tax-exempt goods, and thus controls this kind of tax evasion. It also makes it difficult for influential persons to pressure the tax authorities to exempt their goods from the tax, which would be likely to happen under a tax system that grants numerous exemptions. Furthermore, the wider coverage allows the tax administrators to generate required revenue by instituting a relatively low tax rate. Moreover, because such

a broad tax system has only a minimum effects on decisions of producers and consumers, it causes only the most minimal distortions in the economy.

This broad-based consumption tax, however, is regressive in nature since, under this tax, lower income groups have to pay a relatively higher percentage of their income in taxes than do higher income groups. For this reason, many countries exempt essential goods from the tax to promote equity. This occurs because essential goods make up a large portion of the income of the poor *vis a vis* the rich. Thus, to exempt such items shelters a larger percentage of the income of the lower income groups from the tax net. Even so, the general consensus in tax literature is to avoid introducing exemptions as a way of injecting progressivity into the tax system because some rich persons might well spend a relatively large part of their income on necessities, while the reverse might well be true for many poorer individuals. As a result, economists have generally proposed other measures, such as a social security system, income and property taxes etc. as means for achieving equity. For example, Canada has adopted a refundable sales tax credit system under which a credit is given via the income tax system.[21)]

Another criticism of the consumption tax relates to the treatment of small enterprises. An enterprise whose taxable revenue is less than 30 million yen (US$ 200,000) for the base period[22)] is exempt from the tax even though it may elect to be a taxable enterprise when a refund is due. Such an exemption of small enterprises from the sales tax is common practice in many other countries as well, and in most cases, the reason is ease of administration. For example, in New Zealand, a small

enterprise whose annual turnover is below N$ 24,000 (US$ 14,600) is exempt from sales tax. In the Philippines, the turnover must be below P. 200,000 (US$ 9,500) and in Denmark below Dkr. 10,000 (US$ 1,400). While to have set the threshold slightly higher than do other countries may be justified by the unfamiliarity of the Japanese taxpayers to such a broad based sales tax, the existing limit is too high. To have done so is not desirable for several reasons. It eliminates a large part of total tax base leading either to a substantial loss of revenue or else to the need to raise the tax rate.

Furthermore, it leads to inequities between taxed and tax exempt enterprises because the former pay taxes on their sales, and receive remittances of taxes paid on purchases, while the latter cannot claim tax refunds on their purchases because they do not pay tax on their sales, with the result that the value they add to their products is free from the consumption tax. Moreover, it would appear that "early assessments of the implementation of the tax suggest that a large number of exempt enterprises are ... increasing their prices to match competitors who are liable".[23] Thus a part of the tax paid by the consumers goes into the pockets of private businessmen instead of the public exchequer. Another unintended problem with exempting small business at so high a threshold encourages larger enterprises to divide themselves into smaller units, thus escaping tax liability. This large ceiling seems also to lead to tax cascading. For example, let us suppose that there are three enterprises; M, W and R. M sells to W and W to R. Because M generates over 30 million yen his sales are taxed, and he adds the tax to his sale. But because W's annual turnover is below 30 million, he is exempt from the consumption tax,

though he includes in his selling price the tax passed on to him by M. But R, who buys from W, who is obliged to pay the higher price resulting from the pass through of M's tax, cannot reclaim the amount of M's tax because W is a tax exempt enterprise. Hence R has to pay tax on his tax inclusive price, resulting in some element of cascading.

c) **Rate**:- The consumption tax in Japan is levied at a rate of 3 per cent on all items, except passenger cars, which are subject to a rate of 6 per cent during the first three transitional years of taxation. The uniform rate is levied in order to simplify the tax system by avoiding the necessity to classify goods into different categories and to prepare a lengthy tax schedule. A single rate also means that tax collectors as well as taxpayers do not have to spend time matching every item to the appropriate rate. Also taxpayers are not obliged to maintain separate records for each item they deal with nor does the tax administration have to check such records. In this way, the tax administration is spared the undue pressures that otherwise would be applied by influential taxpayers seeking the application of lower rates to their products. In addition, the single rate avoids distortions generated by consumers choosing among alternative on the basis of tax induced prices since there is no incentive for consumers to prefer one commodity over another as a response to the tax. Finally, the low rate makes tax evasion less attractive, or even possible, while making the tax system more simple and efficient.[24)]

Even so, the tax rate, perhaps the lowest in the world, is unrealistically low. The rate of VAT in other neighboring countries such as, Indonesia, South Korea and Taiwan is 10, 10, and 5 precent respectiv-

ely and is yet higher in other countries including the countries of the European Common Market.[25] But low as the rate is, the consumption tax in Japan replaced taxes whose rates were much higher than 3 per cent. For example, both travel and admission taxes were levied at a rate of 10 per cent, and the commodity tax rates ranged from 5 to 30 per cent. Even Tait has observed that "for most countries, a VAT is probably not worth introducing at less than 10 per cent"[26], an increase in the rate to 10 per cent may not be acceptable in Japan politically. Therefore, if the rate is to be raised to 10 per cent, it is likely to be increased gradually after the tax has been enforced for several years.

d) **Computation**:- The consumption tax base for domestic transactions is the amount of the sales of taxable items. In the case of imports, the tax base equals sum of the import value determined for the purpose of customs duties plus the amount of customs duties and other taxes, if any.

The tax levied on taxable purchases or imports is deducted from the total consumption tax levied on sales. If the amount of taxable sales of a taxpayer exceeds 95 per cent of the total sales during a tax period, the taxpayer is allowed to deduct from the consumption tax on sales all the consumption tax paid on purchases. However, if the amount of taxable sales is less than 95 per cent of total sales "the amounts deductible as tax credit on taxable purchases ... [is] calculated by either of the itemized method or proportional method".[27]

Calculations to determine tax under the itemized method require that the total tax on purchases be divided into (a) tax attributable to taxable sales, (b) tax attributable to other sales and (c) taxes common

to both taxable and other sales. Then, the amount of tax credit becomes the sum of the tax attributable to taxable sales and the taxes common to both taxable and other sales multiplied by the proportion of taxable sales to total sales. The proportional method calculates the deductible consumption tax by multiplying the tax on taxable purchases by the percentage of taxable sales to total sales. Once the proportional method is selected, the taxpayer is required to use it for at least two consecutive years.

A simplified method has been designed for small and medium sized enterprises whose annual taxable sales is 500 million yen or less. Under this system, 80 per cent of taxable sales are deemed taxable purchases for retailers and 90 per cent for wholesalers. Once this method is adopted, it must be continued at least for two years. Of a total of approximately 2.1 million taxpayers, 1.5 million opted for the simplified method by the end of May 1990.[28]

Marginal deductions are granted to small enterprises whose annual sales are above the 30 million yen but less than 60 million yen. In such cases tax liability is calculated by applying the following formula :

$$\text{Tax Payable} = \text{Tax Otherwise Payable} \times \frac{\text{Taxable Sales} - 30 \text{ million yen}}{30 \text{ million yen}}$$

The tax liability is computed from the records in the account books of the taxpayers maintained for the purpose of determining individual income or corporate income taxes. Although the tax is levied on the total value of sales, taxpayers are permitted to deduct from their gross tax liabilty, taxes paid on their purchases, including capital goods. Such a tax credit system avoids multiple taxation ; thus it avoids both the problem of integration and cascading.

The Japanese consumption tax is similar to the consumption type VAT employing the tax credit method. However, unlike the consumption type VAT, the Japanese consumption tax does not make the use of invoices mandatory which leads to several problems. Without tax invoices, the Japanese version of the VAT does not possess a self-policing feature.[29] Since taxpayers are not required to state the amount of tax on an invoice, they might well decide to raise their prices more than the consumption tax on their goods. Furthermore, in the absence of tax invoices, it will be difficult for the tax authorities to trace whether all the tax collected by the taxpayers from their customers has actually been deposited in the public exchequer. And also, because the tax is not stated on invoices, it will be difficult to refund the exact amount of tax levied on exports.

e) **Taxable period, return and payment** :- In general, the taxable period for an enterprise that is not incorporated is the calender year. Corporate business use the business year. It is possible to shorten the tax period for business enterprises primarily engaged in export transactions by taking into account the interest payment burden on consumption tax payments and also those businesses who are regular recipients of consumption tax refund.[30]

Taxpayers are required to file an interim return for the first six months of the tax period within two months of the expiration of the six months period and an annual return within two months of the day after the end of the taxable period stating, *inter alia*, tax on sales, tax on purchases and the net tax liabilty.[31]

Taxpayers are also generally required to pay half of the consumption taxes reported on the final tax return for the previous tax period within

two months of the day following the last day of the six months after the first date of the taxable period and to pay the remainder of the tax due within two months of the day following the last day of the tax period.[32]

About 2 million taxpayers (1.3 million corporations and 0.7 million individual businesses) filed consumption tax returns for 1989 when the tax produced 4,087,400 million yen.[33]

The standard taxable period is somewhat longer than is common in many countries. For example, the taxable period is one month in Belgium, Indonesia and Taiwan ; two months in New Zealand ; and three months in Denmark. The tax period was previously only about one month for the taxes that the consumption tax replaced. As I have written elsewhere, a long tax payment period like the six months period that characterizes the Japanese consumption tax "benefits taxpayers since they have to prepare fewer returns leading to lower compliance costs. Besides, they can hold tax revenue collected from their buyers for a longer period. Under such a system, however, the payment of tax to the Treasury is not only delayed but sometimes the government may even have to lose some revenue. This is because the longer the period of payment, the larger the amounts of revenue which taxpayers hold. Larger amounts tempt the vendor to undertake some undesirable activities such as fraud. Sometimes vendors may even disappear from the business leading to a considerable loss in revenue."[34] As these factors begin to manifest themselves in the Japanese system, it is probable that the tax authorities will find it necessary to introduce a shorter return and payment period, perhaps quarterly.

5. Concluding Remarks :

The introduction of the sales tax, in its modern form, is the most important development in the field of taxation in the 20th century and there has been a growing tendency to adopt a VAT type of sales tax worldwide since 1970s. The VAT, which was first recommended by the Shoup Mission for Japan in 1949 but not actually employed by any government until France introduced such a tax in 1954. Since then the tax has slowly become commonplace. By the end of the 1960s eight countries were using it. After that it was adopted by at least one country each year, except in 1974, 1979, and 1981. By 1990 it had come to be employed by more than 50 countries. The tax is now under consideration in many other countries.

Japan joined VAT movement in 1989 by adopting its consumption tax. As in other countries, the Japanese consumption tax is levied on the basis of the principle of destination, which means that exports are relieved from taxation while imports are taxed. It is a consumption type VAT employing the tax credit method of calculating tax. As this tax extends right through the retail level and covers almost all commodities including foodstuffs, the coverage is very wide. Levied at a uniform rate of 3 per cent, this broad-based, uniform rate tax is attractive particularly from the points of view of neutrality and simplicity, but is subject to criticism on equity ground. It is true that the tax is regressive in its present form, but the introduction of exemptions and differential rates on account of equity would make the tax system more complex and costly without producing any corresponding increase in equity.

Several aspects of the tax system are intended to make it as simple as possible. These include broad coverage, a uniform tax rate, a threshold of 30 million yen taxable sales before registration is required, a simplified tax system for small and medium sized enterprises whose annual taxable sales are 500 million or less and a long taxable period. As the latter figures are, however, much more higher than the corresponding figures generally characterizing VAT tax systems, the Japanese consumption tax suffers a considerable loss in revenue, compared to others.

The Japanese consumption tax also deviates considerably from standard VAT systems by not mandating uniform tax invoices. Instead, taxpayers are required to keep account books in order to calculate the tax liability. In the absence of tax invoices, this tax not only looses the self-policing feature of a normal VAT, but also makes it difficult to trace the exact amount of tax paid in earlier stage (s), thereby leading to some element of cascading.

To sum up. While the broad coverage and uniform rate of the consumption tax have been designed carefully, it will likely need to be revised drastically in order to reduce distortions and become more productive. Pressures to revise the tax will surely be generated as the need for financial resources grows in Japan in the years to come in response to "the ageing of members of society; ... the increase of Japan's responsibilities in the international community, ... the necessity of increased spending on social infrastructure; and ... the continued growth of interest payments on public debt."[35] This means that there will soon be a need to develop a broad-based and stable source of tax revenue. In that context, alterations of the consumption tax by the

Japanese Government rather than an escalation of income tax rates is probable because of the way tax systems are evolving. Although there has been a trend in the developed world since the eighteenth century to generate more revenue from direct taxes with the development of the principle of ability to pay tax, the negative effects of heavy income taxes have led to a shift from the income tax to the commodity tax in European Common Market countries and elsewhere in the recent years. To keep pace with this international trend, to achieve an ideal tax mix, and to rationalize the commodity tax system, it soon will be necessary for the Japanese Goverment to amend the consumption tax drastically. What seems most likely will be a rise in the consumption tax rate, lowering of the threshold size, a revision of the simplified system prescribed for small and medium sized enterprises, the introduction of a quarterly tax return and payment period, and the use of uniform tax invoices, if the Japanese Government is to make the consumption tax a major source of revenue and thus obtain the genuine advantages that the VAT is now bringing to all parts of the world.

Footnotes :

1) Sales tax is a commodity based tax which is levied on sales of generally a wide range of goods and services. The tax may apply to the sales of any one or more stages in the process of production and distribution. If the tax is levied on sale value at all stages of production and distribution, it is known as a turnover tax. On the other hand, a sales tax levied on sales of only one stage of production and distribution, it is known as a single stage tax. It may be levied at the manufacturers' level, or at the wholesalers' level or at the retailers' level and the tax is known as manufacturers' tax, wholesale tax and

retail tax accordingly. When the tax is levied only on value added at each stage in the process of production and distribution, it is known as a value added tax. Like the turnover tax, the value added tax is a multi-stage levy but unlike the former which is levied on total sale value at all stages, the latter is levied only on value added at each stage.

2) France (1914), Germany (1916), Italy (1919), Czechoslovakia (1919), Canada (1920), Belgium (1921), Hungary (1921), Rumania (1921), Union of Soviet Socialist Republic (1921), Yugoslavia (1921), Brazil (1922), Cuba (1922), Luxembourg (1922), Austria (1923), Bolivia (1923), Poland (1923), Ecuador (1925), Turkey (1925), and Uruguay (1928) introduced sales tax during the period of World War 1 to the biginning of the Great Depression of the 1930s; Australia (1930), The Argentine Republic (1931), China (commodity tax, 1931), The Netherlands (1933), New Zealand (1933), Norway (1935), and many American States adopted this tax during the period of the Great Depression of the 1930s; the United Kingdom (purchase tax, 1940), Finland (1941), Switzerland (1941), Sweden (1942) and Chile (1943) entered the sales tax field during the period of World War 11 while the tax spread mainly over developing countries after World War 11.

3) A tax mission headed by Professor Carl S. Shoup of Columbia University designed a comprehensive tax feform plan for the reconstruction of the Japanese economy in 1949.

4) *Report on Japanese Taxation by the Shoup Mission,* Vol. 11. SCAP, Tokyo, 1949, pp. 167-68.

5) *Outline of Japanese Tax 1961,* Okura Zaimu Kyokai, Ministry of Finance, 1961, p. 5.

6) An enterprise tax has had been levied by prefecture governments on the profits of enterprises under their area of jurisdiction. In 1949, the standard rate of this tax was 15 per cent and revenue was shared equally with municipalities. It has had been levied together with a national income tax and a prefecture-municipal inhabitant's tax. In 1949, the combined marginal rate of these three taxes was nearly 70 per cent even on enterprises of a modest income. Such a high tax burden was likely to discourage investment. See *Report on Japanese*

Taxation by the Shoup Mission, op. cit. p. 200.

7) Under the tax credit method, tax is levied on the total sale value but taxpayers are allowed to deduct from the tax on sales the tax paid on purchases.

8) The VAT Law, known as the Local Tax Law of 1950, was enacted by the Japanese Diet in August 1950. Its main features were the subtraction method of calculating the tax, standard rates of 3 per cent for professions and 4 per cent for businesses, the exemption of small enterprises with less than 90,000 yen value-added a year and the requirement that two or three returns be filed each year with year-end adjustments. For details, see M. Bronfenbrenner, "The Japanese Value-Added Sales Tax", *National Tax Journal,* Vol. 111, No. 4, 1950, pp. 306-10.

9) The Shoup Mission rejected a retail sales tax because it would be difficult to implement in view of the large percentage of business done by the small retailers, who were not in a position to keep adequate records for the purpose of this tax. Nor did the Mission opt for a manufacturing level sales tax because of its inherent limitations.

10) John F. Due, *Sales Taxation,* University of Illinois Press, Urbana, 1957, p. 142.

11) M. Bronfenbrenner, *op. cit.*, p. 310.

12) John. F. Due, *op. cit.*, p. 143.

13) *An Outline of Japanese Taxes 1979,* Printing Bureau, Ministry of Finance, 1979, pp. 239-40.

14) "[A] realistic ... lead-in time of no less than two years is essential, if the experiences of several countries ... are any indication. The lead-in period offers an opportunity to reform tax paying and tax collection procedures simultaneously with several reforms." Malcolm Gillis, Carl Shoup and Gerardo P. Sicat, *Lessons from Value Added Taxation For Developing Countries,* World Bank Discussion Paper, 1987, p. 18.

15) Hiromitsu Ishi, *The Japanese Tax System,* Clarendon Press, Oxford, 1989, p. 311.

16) Of these taxes, the admission tax was levied on all entrance fees charged for admission to any place of entertainment such as cinemas, theatres, opera, stadium etc. at the rate of 10 per cent and collected

through the sponsors of performances.

The commodity tax was levied on a number of selected commodities and collected from manufacturers, sellers, or recipients of goods from bonded areas. The tax was levied on retailer's selling price and collected from retailers in the case of precious stones, pearls, gold, tortoise-shell, fur products, carpet etc. while it was levied on manufacturer's selling price (price at receipt on imported goods) and collected from manufacturers or recipients of goods from bonded areas in the case of other goods such as automobiles, electric appliances, television sets, musical instruments, photographic or cinematographic apparatus, films, furniture, watches, cosmetic and soft drinks.

The playing-card tax was imposed on playing-cards including mahjongg sets shipped from factories or withdrawn from bonded areas. It was levied at a graduated specific rate structure and collected from manufacturers of playing-cards or recipients of playing-cards from bonded areas.

The sugar excise tax was imposed on sugar, molasses and liquid sugar shipped from factories or withdrawn from bonded areas. It was levied at a graduated specific rate structure and collected from manufacturers in the case of domestic products and from recipients from bonded areas in the case of imports.

The travel tax was levied on fares, fees or charges of trains, buses, steamships and air craft (other than ordinary class) at the rate of 10 per cent and collected through the operators of transportation. For details, see *An Outline of Japanese Taxes, 1988,* Printing Bureau, Ministry of Finance, 1988, Chapters 5, 10, 15, 16 and 19.

17) The existing specific and *ad-valorem* rates of liquor tax were expressed purely on specfic basis. These rates were lowered and the grading system for *sake* and whiskey was abolished.

The tobacco excise tax was renamed as tobacco tax ; its rates were lowered and fixed purely on a specific basis. For details, see *An Outline of Japanese Taxes 1988* and *1989,* Printing Bureau, Ministry of Finance, 1988 and 1989, Chapters 8 and 9.

18) *An Outline of Japanese Taxes, 1989, op. cit.,* p. 292.

19) Electricity and gas taxes were levied on charges of electricity and gas

at the rate of 5 and 2 per cent respectively, and collected through the providers of these services. The timber delivery tax was levied on the first purchase of timber after logging and was collected through the owner of the standing timber. For details, see *An Outline of Japanese Taxes, 1988, op. cit.*, pp. 217-18.

20) In addition, 24 per cent of the balance of the consumption tax is provided to local governments for revenue-sharing grants. See *An Outline of Japanese Taxes, 1989, op. cit.*, p. 293.

21) Organization for Economic Co-operation and Development, *Taxing Consumption*, OECD, Paris, 1988, p. 140.

22) The base period is the year two years prior to the current year in the case of individual taxpayers and the fiscal year two fiscal years prior to the current fiscal year in the case of corporate taxpayers.

23) Koji Ishimura, "Introducing The New Japanese National Consumption Tax" in *Japan-National Consumption Tax Law*, CCH International, 1989, p. xxv.

24) The uniform tax rate, however, has been criticized on equity ground since it falls on all items equally irrespective of their nature. Generally, luxuries attract higher proportion of the income of higher income groups and necessities of the lower income groups. That is why the luxuries are generally taxed at a higher rate than the necessities. However, such a differential rate structure is not considered an appropriate way of achieving progressivity since it makes the tax system more complex and costly without producing any corresponding increase in equity.

25) See Alan A. Tait, *Value Added Tax International Practice and Problems*, International Monetary Fund, Washington, D. C., 1988.

26) *Ibid.*, p. 39.

27) *An Outline of Japanese Taxes, 1989, op cit.*, p. 156.

28) National Tax Administration, Ministry of Finance, Tokyo.

29) Under the VAT system, "there is a measure of self-polishing in that (except at the retail stage) evasion by suppliers through understating tax collected is counteracted by the purchasers' interest in ensuring that all tax paid is recorded. Similarly, evasion by purchasers in overstating tax paid runs counter to the interests of suppliers." Henry

J. Aaron (ed.), *The Value Added Tax: Lessons from Europe,* Brookings Institutions, Washington, DC, 1981, PP. 3-4. However, such a self-policing feature does not exist under the Japanese consumption tax due to the absence of tax invoices.

30) *An Outline Of Japanese Taxes 1989, op. cit.*, p. 163.

31) Yuji Gomi, *Guide to Japanese Taxes, 1989-90,* Zaikei Shoho, Sha, Tokyo, 1989, pp. 314-15.

32) *An Outline of Japanese Taxes 1989,* pp. 163-64.

33) National tax Administration, Ministry of Finance, Tokyo.

34) Rup Bahadur Khadka, *VAT In Asia And The Pacific Region,* International Bureau of Fiscal Documentation, Amsterdam, 1989, p. 65.

35) Hiromitsu Ishi, *op. cit.*, p. 285.