THE TAX MISSION TO JAPAN, 1949-1950

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Carl S. Shoup

I. Genesis of the Tax Reform

In mid-1947 General Douglas MacArthur and Harold Moss were discussing taxation, in the General's Tokyo office. MacArthur was Supreme Commander of the Allied Powers (SCAP), in charge of the Occupation Forces in Japan. Moss, an official in the Internal Revenue Service of the United States, was en route to Korea to serve as Budget and Tax Advisor to the Korean Interim Government. The two had known each other for some ten years, since the days when they were in the Philippines.

MacArthur was clearly worried about the condition of the tax system in Japan. The Occupation had now been in force for nearly two years, yet imposition and collection of taxes was still on a largely arbitrary basis. The Occupation military were still assuming responsibility for getting tax revenue to the Treasury. A U.S. officer would tell a Japanese district collector of taxes how much he was expected to bring in, no matter what methods he found it necessary to use.

MacArthur told Moss that his reading of history showed that the collapse of nations was due often, if not always, to the mounting ineffectiveness of their tax systems. Japan, although then in a state of near ruin, could in a few decades become one of the world's great democratic powers if the necessary steps were taken, including the creation and operation of a sound tax system. Moreover, if Japan were to become democratic - one of the General's most intensely held aims - local government would have to be strengthened. To this end, prefectures and cities would have to be granted more financial independence, which implied stronger taxing powers of their own.

Moss went on to Korea, but three months later word came from MacArthur calling him to Tokyo. The General had clearly decided to proceed with fundamental tax reform in Japan. Moss was given charge of the Internal Revenue Branch of the Finance Division of General Headquarters of SCAP. A few weeks later the Branch was made a Division, placing it on the same level as the Finance Division, in the Economic and Scientific Section of GHQ.

In the ensuing months, well into 1948, Moss succeeded in getting tax collection methods on a sounder basis, but the structure of the tax system badly needed repair, indeed, an overhauling. Moss suggested that some one versed in tax policy, as distinct from tax administration, be brought from the United States, preferably with a group of colleagues who would form a tax mission. MacArthur agreed, and in the fall of 1948 Moss went to the United States to find a director for such a mission.

II. Initiation of the Project

In October, 1948, Moss called at my office in the School of Business of Columbia University in New York City to explore the possibility of my

forming and directing a tax reform mission to Japan. The following terms were quickly agreed on, and I accepted the invitation. The mission would come to Japan in the summer of 1949, and complete its work by the fall. An earlier date, though preferred by General MacArthur, would be impracticable, since the potential members of the mission that I had in mind were committed to their academic assignments for the next six months. The members would be chosen by me, subject to the usual clearance requirements (no difficulty at all developed on that score). The report would be published by SCAP, both in English and Japanese. There would of course be no censorship or other dictation of the contents of the report from anyone. Moss agreed to devote virtually full time (it came to overtime) on the logistics of the enterprise, the entrees to SCAP and Japanese officials and others, and similar matters. There was no need for me to draw up a budget and estimate a total cost of the project, since we would be assimilated into the military, with similar pay, and transportation and hotel accommodations would be provided, as well as secretarial assistance and the like (contrast, in these respects, the Venezuelan and Liberian missions described elsewhere). The mission would consist of six persons besides myself.
Fortunately, I obtained an affirmative answer from each of the six individuals whom I approached as first choices. They were:

Howard R. Bowen, Dean of the College of Commerce and Business Administration, University of Illinois

Jerome B. Cohen, Professor of Economics, College of the City of New York

Rolland F. Hatfield, Director of Tax Research, Department of Taxation, State of Minnesota

Stanley S. Surrey, Professor, School of Jurisprudence, University of California at Berkeley

William S. Vickrey, Professor of Economics, Columbia University

William C. Warren, Professor of Law, School of Law, Columbia University

Although the members of the Tax Mission did not all arrive in and depart from Japan at the same dates, they were together, in the old Imperial Hotel, for the greater part of the summer of 1949. From the hotel, each day, the members would go out on their agreed-upon assignments, and, reuniting at the hotel dining table for lunch or dinner, would compare notes and develop discussions that would sometimes last late into the evening. Social distraction was at a minimum, since spouses had not been permitted to come to Japan, owing to pressure on accommodations, food, and transport. In August, we repaired to a mountain resort hotel away from the heat of Tokyo to draft the report, which was finished by the end of August, and appeared a few weeks later in four volumes, with facing pages in English and Japanese (Shoup, 1949).

In 1950, August and September, four members of the Tax Mission made a second trip to Japan (Shoup, Surrey, Vickrey, Warren), described below (Shoup, 1950).

General MacArthur discussed with me, shortly after my arrival in Tokyo, the program of the Mission, but made no concrete suggestions except to request that the report not make a "guinea pig" of Japan, by recommending many hitherto untried taxation measures. He received the Mission members at luncheon, and again, in July, in his office, and had another discussion with me just before my departure at the end of the study. The impression he gave was that he wanted to facilitate the Mission's work in every way feasible, but would not discuss specific recommendations and the like before the report was written - the report would be entirely our responsibility. In the event, General MacArthur accepted the report _in toto_ and recommended to the prime minister that it be accepted and implemented without change, as a package.

The facilities afforded the Mission were excellent. Several of the younger Japanese officials in the Finance Ministry were assigned as interpreters, and their high level of general capability, plus an excellent command of English, and knowledge of the Japanese fiscal system, made them invaluable colleagues. In later years these men went on to high positions: for example, one became finance minister and another, president of one of the large banks. Whatever success the Mission had was due in considerable part to the contributions of these talented colleagues.

In other respects, too, the Mission was well served. Adequate secretarial assistance was provided. Automobiles, chauffeured by skilled drivers, were available, and used for several trips through the countryside and to other cities. A private railway car, to be attached to scheduled trains, and on one occasion, indeed, with its own locomotive - facilitated rail travel. All of these arrangements were made by or through the good offices of Harold Moss; this left the Mission members free to concentrate on their task. These circumstances need emphasis, for without this excellent logistical aid much of the Mission's time and energy would have been diverted from its main purpose.

The Tax Mission was the last of the several groups or individuals that had been called to Japan by SCAP to suggest or formulate reforms in the Japanese government and even social structure (for brief descriptions of these reforms, see Perry, _Passim_). The Dodge Mission, in 1948-49, was instrumental in checking the post-war inflation: wholesale prices, which had risen from an index of 100 in 1934-36 to 350 in 1945, had leaped to 20,876 in 1949 (Perry, 111).[1] But they had stabilized by the time the Tax Mission had arrived, and showed promise of remaining so. Thus

[1]. For a summary of the post-war inflation in Japan, see Shoup, "Tax Reform in Japan," 1950, pp. 4-5.

another diversion of the Mission's energies was prevented: its recommendations did not have to include elaborate measures to adapt the tax system to an inflationary environment.

Before considering the Mission's Report, let us look briefly at the tax system then in force in Japan. It was essentially a modern one, in structure. The following extract from Aoki (1985 (p. 435)) sketches the development of the Japanese tax system up to 1949:

"When Japan emerged as a modern state after the Meiji Restoration of 1868, the land tax accounted for more than 80% of the total tax revenue of the national Government. With the advent of the capitalist economy, in 1887 Japan became one of the first states to initiate a national income tax. Under the schedular income taxation in 1899, the income tax was extended to corporations. Around the turn of the century, the liquor tax and other indirect taxes were established. In 1904, the production and sales of cigarettes and tobacco products were brought under the monopoly of the Government, which lasted until March 1985."

"After World War I, the income tax was completely revised. By that time the revenue from income tax, including both corporate and personal taxation, as a percentage of the total tax revenue exceeded 20% while those from the land tax fell below 10%. Later in 1938, the predecessor of the commodity tax was introduced. On the eve of the Pacific War, a far-reaching reform of the tax system was put into effect. The former income tax was divided into the income tax (on natural persons) and corporation tax. Since then, in Japan, the term "income tax" means only the tax imposed on individuals under the Income Tax Law and the term "corporation tax" means the one on income of corporations under the Corporation Tax Law. The new income tax was featured by the bipolar system, which employed schedular taxes and graduated global tax. Withholding tax at source which had been hitherto applied to interest and dividends was expanded to wages and salaries. The corporation tax was imposed on corporate profits at a flat rate. The share of the direct tax revenue in the total national tax revenues rose from 34.8% in 1934 to 36 average to 65.1% in 1941...."

"Immediately after World War II, various taxation measures were taken to curb inflation and to reorient the economy. The property tax with highly progressive rates was introduced. In 1947, the bipolar system of income taxation was replaced by the purely global tax with progressive rates and the American "self-assessment" system superseded the traditional method of Government assessment and collection. Some national taxes such as land and business taxes were transferred to local governments. For a brief period from 1948 to 1949, the turnover tax was put in force."

III. The Tax Mission Report

1. Publication

The achievement represented by the publication of the Tax Mission's Report of 1949 was a remarkable one. It appeared in the form of photocopy of typescript. The first two volumes contained the report proper; the second two, appendices. The report proper took up 227 pages of double space text. There were in fact twice that many pages, since the Japanese translation appeared on the (right) facing page. The last two volumes contained four appendices.

As these data imply, the Mission thought of its work as largely an educational task, as well as a direct guide to policy; care was taken to explain the reasons for every recommendation, and the Report was widely distributed over the country. Memory does not serve too well here, but I seem to recall being told that some 20,000 sets of the four volumes were sent out. The definite intent was to bring the tax system out into the open, to give the public a chance to understand the system and its problems.

The speed with which the Report was published was remarkable, too, and was due chiefly to the efforts of Harold Moss. It was available in October of 1949, as I recall, although the Mission had not finished its writing until early in September, and translation had to take some time.

In 1950 the Second Report of the Mission was printed, again with facing pages in Japanese. It contained only 92 pages (184, counting the Japanese pages), and covered only certain selected topics, as described below.

Three and a half decades later, these two reports were retranslated and published, in 1985, by the Kasumi Publishing Company, Tokyo, in a single volume, with a two-page preface written on request by Shoup. Aside from this preface, there is no English text, naturally enough. The new translation is the work of "a group of some former and present officers of the Ministry of Finance....For one thing, the importance of the Recommendations has recently been anew widely recognized and strongly emphasized in discussions for tax reform to be made. For another thing, Japanese language, both its terminology and expressions, has considerably changed for the past thirty-five years, and the original translation has become a little old-fashioned". (H. Kaneko to Shoup, July 15, 1985).

The research group for the new translation numbered fourteen. The work was started in 1983. The volume contains a few pages of material supplied by this group to supplement the Report, including a schematic map of the travel within Japan by the Mission (dates and places, p. 454).[1]

The authorities publicized the Report in 1949 and 1950 and sought to educate the taxpayers in many ways.[1] For example, a wall calendar, 16 by 10 inches, showed a beaming young Japanese woman holding a copy of the Report, while the leaves of the calendar beneath, upon being turned up, revealed exhortations alongside the month's calendar, from January to December, as follows (in translation): "Jan.: The final return of income tax shall be filed in January. Don't forget your filing and tax payment...Feb.: Finish your tax payment as soon as possible....March: To prepare for tax payment, deposit money for that purpose...April: Let us file returns for Commodity Tax by 10th of next month...May: Correct bookkeeping for correct tax payment...June: Let everyone file his provisional return of income tax...July: Never let tax become delinquent, in order to establish a bright and cultural Japan...Aug.: Let us subscribe "Zeino Shirabe (The Way to Tax)", top level tax. Sept.: Let us exterminate illicit sake and illicit tobacco...Oct.: Don't forget the second term payment of income tax...Nov.: To prepare for tax payment, let us deposit money obtained through rice quota delivery...Dec.: Finish your tax payment this year, and welcome a bright new year".

2. Contents, in General

The 1949 Report proper, that is, Volumes 1 and 2, considered the tax system tax by tax except for three opening chapters dealing with the tax system as a whole, intergovernmental fiscal relations, and prospects for government expenditures with the corresponding changes in tax revenue to come from the Report's recommendations for the tax system.

Of the several taxes, the income tax, individual and corporate, received by far the most attention. This reflected the Mission's view that the income tax should be the largest single source of revenue and that it needed a great deal of reconstruction if it were to play this role. Accordingly, the income tax took up 120 pages of the total in the first

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[1]. Letters from H. Date, October, 1985, and I. Inouye, January, 1986.

[1] A news dispatch from Tokyo in the September 12, 1949 edition of The Mainichi, an English-language daily in Tokyo, read in part as follows: "Seventy percent of the nation has read the Shoup recommendations on the tax system, according to a Kyodo News Service public opinion survey. A Majority regarded the recommendations as 'satisfactory,' while 40 percent considered the present tax 'too heavy.' The survey was conducted immediately after the Shoup recommendations were made public. Two thousand five hundred and sixty-eight persons in every regional, vocational and sex division were interviewed directly. Replies obtained numbered 2,528."

two volumes, the Report proper, which ran to 226 pages. The two Appendix volumes were almost entirely devoted to income taxation: 142 pages out of 173.

Separate chapters were given to the taxation of gifts-bequests, the local inhabitants tax (counted in the income tax total above), to the real estate tax, and to other local taxes. The indirect tax system, aside from a few local taxes, was covered in just two chapters, one on the tobacco monopoly and the liquor taxes, the other on the turnover tax, various excises, customs duties, social security taxes, and revenue from government monopolies other than tobacco. This brevity of treatment reflected the Mission's view that the turnover tax should be repealed and should not be replaced, on the national level, by any other broad-based sales tax (the value-added tax suggested for the prefectures will be noted below), and that the excise taxes, in concept or in administration, did not call for much change, at least relatively to the income tax.

The four appendices in the last two volumes of the Report were given to: (A) Finance of Local Governments, (B) Treatment of Irregular Incomes under the Personal Income Tax, (C) Revaluation of Assets (for purposes of income taxation), and (D) Administration of the Individual and Corporate Income Taxes. Item (C) reflected the need for revaluation following the period of drastic inflation.

The 1950 Report consisted of a press statement of the Tax Mission released September 21, 1950, and three supplementary memoranda: The Equalization Grant, Administration of the National Income Taxes, and Local Tax Administration Problems. The emphasis placed on tax administration is evidenced by these memoranda titles and by the devotion of a considerable part of the 23-page press release to administrative problems. Conceptual and tax-theory issues were restricted almost entirely to the paragraphs devoted to the proposed value-added tax (prefectural) and to the grants made by the national government to the local units.

Taking the 1949 and 1950 reports together, we find that, of a total of 492 pages, 121 pages, or 25 percent, were devoted to tax administrative and tax compliance problems, all but 13 pages of the 121 being devoted to the income tax. Of course, the remaining 371 pages, on conceptual and substantive policy issues, contained some discussion of administration and compliance. Perhaps about one-third of the two Reports together are of special interest to the tax administrator, with respect to the activities of the administrator, and those of the taxpayer as he seeks to comply with (or evade or avoid) the tax laws.

3. Recommendations in 1949 Report: Conceptual and Substantive Issues

The Tax Mission's recommendations were summarized in a press release distributed at a press conference on August 26, 1949 (see e.g., Nippon

Times, August 27, 1949). They are given in detail in the four-volume Report.
We consider first the major recommendations on conceptual and substantive issues. They were as follows:

1. Total tax revenue to be decreased by 2.5 percent in the 1950-51 fiscal year from the 1949-50 fiscal year.

2. National government tax revenue would decrease by 9 percent, this being largely offset by a 27 percent increase in the much smaller total of local (prefectural plus municipal) tax revenue.

3. The personal income tax to continue to be the major source of revenue for the national government, slightly decreased by the net result of the following proposed changes:

a. The bracket rates to be reduced somewhat, with the top rate to be only 55 percent compared with the existing 80 percent rate. This top-rate reduction to be partly offset by the introduction of a personal net worth tax on individuals with more than 5 million yen, at rates ranging from 0.5 percent to 3 percent on that part of the net worth over 50 million yen. This combination, it was argued, would reduce the disincentive to investment and entrepreneurial labor.[1] The starting rate would be 20 percent on the first 50,000 yen. The 55 percent rate would apply to that part of one's income over 500,000 yen.

b. The personal exemption to be increased from 15,000 yen to 24,000 yen, part of this increase being to absorb a recommended reduction in the earned income credit, which was deemed to give too great a tax advantage to the wage or salary earner over the farmer or small businessman.

c. The allowance for a dependent to be increased somewhat, and its form changed from a credit against tax to a deduction from income, on the grounds that the tax differential due to a dependent should increase with income (degree of p ogressivity desired is obtained by the rate schedule).

d. Deduction to be allowed for medical expenses and loss of property due to accident or theft, to the extent that the total of such expenses and losses exceeds 10 percent of net income.

e. Capital gains to be included in full, instead of only 50 percent, under existing law, and capital losses to be allowed in full. The net gain or loss would be averaged forward over five years. Gains or losses resulting from a change in the price level of more than 15 percent would not be taken into account.

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[1]. For the reasoning leading to this conclusion, see Report, pp. 81-84, and Shoup, "Tax Reform in Japan," 1950, pp. 8-9.

f. Other types of fluctuating income, e.g., royalties, also to be averaged forward. The income would be divided into, say, five equal parts, one part to be included in each of the next five years' incomes.

g. An extra 12,000 yen of personal exemption to be allowed to the blind and, possibly, to those with similarly severe physical disabilities.

h. An individual stockholder to be given a tax credit equal to 25 percent of dividends included in his return, to compensate, more or less, for the 35 percent corporation tax (see below).

i. Contrary to a proposal being urged in Japan at that time, no favorable tax treatment should be given to interest paid on bank deposits or other savings accounts.

j. Again contrary to proposals strongly urged, no special income tax treatment should be accorded foreign nationals working in Japan.[1]

Certain recommendations affecting both the personal income tax and the corporation income tax will be noted under No. 5 below.

4. The role of the corporate income tax to be decreased somewhat.

a. The excess profits tax, introduced in 1947, to be repealed, as impairing incentives unduly and being difficult to administer.

b. The corporation income tax rate to remain at 35 percent.

c. Withholding tax of 20 percent on dividends paid to be repealed.

d. A new tax to be levied annually on total retained earnings of a corporation, at 1 percent. This would represent roughly an interest charge on personal income tax deferred by retention of earnings in place of paying taxable dividends. The tax would apply only to earnings accumulated after July 1, 1949. A higher rate, perhaps 9 percent, would apply to family corporations.

e. Repeal the tax on corporations levied when they liquidate, and tax the accumulated surplus and the portion of capital representing capital gain by the shareholder at the shareholder level.

5. The taxation of business profits, whether arising in a corporation or an unincorporated enterprise, to be modified as follows:

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[1]. For a discussion of this, and alternatives, see Shoup, "Tax Reform in Japan," 1950, pp. 10-11.

a. All depreciable business assets, and land, to be revalued to current prices, to allow adequate depreciation, or basis, for computing taxable income. A 6 percent tax to be imposed on this recorded increase in asset values, as a matter of equity vis a vis firms that had been taxed in the past on realized paper gains and holders of fixed money claims who could not deduct their real losses, due to inflation, for income tax purposes. (The price level had increased since 1940 by something between 100 and 200 times.) (For special provisions recommended, see p. 126-129 of 1949 Report).

b. Repeal the 66 2/3 percent tax levied on inventory profits whenever official prices are increased under the Price Control Law, except as the increase can be traced to removal of a price subsidy (see pp. 131-133 of 1949 Report).

c. Allow a two-year carry-back of business loss and an unlimited carry-forward.

d. Allow certain other inventory methods in addition to the sole method then allowed, the weighted average method (average cost method).

e. Allow certain other depreciation methods in addition to the sole method then allowed, the declining balance method.

6. The existing estate and gift taxes to be replaced by a cumulative accessions tax on the recipient of gifts intervivos and property passing at death, with a top rate of 90 percent. An exclusion of 30,000 yen would be granted each year with respect to property passing from any one donor (this, for administrative reasons), and, in addition, each recipient (each taxpayer) would be given a 150,000-yen lifetime exemption. The Tax Mission Report explained that this move would avoid many of the problems that were undermining the estate-gift tax in the United States, and would promote a wider distribution of gifts and bequests.

The top rate would apply to the excess over 50 million yen.

(For further details, see Report, pp. 143-155).

7. The government tobacco monopoly to be continued, not to be replaced by putting that industry in private hands and then taxing it. The Mission did not have the time or resources to compare these alternatives carefully. As soon as further national tax reduction was possible, it should include some slight decrease in prices of tobacco products. The monopoly was obtaining a profit on low-price cigarettes equal to a tax of 200 percent on a retail price net of tax or profit, and 600 percent on high-priced cigarettes. Such high implicit taxation was aimed partly at reducing tobacco production severely, not for health reasons (scarcely an issue in those days), but to increase land available for producing food.

The resulting monopoly profit was very large: in the national budget for 1949-50 it was estimated at 120 billion yen, which was 15 percent of total national and local tax revenue ("tax revenue" includes these monopoly profits, unless otherwise noted).

8. The tax rates on liquor (i.e., alcoholic beverages) to be increased substantially. They had been reduced in May, 1949, on the assumption that revenue would be increased, but, with better administration, the Report conjectured that the maximum-revenue rates had not yet been reached. Existing rates were the equivalent of about 300 percent of the retail price ex-tax, more or less; there were nine rates, all specific, varying with the type of liquor. The Report based its maximum-revenue rates proposal on the luxury nature of liquor consumption generally, apart from the rationed supply that was allowed, at the lower end of prices, to farmers and certain workers. A further rise in the national tax rates on liquor was recommended to take effect if, as the Report urged, the 5 percent tax on liquor sales levied by municipalities were repealed. Finally, the national government should resume control of the wholesale distribution of liquor. The revenue from the national tax on liquor for 1949-50 was estimated at 65 billion yen, about half the yield from the tobacco monopoly.

9. The general sales tax, a turnover tax on all sales (cascade tax), to be repealed if the national government's expenditures were reduced as recommended, or contemplated, in the Report's Chapter 3. This 1 percent tax, introduced September 1, 1948, was opposed by the Tax Mission partly because it burdened the poor to some extent (but staple food and dwelling accommodation were exempt), but also because the rate could not be raised without causing serious economic disadvantages, and at the 1 percent rate it was not being taken seriously enough by either administrators or taxpayers. The estimated yield of this "transactions" tax for 1949-50 was only 45 billion yen. No other type of general sales tax was recommended for the national government (for the value-added tax recommended for prefectures, see below).

A retail sales tax was deemed not feasible, in view of the fragmentation of the retail trade among small firms.

10. The manufacturer's excises, levied on a large number of specified goods, to be retained, but the tax rates in the two highest-taxed groups (100 percent and 80 percent of the manufacturer's price) to be reduced to 70 percent and 60 percent. The 50, 30 and 20 percent rates were to be retained. The specific tax rates on five other commodities were to be retained, also. Goods used wholly or chiefly by business firms should be exempt. The yield of all these taxes was estimated for 1949-50 at only 27 billion yen. They were acceptable because virtually all of them fell upon luxury or semi-luxury expenditures.

11. The textiles tax to be repealed, as an undue burden on clothing, one of the necessities of life. The tax, levied on producers of silk, rayon,

woolen, cotton and staple fibre goods, was 40 percent on silk, rayon and woolen goods, and 10 percent on the other two. The luxury element in silk was offset by the special difficulty the silk producers were experiencing in their export markets.

12. As to other indirect taxes, the tax on sugar was to be repealed, the new gasoline tax to be retained, customs duties to be reconsidered later (at that time practically all imports were either from the United States as aid, or for Occupation personnel, or by the Japanese Government's Foreign Trade Fund). For lack of time to study them no recommendations on a firm basis were made as to the tax on soft drinks, the tax on transfer of securities, the tax on passenger transportation, the tax on mah-jong and other playing sets, registration taxes, and the stamp taxes on legal documents and the like. The inclination of the tax mission was, however, clearly to repeal these taxes, save the one on playing sets.

13. Several taxes were being imposed on payrolls, to help finance various parts of the social security program. The Report made no fundamental recommendations on these taxes, partly because of a thorough report on the social security system by a Mission that visited Japan in 1947. The Report did recommend consolidation of the various payroll taxes in the hands of the Ministry of Finance, to be integrated with the withholding of income tax from wages. The Report gave no data on tax yields or tax rates in this area.

14. The minor, or even negative, revenue aspects of the government monopolies of salt, camphor and horse-racing left the Report with little to say on these items.

15. One of the main local taxes, the inhabitant's tax, shared by the prefectures and municipalities (cities, towns, and villages), to be based more on income and less on other factors, including per capita and ranking (for description, see Chapter 11 of the Report), and to be reserved entirely for the municipalities. Corporations should be excluded from this tax. The municipalities would get about 60 billion yen a year from it, under the Mission's recommendations, a substantial increase from the existing yield of some 25 billion yen, shared about equally between the two levels of government.

16. Expansion of the tax base was recommended for the real estate tax, which, despite its label ("land and house tax"), applied also to business real estate.
The revenue from the tax was negligible, about 14 billion yen, because the annual rental values on which the tax rate was imposed were those of the pre-war period, before the 100- to 200-fold inflation. To be sure, rentals were under severe rent control, but half or more of the real estate was used by its owners, domestic or business. The Report recommended that this tax (a) be reserved for the municipalities and administered entirely by them, (b) be based on capital value, and (c) be expanded to include all assets of a business firm subject to a

depreciation allowance under the national income tax. The tax rate for 1950-51 should be 1 3/4 percent of the newly appraised capital values. The yield of the tax was expected to be, under these reforms, about 50 billion yen, all to go to the municipalities, representing a gain of some 40 billion yen for them.

17. The local enterprise tax to be replaced by a tax on value added of business firms, the tax revenue to go entirely to the prefectures instead of being split 50-50 between the prefectures and the municipalities. This tax was levied on business profits as reported for the national income tax, although in practice some sort of standard rate of profit was often assumed. The standard rate of tax varied from 15 percent to 22.5 percent, among the prefectures. Agriculture, live-stock breeding, forestry and fishing were taxed, generally, at two-thirds the standard rate, and income from staple foods was exempt. The cumulative tax rates on business profits of an unincorporated enterprise could, considering the national income tax and the inhabitant's tax, rise to a total of 70 percent. The Tax Mission deemed this too high, and sought a lower rate for the enterprise tax, something between 4 and 8 percent, which would be possible under the broader base of value added. This, the only major recommendation of the Report that was never put in force, is discussed in more detail in Section IV(1) below. The revenue from this new tax would be about the same as that from the existing tax.

18. The admissions tax rate to be reduced from 150 percent to 100 percent, and to a still lower level in some later year. The entire yield of about 14 billion yen should go to the prefectures instead of one-third to prefectures and two-thirds to municipalities, since such a tax is a very uneven source of revenue as among different types of municipality. The 150 percent rate was an unfair discrimination against this economic sector, and induced much evasion.

19. The real estate acquisition tax to be repealed, as hindering unduly the transfer of such properties to their most economically efficient uses, especially at the standard rate of 20 percent (10 percent on small houses). This tax, yielding about 12 billion yen, was shared equally between municipality and prefecture.

20. The tax on amusement, eating and drinking establishments (20 percent up to 150 percent) to be retained, but the 12 billion yen of revenue to go all to the prefectures in place of being split equally with the municipalities.

21. The 5 percent tax on retail sale of liquor (half to prefectures, half to municipalities) to be repealed, taxation of liquor to be concentrated at the national level.

22. A group of 14 minor local taxes to be retained (Report, p. 209), and another group of 7 to be repealed (pp. 209-210).

23. Some 40 billion yen, apparently, was being raised by municipalities through so-called voluntary contributions, chiefly for building school houses, police stations, and the like. These contributions were a source of difficulty and unfairness, and the Tax Mission indicated a hope that they would decline, perhaps vanish, as the system of regular municipal taxes was strengthened.

24. In general, as to local taxation, the following changes (implemented by the recommendations above) to be made:

(a) Total tax revenue raised by local taxes to increase from 150 billion yen to 190 billion yen, all this increase to go to municipalities.

(b) The device of municipal surtaxes on prefectural taxes to be abandoned, each of the two local levels to have its own kinds of tax.

(c) The taxes to be fewer, at higher rates, in place of the existing medley of taxes.

(d) The three major local taxes to be extensively revised, the yield of the inhabitant's tax to be more than doubled, and that of the real estate tax more than tripled (the enterprise tax yield would remain about as before).

25. The system of grants-in-aid by the national government to the local governments to be revised as follows:

(a) The total of 143 billion yen to be increased to 165 billion yen.

(b) Almost all of the 100 percent grants (total, 10 billion yen) to be abolished, since the citizen is confused as to which level of government is responsible for the activity in question, there is undue control from the national level, and friction is created between national and local officials.

(c) The more than 200 less-than-100-percent grants (e.g., the national government pays 50 percent of the salaries of teachers in local elementary schools) to be replaced by a general-purpose equalization grant. Those partial grants designed to induce localities to pioneer in new services or better methods would be retained.

(d) Grants for local public works to be retained (30 billion yen).

(e) The percentage share of the localities in the national personal and corporate income taxes' revenue (33 percent in 1948-1949, and 17 percent in 1949-1959) to be replaced by the general purpose equalization grant, to avoid undue annual fluctuations in the amount of the grant. In 1948-49 the amount was 58 billion yen.

(f) The equalization grant to be computed for each locality separately, to equal the difference between (i) what would be yielded by local taxes at certain standard rates and (ii) the minimum cost of providing necessary local services in the locality. This grant would be about 120 billion yen.

26. A Local Finance Commission to be established, to gather information and to decide certain matters that cannot be regulated closely by law. The existing Local Tax Deliberation Committee and Local Autonomy Agency were not representing local interests adequately. A temporary Commission on Local Government Organization should be formed to allocate particular governmental functions among the national, prefectural and municipal governments.

These intergovernmental financial issues were examined in considerable detail in Appendix A of the 1949 Report, and, as to the proposed equalization grant, in the 1950 (Second) Report.

4. Recommendations in 1950 Report: Conceptual and Substantive Issues

In this 1950 Report, submitted almost exactly a year after the first Report, attention was centered on the question of what kinds of tax reduction should be voted, in view of the prospective national budget surplus for 1951-52. These recommendations, although important for short-term policy at that time, are of limited interest for the present study and are not reproduced here.

The only important conceptual or substantive issues discussed in the 1950 Report concerned the as yet unimplemented value-added tax to replace the income-based enterprise tax for the prefectures. The Report concluded that firms should be allowed to deduct, in computing value added, depreciation on property owned by them when the tax took effect, as well as deducting the amounts spent subsequently, immediately upon expenditure, on capital equipment. Complaints had been heard that firms that had undertaken capital expansion programs just before the tax was introduced would otherwise be at a disadvantage competitively. (This argument now seems to me not as justified as it appeared then, unless the firm in question had paid the now-to-be-repealed turnover tax on purchase of that plant and equipment.)

In addition, any firm that preferred to go to a depreciation basis permanently, instead of deducting the cost of capital equipment in the year of purchase, should be allowed to do so. It might prove difficult to get a prompt payment from the government on a negative value-added, as would occur if such outlay were large enough. (At this time the distinction between the income type of value-added tax and the consumption type had not yet been formulated.)

The proposed tax rate schedule of 3, 4, 6, and 8 percent for various types of business should be replaced by a single tax rate.

Government railroads should pay this tax.

The new equalization grant was given a thorough study, and several recommendations were made for further improvement; these are not summarized here (see pp. 19-20 and 27-46 of this Second Report).

5. Recommendations on Tax Administration: 1949 and 1950 Reports

"We get the impression," said the 1949 Report (p.15) "that total tax revenue might increase anywhere from 25 percent to 100 percent, if all taxes were fully enforced according to the law as it now stands". Therefore, although "The details of administrative reform are... outside the scope of this report," (p. 16), issues of "Compliance, Enforcement, and Appeal under the Income tax" (the title of the 16-page Chapter 14) were addressed, and, indeed, the 1950 Report went into some detail in discussing these problems under the local property and inhabitants tax and again, the income tax. Moreover, the description and analysis of each of the other taxes usually contained discussion and some recommendations on these administrative issues.

The major recommendations were:

1. An income taxpayer agreeing to keep books and records as specified by the tax administration would be distinguished by filing his return on a form of a distinct color and would thereupon not be subject to reassessment until after an actual field investigation; if a reassessment were made, the specific reasons for it would be given. Other inducements might be offered: depreciation deductions and loss carry-overs might be denied to those who failed to keep books. (Pp. D58-D59). The 1950 Report (pp. 53-55) returned to this proposal briefly, urging that administrators not put obstacles in the way of using the "blue return" form. At that time, this form had been chosen by 47.2 percent of the taxpaying corporations, but only by 4.4 percent of individual taxpayers.

2. The general aim for income tax administration should be to eliminate, or reduce to a minimum, "the use of goals and quotas, the collective allocation of tax amounts among associations.. the allocation by an association of a group amount among its members [and] any extreme reliance upon standards to measure income..." (p. D4). Under the goal system, in widespread use in Japan at that time, a tax collection goal was assigned to, or computed by, each Tax Office (a given Tax Office covered a specified geographical area). The total of the goals was the budget figure of expected income tax collections.

3. Estimated income tax payable under the current-payment system should be based on the previous year's tax as a minimum.

4. An income tax return should be held confidential, not open to inspection, as it was then, by anyone willing to pay a nominal fee.

5. The income tax on farm income should be based less on standards and more on the particular farmer's actual income, and payment should be adjusted to seasonal farm income patterns. [1]

6. All bank deposits should be in the real name of the depositor.

7. All securities should be registered (e.g., no bearer bonds).

8. The procedure for taxpayer protest of assessment should be reformed.

9. Litigation by the taxpayer, scarcely in use at that time, should be provided for.

10. The system of penalties for income tax violations should be recast.

11. The procedure for tax refunds should be reexamined.

12. The large amount of income tax delinquency should be reduced.

13. The internal administration of the income tax should be further improved, with regard to basic structure, calibre of tax officials, operating instructions, administrative interpretation of tax laws, and office procedures.

14. "The participation of the trade association in tax activities must be ended..." (p. D60). At that time, "trade associations often enter into a system of 'collective bargaining' with the Tax Offices by which an overall tax figure is arrived at for the business activity represented by the association....The association then allocates such tax figures among its members." (P. D60).

15. The "Tax Practitioner," the taxpayer's representative, should be required to know more tax law and accounting, not be merely a skilled negotiator.

16. Tax materials (laws, etc.) should be more readily available to the public.

The Second Report (1950) returned to several of these issues, but without strikingly new recommendations.

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[1]. "Collection [of the income tax] from the farmers was ... fairly good considering that farmers in Japan seldom till more than an acre or two and keep almost no records. They have been supposed to make out their own income tax returns, but in practice they simply enter what the local tax office broadcasts as being an estimate of average net income per acre for that area." Shoup, "Tax Reform in Japan," 1950, p. 6.

6. Recommendations on "Tax Atmosphere": 1949 and 1950 Reports

The Tax Mission recommended that an informative tax atmosphere (that term was not used by the Mission) be developed in Japan. This would include: (pp. D66-D67).

1. Professional and technical journals containing qualified articles on technical tax matters;

2. Textbooks on substantive provisions of the tax laws;

3. Forums on taxation, by bar associations, accounting organizations, university organizations, and the like, to promote informed discussions in the tax field.

4. Courses in tax law as a distinct subject, in law departments of universities;

5. Access to foreign literature on both substantive and administrative aspects of taxation;

6. Introducing accounting in Japan as an independent profession (there were virtually no independent certified public accountants in Japan) (see pp. D50-D56 for detailed recommendations, in the 1949 Report, and pp. 78-80 in the 1950 Report).

Implied in these recommendations was one "of an informal nature, not spelled out in the report but which is already well on the way to adoption. This is the formation of a national body, meeting at least once a year, publishing a journal and a volume of proceedings, composed of professors and other instructors in public finance in the colleges and universities, tax administrators of the central and local governments, tax officials of corporations, tax lawyers and accountants engaged in tax work.... A preliminary meeting of some thirty prominent Japanese interested in taxation was held in the middle of August [1949], and the idea seems to have been taken up with genuine enthusiasm....In the long-run, I should not be surprised if this, the formation of a Japanese National Tax Association, ...should prove the most fruitful of all the suggestions made by our tax mission." (Shoup. "Tax Reform in Japan," 1950, p. 16).

IV. Degree of Implementation of Tax Mission's Recommendations

1. Conceptual and Substantive Issues

Almost all of the more important conceptual and substantive recommendations in the Report were implemented over the short run, in the year or two following publication. Over the longer run, however, to 1987, some of these measures were repealed or substantially altered. Moreover, some of the less important recommendations remained unimplemented both in the short- and long run.

As to the interim period from 1949 or 1950 to 1987, a year-by-year tracing of the fate of the Report's recommendations would be lengthy and somewhat tedious, and, for most years, difficult to compile. There are two interim years, however, for which a comparison with 1949 has been made. One, by Bronfenbrenner[1] and Kogiku, refers to 1956, and the other, by the Tax Bureau of the Japanese Ministry of Finance, to 1981 (see References).

(a) Short-Run Results

"General Douglas MacArthur has told Japanese Premier Shigeru Yoshida in a letter dated September 15 [1949] that he hoped the Japanese Government will be able to 'formulate an appropriate program for effectuating the broad principles and objectives set forth in Dr. Shoup's recommendations.'

"This virtually assured quick passage by the Japanese Diet of the Shoup recommendations" (The Mainichi, September 18, 1949; see Appendix A below for the full text of the MacArthur letter and of Yoshida's reply).

The Report was presented, in summary form, at a press conference on August 26, 1949. Even before then there had been indications that the Japanese Government was in a receptive mood, prepared to enact most if not all of the as yet undisclosed recommendations. This receptivity may have been in part due to the apparent approval by the Government and the Japanese public of the research techniques used by the Mission, especially the wide-ranging interviewing of taxpayers. Some second thoughts a little later were less favorable.[2]

The Japanese Diet did in fact quickly enact the Report's recommendations. The only major exception was the value-added tax proposed for the prefectures to replace the use of income as a tax base for the enterprise

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[1]. Professor Martin Bronfenbrenner, then of the University of Wisconsin, was requested by SCAP, upon my recommendation, to assist the Japanese Government in implementing such of the Report's recommendations as they adopted. Bronfenbrenner was engaged in this task for several months, from September, 1949, well into 1950.

[2]. These statements are based on news dispatches, chiefly in Tokyo English-language newspapers.

tax. This tax was enacted later, but its application was suspended, and it was never put in force. Unfamiliarity with the basic concept of value added, coupled, perhaps, with some fear of inter-prefectural disputes over transactions crossing boundarylines, and with less concern over the cumulated burden of the three levels of income taxation than the Tax Mission had shown explained the rejection of this proposal.

The rate to be used under the new real estate tax was debated for some time, and this change in local taxation was not made fully operative at once.

(b) Long-Run Results

The long-run results of the Mission's work are cast in terms of a comparison of the tax law as it stands today (1986-1987) with that in effect in 1949. Admittedly, the term "results" may be too strong in some instances; a conformity of a certain part of the present day law with a recommendation of the Report may be no more than a coincidence.

A tax-by-tax comparison is followed by an overview comparison of the tax system as a whole, 1987 versus 1949, with respect to total tax revenue and the division of that revenue between national and local taxes. For a detailed description and analysis of the present Japanese tax system, the reader is referred to Aoki (1985) and Homma, Maeda and Hashimoto (1986).

(i) Particular Tax Provisions

The income tax base and rate structure have by now departed substantially from the report's recommendations. There are a number of exemptions, deductions and tax credits for this or that type of income or use of income presumed socially important, in the individual income tax. The top rate is 70 per cent (national tax). Homma, Maeda and Hashimoto, who give details of these measures, remark that "Japanese income taxes are riddled with special provisions, which produce major inequities and distort economic activity" (p. 1).

Moreover, individual income are classified into ten categories. The treatment of deductions differs somewhat among these categories. Special tax rates apply to capital gains (there is no tax on gains from the sale of securities except for "continuous traders"). Only half of retirement income is taxable income. Up to 3 million of principal amount per taxpayer, interest is in general exempt; however, interest and distributions accruing in an anonymous bank account are taxed at a flat rate of 35 percent. And there are still more complexities in the individual income tax. Perhaps all these special rules and preferences help explain why the bulk of the Japanese individual income tax revenue comes from tax withheld.

The corporation income tax, too, provides a number of tax preferences, including accelerated depreciation and tax-free reserves.

With respect to integration of the corporation income tax and the individual income tax, the present system appears to adopt the philosophy, if not the exact technique, of the Report. Homma et al. report that "In Japanese tax law, the corporation income tax is regarded as an advance payment of the individual income tax. A dividends-received-credit is provided at the individual level and a dividends-paid deduction is provided at the corporate level, the former eliminating three-quarters and the latter one-quarter of the double taxation of distributed profits (p. 16)."

The current wave of income tax reform proposals in Japan seems to be based largely on a desire to eliminate many of the tax preferences and to reduce the tax rates. The immediate stimulus for this kind of reform may have been the example set by the United States in 1986. The reform proposals do also accord with the views set forth in the Tax Mission Report, and in this sense we may say that Japan is perhaps on the road back to the type of income tax envisaged by the Report. On the other hand, the Government's proposal to introduce a value-added tax for the national government, a proposal rejected by popular protest, did not accord with the Report, which advocated only a low-rate VAT for prefectural use in place of the prefectural income tax. For a description and appraisal of current tax reform proposals in Japan, see Aoki (1987) and Homma et al. (1987), and, from an American point of view, Teuber (1986).

The tax on retained profits of corporations, recommended at 1 percent by the Tax Mission Report, but enacted at 2 percent, was repealed in 1952 except for family corporations. This was done "in view of the important role of the profit retention in business financing."[1]

Capital gains and losses from the sale of securities were removed from the income tax in 1953, because "the taxation of capital gains allegedly hampered the development of the securities market" and "technically the tax on such gains was found difficult to properly assess and collect."[2]

The net worth tax was abolished in 1953 because it "proved inequitable because real property owners whose net worth is easily identified bore the full brunt while others escaped to some extent." [1]

The accessions tax (termed "inheritance tax" in the Outline) was revised in 1958. The tax had proved "unsatisfactory because the tax amount due

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[1]. From An Outline of Japanese Taxes, 1986, pp. 8-9.

[2]. For further details on present-day income tax law compared with the Report's recommendations, see Appendix E below.

varied depending on the method of dividing estates and taxpayers often made false reports as to shares received by heirs. In 1958, a revision was made so as to calculate the tax on the basis of the statutory shares of estates provided under the Civil Code."[1] The total tax to be paid by heirs and legatees is now computed by assuming the statutory heirs inherit property in accordance with the Code provisions, and this total tax is then allocated to each heir in proportion to his actual share (Outline, p. 272). The rate schedule runs from 10 percent on the first 2 million [sic] yen after deductions and credit to 75 percent on the excess over 500 million yen. The deductions are (i) 20 million yen and (ii) 4 million yen for each statutory heir, these deductions apparently being against the estate as a whole. A separate gift tax, on properties acquired by gift over a lifetime, is levied by a rate schedule ranging from 10 percent on the first 500,000 yen to 75 percent on the amount in excess of 70 million yen.

Before moving on to the indirect taxes, we may ask, did the income tax in fact become the mainstay of the entire tax system, as the Report hoped it would? Comparing 1949 revenue data with those for 1986 (for the latter, see Outline, pp. 304-307) we find that, somewhat surprisingly, the share of the individual income tax of the national government in total national and local tax revenue declined sharply, from 40 percent to 26 percent. That of the corporation income tax, however, rose from 6 percent to 19 percent. Finally, the share of the inhabitants tax, which is based largely on income, rose from 5 percent to 15 percent. All three income taxes together, therefore, raised 51 percent of total tax revenue in 1948 and 60 percent in 1986. But the rise of the corporation tax share and decline of the individual income tax share were directly contrary to what the Report evidently favored; it seemed to regard the corporation income tax as a sort of necessary evil.

The decrease in the share of the individual income tax was caused chiefly by yearly increases in the personal exemptions and by new tax preferences rather than by reduction in the general rate schedule. Most of the decline occurred in the period 1961-1975 (Ishi (1983) gives details). It was motivated largely by a desire to compensate for "bracket creep" under inflation, but in fact did more than that (Ishi (1983), p. 27) and was made possible by budgetary surpluses, which, however, turned into deficits in the years following the "oil shock". The tax preferences, on the other hand, were designed chiefly to increase personal saving. Ishi concludes that they had a minor, if any effect, in increasing saving, compared with other forces (Ishi (1983), p. 36). For the opposite conclusion, see Nakatani (1986), p. 126. In 1984 the individual income tax was reduced for the first time since 1977, chiefly by an increase in personal exemptions, and the corporation income tax was increased, along with the liquor tax. Certain other taxes were also increased (Miura (1984)).

These data do not include contributions paid to the social security funds, which are generally not counted as taxes in Japanese tabulations.

They are much more important now than they were in 1949-1950. If they are included in income taxes, the increase in income tax share since 1949 becomes considerably larger. Aoki (1987, p. 437) shows the following shares in total national and local tax revenue in Japan in 1982: income and profits taxes, 45.0 percent (individual, 25.3 percent; corporation, 19.7 percent); social security taxes, 30.4 percent; property taxes, 8.9 percent; taxes on goods and services, 15.4 percent; other taxes, 0.3 percent.

Appendix C below presents details of social insurance contributions in Japan, by funds (there are seventeen) for 1976 to 1985, courtesy of the National Tax Administration in the Ministry of Finance. For a description and analysis of old-age social security in Japan, see Murayama (1978).

We turn now to particular indirect taxes.

The government tobacco monopoly has been replaced by ordinary companies and an excise tax was imposed on their output, in April, 1985. The tax rates have been set so that the burden on each kind of tobacco product remains basically the same as was reflected in the former charge on the monopoly.[1]

As to the taxes on alcoholic beverages, it is not clear, from the data at hand, whether the tax rates have been changed substantially in real terms from 1949 levels, since the changes in the specific rates must be compared with changes in the selling prices, and the ad valorem rates are imposed only on certain high-priced alcohols.[1]

The commodities tax now includes, besides the excises on certain manufactured products, a 15 percent tax on the retail sales of certain jewelry and furs, and a 10 percent tax on carpets. The maximum tax rate under the excises is only 30 percent; the reduction of high rates has thus gone even beyond the Report's recommendations.[2]

Among the other particular-product taxes, that on textiles has apparently been repealed, as recommended.[3] The sugar excise tax, however, has not been repealed.[4] The gasoline tax has been retained.[5] The rest of

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[1]. <u>Outline</u>, pp. 136-137.

[1]. <u>Outline</u>, pp. 128-135.

[2]. <u>Outline</u>, pp. 138-142.

[3]. <u>Outline</u>, <u>passim</u>.

[4]. <u>Outline</u>, pp. 150-151.

these taxes, which the Report was inclined to oppose, are still being levied, except, it appears, the tax on soft drinks.[6]

As to the local taxes, the inhabitants tax has apparently not been wholly reformed as suggested in the Report. It still contains a per capita element, though a small one for individuals, and is still imposed by both prefectures and municipalities. Corporations are still included.[7]

The real estate tax, in contrast, remains today the same as it was following the changes made shortly after the Report was issued, to conform with the changes there suggested. The tax base has been broadened, it is levied on capital values, and is reserved to the municipalities.[8]

The enterprise tax--the local income tax on profits -- is now reserved to the prefectures, as the Report recommended, but its base has not been changed to value added.[9]

The admissions tax rate has been reduced to a level even lower than the Report implied, to 10 percent.[1]

The real estate acquisition tax and the local tax on retail sale of liquor have been retained, contrary to the Report's recommendations. The other minor local taxes are not covered here. Apparently the custom of "voluntary" contributions has been discontinued.[2]

The rule of distributing at least some grants money to localities according to need has been accepted to a degree, but the total amount of such grants is still linked to the yields of certain national taxes.[3]

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5. Outline, pp. 143-144.

6. Outline, passim.

7. Outline, pp. 189-191, 199-204.

8. Outline, p. 204-206.

9. Outline, pp. 191-193.

1. Outline, pp. 157-158.

2. Outline, passim.

3. Outline, pp. 187-189. The general-purpose equalization grant, distributed largely by formula, is termed the "local allocation tax," and consists of 32 percent of the yield of the individual income tax, the corporation income tax, and the liquor tax. In 1954, the initial year of this grant, the percentage was only 20. It reached 32 in 1966. The national

In general, the Report's recommendations as to local finance have been followed in some important instances, especially as to the real property tax and the use of a need index for distributing some grants-in-aid, but not, in others, notably for the enterprise tax.

(ii) Size of Tax System

In the almost four decades elapsed since 1949, total tax revenue in Japan, excluding social security premiums, has increased only moderately as a percentage of national income.

In 1949 national, prefectural and municipal tax revenues came to about 20 percent of national income. At that time, national income data were fragmentary, and the total was but an educated guess. Using that guess, one obtained a percentage of 26, but since the national income seemed almost surely higher than that estimate (Report, pp. 4-8), a figure of 20 percent was probably nearer the truth. A recent estimate for 1950 is 22 percent (Financial Statistics, p. 37).

The estimated percentage for 1986 is 25 (Financial Statistics..., p. 37). This level, the highest in the 37-year period, was reached by a series of yearly increases that began in 1978; in 1977 only 18.9 percent of the national income was taken in taxes.

If social security premiums are included in the tax total, that total, as a percentage of national income, rises from 25 percent to about 36 percent.

If government expenditure totals are taken, instead of tax revenue, the percentage of national income rises appreciably. Another 4 percentage points can be added for 1986, for a total of 29 percent, quite apart from social security outlays. That is, the amount borrowed by the national government to finance its general account expenditures represented 4 percent of the national income (Financial Statistics, p. 18, "Public bonds", and p. 37, national income). If the figure for "Deficit financing bonds" is used instead, we add only 2 percentage points instead of 4 (p. 17).

In addition, there are central government "Special Accounts," which have their own sources of revenue to some extent.

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government also distributes substantial amounts for specific purposes, allocated by discretion rather than by formula. There are also certain other distributions. For details, see Yonehara (1986), 160-168, Yonehara (1981), and Ishihara (1986).

On the other hand, national defense expenditures are low: only 1.3 percent of national income, for 1986 (pp. 18, 37).

(iii) National versus Local Tax Totals

The share of local tax revenue in total tax revenue has doubled. It was 19 percent in 1949, and is now (1986) 37 percent. In general, this accords with the recommendation of the Report (p. 35).

Of the three important local taxes, the inhabitants tax, based on individual incomes, accounted for two thirds of this increase in share. In 1949 it accounted for only 3 percent of total tax revenue; by 1986 this had risen to 15 percent. Hence this one tax contributed 12 percentage points to the 18-point total increase in local share.

The tax on real property, greatly strengthened, contributing only 2 percent in 1949, accounted for 8 percent in 1986. The enterprise tax, wholly prefectural, and based on business profits, did not increase in share at all; in 1986, as in 1949, it accounted for 6 percent of total tax revenue.

Despite these substantial changes in the roles of two of the three chief local taxes, and despite the great increase in share of local tax revenue to total tax revenue, the relative importance of the prefectures and the municipalities with respect to each other was almost unchanged. In the earlier period the prefectures collected 47 percent of total local tax revenue; in 1986, 43 percent. Thus the Report's recommendation that the municipalities notably increase their share in total local taxes (p. 23) has not been adopted. But the increase in the local tax share has been achieved by substantial increases in the two major local taxes that the Report was inclined to favor: the inhabitants tax and the real property tax. However, the recommendation that the municipalities be given sole use of the inhabitants tax has not been adopted; they now get only 69 percent of the total revenue from that tax. On the other hand, the recommendation that only the municipalities should use the real property tax and that only the prefectures should use the enterprise tax is reflected in the present system (see Outline, pp. 306-307).

In terms of direct expenditures, local government in Japan is almost twice as large as the national government. This is because the latter transfers important amounts to the local units in the form of various grants, to be spent by the prefectures and municipalities: "...the huge size of local public finance has a strong influence on national economy" (Japan, Ministry of Home Affairs, p. 110).

To be sure, there is still "strong administrative and financial control [over local governments] by the national government" (Shindo, 1982, p. 132), so that, in a sense, the almost two-to-one ratio just noted exaggerates actual local influence. The duties of the Governor of the Tokyo Metropolitan Government, for example, despite the fact that he is elected by the residents, includes acting "as an agency of the central government." His execution of certain functions is "under the instruction and supervision of the competent [national] minister and is outside of the scope of the vote of the Metropolitan Assembly" (Nomura, Vice Governor of the Tokyo Metropolitan Government, 1982, pp. 141-142).

2. Tax Administration

1. All the Report's recommendations as to the blue return system were adopted in 1950 except that which called for denial of deduction for depreciation if the blue return was not used.[1] In general, the blue return has flourished. By 1970, 48 percent of individuals whose main income consisted of business income and real estate income, excluding agricultural and forestry income, were filing such returns, and by 1979, 53 percent (Fukuda, 1981-1982). In 1984, for a somewhat narrower group of individuals (excluding not only farming and forestry but also professions) the percentage was 59. Of all 7.1 million individual businesses, however, only 2.1 million, 30 percent, used the blue return. As to corporations, the 47 percent of 1950 rose to more than 90 percent by 1979, and in 1984 was just 90.

Evidently, the blue return, instead of being an intermediate kind of return, between the simplest form and the standard form for large enterprises with sophisticated accounting methods, has become a standard form, the only other type of form being the "white return," which is used only by the smallest taxpayers, including, supposedly, some small corporations. In a sense, then, the blue return may have outlived its usefulness, and, indeed, in 1981 the Tax Administration was considering asking for repeal of the blue return system, perhaps on an assumption that it had accomplished its main task, i. e., bringing most taxpayers up to a reasonably sophisticated regime of bookkeeping.
Sometime after 1949, Blue Return Taxpayers Association was formed. By 1981, about 40 percent of blue return filers were members of this association.

The remark above on sophisticated bookkeeping system needs to be qualified as follows. A taxpayer who uses a "simplified accounting system," i. e., one that does not employ double entry, need not include with his blue return a balance sheet. About 50 percent of blue return taxpayers fell in this class as of 1981.

In 1984, the keeping of books became a requirement rather than a reward, for all corporations and for those individual business firms with income of more than 3 million yen, but the level of bookkeeping required is much simpler than that demanded of the blue return taxpayer.

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[1]. For this information, for the 1984 data on blue returns, and for all the information given in Nos. 2 to 16 below, I am indebted to Professor H. Kaneko.

2. The goal system was abolished in 1950, except that, for some years, it was retained in allocating among district tax offices the amount of reduction of delinquent taxes.

3. A requirement that estimated income tax be based on the previous year's tax as a minimum was adopted in 1950; the district tax office could grant permission to pay less, upon a proper showing. Subsequently this estimated tax requirement was modified somewhat. It now applies to any taxpayer with estimated tax of 150,000 yen or more on permanent, ordinary income. The taxpayer can apply for permission to use a figure below last year's income in computing estimated tax.

4. Income tax returns were made confidential except that each district tax office posts the names of individuals whose tax (until a few years ago, whose income) exceeds a certain amount: currently, ten million yen of tax. Similarly posted are the names of corporations with more than 40 million yen of net income.[1]

5. As to farmers' incomes, I quote from Professor Kaneko: "Before the recommendation ((of the Tax Mission Report)), a farmer's income was assessed by an estimate using the area of farmland as the standard. After the recommendation, the practice was changed to use gross sales as the standard, a method closer to the actual income. (Since farmers were required to sell all the rice and wheat products to their cooperatives, semi-official bodies, it was possible to check how much their gross sales were. Imputed sales--their own consumption--could be estimated by the number in each family). However, it is extremely difficult to assess their actual income (nowadays they produce various things other than rice and wheat), and the blue return farmers are not many. Therefore, taxation by standard is still the ordinary and usual pattern. Nowadays, the standard of compliance of farmers is severely criticized by many people, and the tax authorities have been trying to improve the situation."

6. The recommendation that all bank deposits should be in the real names of the depositors was not adopted, owing to strong objection from the business community, especially banks and other financial institutions, as well as the Business Section of SCAP (the Occupation forces). In 1986 a small step was taken: the real name was required of any holder of a savings account entitled to tax-exempt interest.

7. The recommendation that all securities be registered, i. e., no bearer securities, was never accepted, owing to the opposition noted in paragraph 6.

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[1]. On this practice, see Pechman and Kaizuka, pp. 333-334.

8. The procedure whereby the taxpayer can protest an assessment has been changed somewhat, as recommended in the Report. Appeals from the district director now go to a National Tax Tribunal, established in 1970 as a quasi-independent organ of the National Tax Administration Agency.

9. After appeal to the Tribunal, the taxpayer can go to the ordinary courts. Professor Kaneko remarks, however, that, "Compared to American taxpayers, Japanese taxpayers are timid in suing tax authorities. Nevertheless, about 300 new suits are brought to courts by taxpayers each year. Among all suits against Government agencies, the number of tax suits exceeds the number of suits in any other field."

10. Criminal penalties for tax evasion were strengthened somewhat. "However, sentence of imprisonment in tax cases is rare in Japan. Though in exceptional cases sentence of imprisonment is given[1], it is usually suspended" (Kaneko). The Report's recommendations regarding penalties for failure to file on time or filing a deficient return or late payment of withheld tax were, on the whole, adopted, as were those concerning fraud. The excessive rate' imposed for tax delinquency were reduced.

11. The procedure for tax refunds may have been reexamined, but no change was made, although refunds presumably increased under adoption of a carry-back of business losses.

12. It took several years to reduce the large amount of income tax delinquency to a normal level.

13. Substantial progress was made in improving the internal administration of the income tax. Professor Kaneko reports that

"(1) To improve tax administration according to the recommendation, funds have been generously allocated to the National Tax Administration Agency in the National Budget since 1950, and its administration was improved in every respect, although the basic structure of the National Tax Administration Agency was unchanged, except that the Collection Department was newly established, replacing the former collection division in the General Department in order to strengthen the collection of delinquent taxes.

"(2) To improve the calibre of tax officials, education at the Tax College was very much improved.

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[1]. " 'Violence,' says a Japanese gangster ...'is obsolete. Today we go to prison for tax evasion.' The fine art of underreporting income, and the equally fine art of nabbing those who do, is the all-embracing subject of 'A Taxing Woman,' the solemnly funny new satire by Juzo Itami." Vincent Canby, New York Times, September 26, 1987.

"(3) Concerning operating instructions, various manuals were made to harmonize the tax administration of all the regions.

"(4) Concerning administrative interpretation of the tax law, many detailed regulations and rulings were issued for each statute of tax law.

"(5) Concerning office procedures, it became the policy of the National Tax Administration Agency after the recommendation to improve and strengthen the self-assessment system by encouraging the tax officers to avoid arbitrary assessment, to contact and assist taxpayers before the filing of a return,to encourage them to make an accurate return, and to encourage them to make an amended return when a deficiency was found (instead of making a deficiency assessment)."

14. Participation of trade associations in tax matters was completely abolished.

15. As to taxpayers' representatives, important progress has been made. The system was changed to one of "tax accountants" by the Tax Accountants Act of 1951. Professor Kaneko reports that "To be a tax accountant, one should pass the national examination, which is rather difficult. Applicants should take exams in three fields of tax law (as, individual income tax law, corporate income tax law, and inheritance tax law) from the seven enumerated fields of tax law, and exams of bookkeeping and financial statements from the field of accounting. To practice, they should register with the Federation of Tax Accountants Associations. Discipline is maintained by the National Tax Administration Agency. There are now about 50,000 tax accountants. The scope of their activities is (1) representation for tax matters, (2) making tax forms and documents, and (3) consulting on tax matters. Only qualified tax accountants can practice these activities."

16. Finally, "Tax materials--law, administrative regulations and rulings, etc.--are all readily available to the public. These materials are published by many publishers (law, cabinet orders and ministerial orders are also published in the Official Gazette)" (Kaneko).

On the whole, the Report's administrative recommendations were adopted, with the important exceptions of Nos. 6 and 7 above (all bank accounts to be in real names, and bearer securities to be abolished) and perhaps No. 11 (refund procedures). Some observers, e. g., Jason James, consider Nos. 6 and 7 crucial, so that failure to adopt them has constituted in itself a fundamental rejection of the Report's administrative recommendations.

Despite improvements in tax administration, the individual income tax remains plagued, it would appear, by great differences in compliance among three groups of taxpayers: employees, non-farm self-employed, and farmers. A popularly received opinion is embodied in the phrase "ku-ro-yon," or "nine-six-four," which implies that while 90 percent of income that should be taxed is in fact taxed, as to employees (through withholding, chiefly), that percent is only 60 as to the non-farm self-employed, and only 40 as to farmers. Ishi, testing this popular hypothesis, has concluded that "the 'ku-ro-yon' ratio does indeed seem to be approximated by these statistical procedures, although the results are far from satisfactory." He attributes these gaps both to outright evasion and to avoidance (1984, p. 22). Unless these gaps can be closed, it may prove quite difficult politically to call on the individual income tax to help reduce Japan's budget deficit appreciably[1].

3. Tax Atmosphere

Some of the suggestions made in the 1949 and 1950 Reports for improving the tax "atmosphere" in Japan have been accepted and vigorously developed.

The Japan Tax Association, founded as a direct result of the Tax Mission's informal suggestion on this score in 1949, and with the aid of some of the Mission members, has developed into a substantial research and discussion organization. In an English-language brochure published August, 1982, the Association notes that it "was established in 1949 by leading business men, scholars and government officials," to "research Public Finance Policy, Tax Policy and Tax Administration" and "make proposals and recommendations," as well as to "exchange information among the members and publish some results of its research works.... Since establishment, we have published a great number of reports...of our research works" (p.1). Photographs are given of the first General Meeting for research reports on taxes, November, 1949, and several subsequent meetings.

The Association's research program for 1982 was to be carried on by committees on national tax policy, local tax policy, public finance and the economy, tax accounting, international taxation, and by study groups on tax accounting and on the Shoup tax recommendations (pp. 3-5).

The membership of the Association appears to be somewhat more heavily weighted by representatives of the business world and the legal and accounting professions, and less by government tax officials and

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[1]. "The New Salaried Men's Party, created on the single issue of income tax fairness (or current unfairness) for salaried workers, won two seats in a Japanese parliamentary election last year ((1984))" (Ryan).

academics than its counterpart in the United States, the National Tax Association. Most of the members are corporate bodies[1].
The Association meets annually, and publishes a volume of Proceedings of each meeting, and also a monthly journal, "Tax Studies--Research on Fiscal Policies and Tax Problems" (Sozei Kenkyu -- Zaisei Sozei Mondai no Kenkyu Chosa). It also publishes various ad hoc reports concerning, mainly, current and proposed tax legislation.

The Association is said to keep some distance between itself and the Government by refusing to receive Government subsidies and by never electing a current or former Government employee to its presidency.

The literal translation of the Japanese name of this organization, Nippon Sozei Kenkyu Kyokai, is Japan Tax Research Association, but the Association uses the name, Japan Tax Association, in its English-language publications.

The nation-wide trade association of tax consultants ("tax accountants" noted above) contains a section, the Japan Tax Matters Research Center (Nippon Zeimu Kenkyu Center) that publishes a journal, "T. R." (Zei Ken), the initials for "Tax Research." A separate group, The Japan Tax Law Association (Nippon Zeiho Gakkai), has a membership consisting mainly of registered tax consultants. It appears to publish no periodical.

The Tax Law Association (Sozeiho Gakkai), to be distinguished from the Japan Tax Law Association just noted, is composed of mainly academic lawyers. It publishes an academic journal, "Tax Law Studies" (Sozeiho Kenkyu).

Tax law professorships, recommended by the Tax Mission Report, were instituted initially in Tokyo and Kyoto Universities. They were gradually increased until today they are found in five major national universities, out of a total of nine such universities (the successors of the former Imperial Universities), and in some thirty private universities. Certain of the junior colleges have professorships in tax accounting.[1]

In general, then, it appears that the tax atmosphere in Japan has changed, since 1949, along lines suggested by the Report, and is very

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[1]. As of mid-1986 the membership classification was: corporations, 613 (business, 493; non-profit, 80; university research groups, 10; law offices, 17; local governments, 11; a Diet committee, and a Korean government representative) and private (individual), 89 (professors, 50; tax consultants, 17; certified public accountants, 17; tax lawyers, 5), for a total of 702. I am indebted to Professor Hirofumi Shibata for obtaining this information.

[1]. See previous note.

different from that of the years before 1949, when tax policy and tax technique were hardly matters for public debate at all.

V. Some General Appraisals of the Tax Mission's Report

We turn now to some general appraisals of the tax mission's report, and to opinions as to whether the existing Japanese tax system is truly based, still, on that report, or at least coincides, except in some details, with the system recommended.[2]
The selection to follow is biased in that it includes only comments written in English or translated from the Japanese by English-writing commentators. It therefore provides a list of certain points to be considered rather than a balanced view of the Report as seen by Japanese commentators.

1. Bronfenbrenner and Kogiku

In 1956 Martin Bronfenbrenner and his research assistant, Kiichiro Kogiku, in two articles in the National Tax Journal, "The Aftermath of the Shoup Tax Reform," Parts I and II, appraised the Tax Mission's program as "only a limited and partial success" (p. 237), in terms of enactment, partly because it "included several novel fiscal experiments, which the Mission suggested for Japan without benefit of large-scale experience in other countries...[especially] the net worth tax; the accessions tax, and the value-added tax" (p. 240]. (Here, B-K are partly incorrect: the net worth tax had a long and successful experience in several European countries.] B-K concluded that "through 1956 the Japanese national tax system retained the essential features of what one newspaper called the 'patched and tattered' Shoup plan, while the local tax system had departed further from the Shoup framework." B-K cite "Influential Leftist attacks on the Shoup Mission" (p. 241).

Of particular importance, in the present writer's view, is the comment by B-K that "The downward trend in self-assessed income tax receipts" gives "grounds to fear that it reflects...some deterioration of enforcement, so that the Japanese [personal] income tax may become in time little more than a disguised payroll tax...in the sense of hitting primarily wage and salary earners, while leaving the rest of the population relatively untouched." (p.243).

B-K state that the 6 percent tax on book gains from revaluation of assets was repealed, but do not give the date (p. 244).

They also state that "The Equalization Grant is gone; national grants to local units are largely ad hoc and have the traditional strings attached" (p.245).

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[2]. For still other appraisals of the Report, see the References in Ishi (1983); Yamamura (1967).

In a second article, Bronfenbrenner and Kogiku examine what in their view were the causal factors - political, economic, and social - that explain "the Japanese modifications of the Shoup tax system."

The Report's "details never achieved the full support of the Japanese Government, the Japanese Opposition parties, or the Japanese administrative bureaucracy. Even the Report's "honeymoon period" (Autumn 1949) combined acclamation in the large with obstruction in the small." (345).

"Keiichiro Hirata, who worked closely with the Mission...expressed what probably was the bureaucracy position in two separate volumes [cited]. He described the Shoup tax system as theoretically ideal, and possibly applicable to some future Japan with more highly developed capitalism, higher national income, and greater tax-consciousness, but poorly adapted to the Japan of 1949-50." (345-346).

"Perhaps because of the lukewarm enthusiasm for the Shoup Report shared by the Japanese Government and its higher bureaucracy, the Japanese tax administration never developed enough technicians adequately trained to administer the more novel and complex features of the system." (346)

"Bills were drawn up, introduced, and in some cases passed on an overly aggressive basis, i. e., without sufficient attention to the special problems of the special interest groups affected most drastically by the Shoup program." (347).

"On the economic side, the Shoup Mission's greatest handicap was in having been oversold. The Japanese expected a miracle man who could cut their taxes and prices simultaneously, and Shoup disappointed them."

The Report challenged "the Japanese view that they were overtaxed," since tax-to-national-income ratios were not large compared with the United States and Great Britain. "This was anathema to the Japanese," who insisted that the comparison take into account official exchange rates, point to personal exemption levels, specify some prewar standard period, and be based on "supernumerary" income (350).

"What might SCAP and the Shoup group have done or avoided doing to increase the long-term fruitfulness of the Shoup Mission? Four main groups of possibilities suggest themselves...

"1. The Mission should have been summoned earlier, before deterioration of relations between SCAP and the Japanese had set in...

"2. Seven Supermen could not draw up in five months a document of the length and scope of the Shoup Report without some technical defects....

"3. ...had time permitted, the Shoup Report might have been more palatable if presented in the form of alternatives among which the Japanese themselves might choose (perhaps within limits).

"4. ...the jurisdiction of the Mission should have included some over-all aggregative recommendations on the expenditure side.... The Mission might also have been permitted representation in policy decisions on money, credit and debt matters..." (359-360).

"Low marks must be assigned the Shoup Mission's efforts at inculcating tax-consciousness among the Japanese prefectures and municipalities. Herein lies an important economic reason for the submersion of the Shoup system of local finance in a sea of red ink." (351-351).

"...certain technical shortcomings of the Shoup system may explain why the increase in local tax-consciousness was somewhat disappointing." (353).

"Passing on to fiscal sociology, the Shoup system's limited ability to improve taxpayer morale in connection with self-assessment might well have been forecast." (355).
"...the Mission may have yielded too much to rationalist predilections in overestimating the strength of logical argument in tax matters as against certain ingrown Japanese popular attitudes.... We may cite three folk prejudices with which the Shoup Report collided.... Both Japanese and Chinese have tended traditionally to prefer indirect over direct taxation because they associate direct taxation with inquisitorial methods of enforcement and with tyrannical government generally.... In Japanese history, periods of local independence have seen periods of lawlessness and civil war...the undivided family is felt by many Japanese to exercise a real function in reducing fragmentation of landholdings and...in assuring support for family members.... The accession principle in succession taxation flies in the face of this feeling..." (356-357).

"The ultimately damning ideological handicaps which the Shoup tax system never overcame were its American origin and the lateness of its imposition in Japan.... Had the Shoup Mission been summoned and submitted essentially its same plan in 1946 or even as late as 1948, a greater proportion of that plan would almost certainly have endured as well [as did earlier reform programs in the Occupation]." (357-358).

"Three things had happened by 1949 to end the era of good feeling. The Occupation had overstayed its welcome.... It had also changed its primary function (without consulting the Japanese) from mopping up Fascism to holding back Communism...Finally, the Japanese themselves had turned a corner economically..." (358).

2. James

In a master's dissertation at King's College, Cambridge University, completed in 1987 and entitled Japanese Tax Policy in the Wake of the Shoup Mission, Jason C. James examines the changes in the Japanese tax system during the seven years following publication of the 1949 Report. Only the Mission's recommendations for the tax law are covered; James excludes from his study the recommendations on tax administration and tax education (tax atmosphere), though noting that in the latter two fields "The achievements of the Reports [1949 and 1950]...should not be underestimated." (p.1)

Although James limits the time frame of his study to the period 1949-1956, some of his conclusions seem to refer to 1987: "...the reforms enacted following the...1949...Report are often held to constitute the basis of the present [sic] Japanese tax system. The present study aims to show that this is so only in a very limited sense.... I aim to show that...hardly any of what one may call the Report's 'strategic objectives' in the field of law were fulfilled in the longer term [1956? 1987?].... By showing that almost all the major objectives of the Shoup Missions were dropped during this period, and that the structure envisaged by the Missions for most of the major taxes was lost, I intend to demonstrate that the effect of the Shoup Missions on the Japanese tax system in the long run [sic] was not great" (pp. 1-2).

In his last section, "Conclusion," James says:

"The discussion above of the main aims of the Shoup Report and of how its recommendations fared in the next five years reached the following conclusions:

"The two criteria on which the recommendations were based, namely equity and simplicity, were both subordinated to another criterion which the Report did not recognize, namely, the achievement of a higher than market rate of economic growth.

"Turning to what I have defined as the broad objectives of the Mission, namely (i) the creation of a permanent tax system for Japan, (ii) increased local fiscal autonomy, and (iii) an increase in the proportion of direct relative to indirect taxation, the results were mostly negative. Looking at (i), it is of course easy to demonstrate that the Shoup system was altered afterwards, but not so simple to answer the question whether these alterations were significant in terms of the system itself, or just adjustments which left the fundamental system unaltered. In view of the effect which the alterations had on the objectives of the Mission, I conclude that the Mission did not create a permanent tax system. I have described above how the Mission failed in its quest for greater local fiscal autonomy (ii). Objective (iii) was achieved in the long-term (although the results were not particularly visible in the time-period I have been discussing), but not in the way that the Mission had in mind. The subsidiary objective of making the income tax "the mainstay of the fiscal system" was not achieved.

"The recommendations for the structure of the main taxes met with mixed results. Among the national direct taxes, which the Mission wanted to see raising the bulk of national tax revenue, the Individual Income Tax soon lost the structure envisaged by the Mission, returning to higher top rates and no Net Worth Tax, and moving back towards a schedular rather than a unified treatment. The Corporate Income Tax did not move so far away from the Mission's recommendation but the fundamental principle that corporations should be taxed according to the 'legal fiction' view was dropped, and many special provisions of which the Report would not have approved were added to the corporate tax law. The procedure for asset revaluation, however, which affected several other areas of the tax law apart from this one, can be said to have been the greatest success among the Mission's recommendations. It was only an on-off operation rather than a part of the tax system, but it achieved its aims and was carried out more or less according to plan. The Estate and Gift Taxes survived in roughly the form envisaged by the Mission during the time period under consideration (although they reverted to the old format in 1958).

"Among the National Indirect Taxes, the proposed increase in the proportion of revenue raised from the liquor tax and reduction of the proportion raised by the tobacco monopoly were never carried out. The Transactions Tax was, however, repealed as recommended.

"The Shoup system of local finance never really got started. The biggest blow to it was the abolition of the Equalization Grant in 1954, but the system was already severely endangered by the fact that the Enterprise Tax was never imposed on a value-added basis as recommended, thus depriving local governments of 18 billion yen in the very first year after the Report was published. The recommended, relatively minor, alterations to the Inhabitant's Tax and Real Estate Tax were however carried out.

"I conclude therefore that while a great number of the detailed suggestions contained in the Report were implemented, it did not have a great impact on the Japanese tax system in the longer term. It is going too far, though, to conclude that consequently the Report was a failure. It was asked to provide detailed recommendations for the Japanese tax system and this it did. The blame, if any, for failure to incorporate the recommendations into Japan's tax system lies not with the Mission but with the Japanese political process."

James' evaluations are to be taken seriously, especially his analysis of why the outcome was as it was; his facility in the Japanese language has enabled him to tap sources not accessible to the present writer. Especially informative are his translations of passages from books (post-1949) by the finance minister of that time, Ikeda Hayato, and by Hirata Keiichiro, then director of the Central Tax Office.

James' general conclusions rest, however, on a scale of implicit weights that he gives to the several recommendations that differs from my own. I attach great importance, for example, to repeal of the turnover tax without replacement by any general sales tax at the national level, to repeal of the excess profits tax, to strengthening of the local real estate tax, and to the provisions for revaluation of assets. James seems to view the first two rather casually, and, while agreeing that the last two were important, weighs them lightly compared with certain income tax provisions adopted, or not repealed, in 1950-1956 that went counter to the Report's recommendations or philosophy. Two especially concern him:

"(b) Abolition of anonymous accounts: Two other recommendations which seem to have been discarded out of hand were the abolition of anonymous accounts and the record-keeping requirement for wealthy individuals.[1] The former was passed as a Ministry of Finance Ordinance in 1950, but was repealed in 1951 without ever being enforced. The latter was never included in the Tax Bill as passed by the Diet. These omissions were particularly unfortunate since they made effective enforcement of the Net Worth Tax, Individual Income Tax and taxes on capital gains (treated on the same footing as ordinary income under the recommendations) impossible and thus undermined the whole logic of the Shoup system of individual and corporate income taxation. Shoup was well aware of the implications of anonymous accounts in particular and denounced them in no uncertain terms.[2] The explanation for this serious omission from the reform programme as passed into law can be found in Bronfenbrenner & Kogiku.[3] In the deflationary environment of 1949-50, there was thought to be the possibility of a banking and securities crash if enforcement of rules on anonymous accounts caused large withdrawals. SCAP was too easily convinced of this danger by the fact that it was in any case trying to encourage expansion (and thus democratization) of the securities markets. If there had really be a will to enact these record-keeping requirements into law, then the boom from the latter part of 1950 caused by the outbreak of the Korean War, when there was no likelihood of a stock market or banking crash, would have been the perfect opportunity. That resistance to such a law is well entrenched in Japan, however, is demonstrated by the fact that nearly forty years later this nettle has still to be grasped" (pp. 12-13).

Other measures that ran counter to the Report's recommendations or philosophy were, according to James (pp.14-15):

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1. E.g., First Report, p. 99.

2. E. g., First Report [of the Tax Mission], p.85.

3. Op. cit., p. 348.

"(a) Equity: The principle of equity, which the Report insisted on as being of paramount importance, was gradually subordinated to other concerns by Japanese policy-makers. Once equity in enforcement had been dealt a serious blow by the discarding of the recommendation on anonymous bank accounts, etc., the case for equity in the law itself was severely weakened. The law began to discriminate between different forms of income for a mixture of two reasons: (i) that taxation of certain types of income was particularly difficult to administer, so in these cases, taxation should be at lower rates to encourage compliance, and (ii) that certain activities (e.g saving, investing in certain types of equipment, exporting) should be encouraged by favorable tax treatment.

"(b) Simplicity: The simplicity of the tax system was somewhat impaired by alterations between 1950 and 1956. Income tax, for instance, began to move back towards a schedular form, with bank interest, dividends, retirement income and forestry income all receiving special treatments. An additional top rate of 65% was added to the income tax rate scale in 1953. Capital gains were given special treatment, also in 1953. Corporate income tax was being levied on ordinary corporations at two rates instead of the recommended single rate by 1956. A lower rate for special corporations was introduced in 1952. The only corresponding moves toward simplicity were the abolition of some recommended taxes.

"Unhappily for local autonomy the Equalization Grant system was abolished in 1954 precisely because of budgetary problems at the national level. The recession caused by the cease fire in the Korean War from July 1953 necessitated a reining back of budgetary expenditures, and the Equalization Grant was the preferred target.[1] The Mission's formula plan for distribution of the Grant was still used by the Local Autonomy agency in the distribution of shared taxes,[2] but the amount distributed to local authorities became once more dependent on the national government's decision as to how much was available, rather than on an independent assessment of how much was necessary. "The Equalization Grant should have been a system for fiscal support of local autonomy 'from below', but on the pretext that it was 'not suited to conditions in Japan' it disappeared completely in just four years."[1]

"The Municipalities were never given control of the rate of the Real Estate Tax, and by 1957 the Inhabitant's Tax rates were also nationally controlled. Given the fiscal pinch felt by the local authorities all through the intervening period, they never had any option but to set their tax rates at the nationally fixed ceilings in any case.

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[1]. Nishi, p. 140.

[2]. Bronfenbrenner and Kogiku, p. 252.

[1]. Nishi, p. 139.

"More importantly, the income tax structure as envisaged by the Mission simply unravelled between 1949 and 1953. The Net Worth Tax could not be effectively enforced without the banning of anonymous accounts and the record-keeping requirement on wealthy individuals. It was thus repealed in 1953. It, therefore, followed that to maintain the progressiveness of the income tax, the top bracket rates had to be raised (to 65%, also in 1953). The Mission itself had stated: "We should certainly not recommend lowering the top income tax rate to 50 or 55 percent (national tax) if a net worth tax were not available."[1] The lack of effective administration procedures also made it impossible to tax capital gains effectively, so, again in 1953, the law was changed such that capital gains of less than 150,000 yen became tax-free, and only half of capital gains above that figure were taxable. Inconsistently capital losses continued to be fully deductible. Capital gains and losses on securities transactions were to be ignored altogether for tax purposes because of the particularly great administrative difficulties involved, and because of pressure from banking and securities interests. Even the official Ministry of Finance account sounds less than wholly convinced of the case for making capital gains from securities transactions completely tax-exempt: "[T]he taxation of capital gains allegedly hampered the development of the securities market[2]," (my italics).

"(c) Corporate Income Tax: The Mission's procedures for revaluation of assets were carried out, although they took rather longer than the Report anticipated. They were carried out in three stages and were not completed until 1954.

"Corporation tax rates have remained relatively low in Japan in accordance with the Mission's recommendation. But withholding tax on dividend payments had to be restored in 1952 as a result of the lack of effective records of securities holdings, meaning that the 'legal fiction' approach which the Shoup Missions took towards corporations had effectively had to be abandoned. More importantly, between 1951 and 1956 the Corporation Tax became riddled with special measures intended to promote economic growth. There were over 50 of these on the statute books by 1956.[1] Nakamura Takafusa argues that already by 1951 tax

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1. First Report, p. 84.

2. Outline of Japanese Taxes, 1986. Tax Bureau, Ministry of Finance, Tokyo.

1. Pechman and Kaizuka, "Taxation," in Patrick, H. and H. Rosovsky, Asia's New Giant: How the Japanese Economy Works. Washington, D.C.: Brookings Institution, 1976.

exemptions had replaced direct subsidies as the government's preferred method of implementing industrial policy.[2]

"The history of the 'income surcharge' is interesting. The Mission recommended its imposition at 1% p/a for ordinary corporations, but it was in fact imposed at a 2% rate and then repealed altogether in 1951 "in view of the important role of the profit retention in business financing."[3] One may suppose that pressure from bureaucratic policy-makers (e.g. MITI) and from business interests led to the repeal of this tax, but why was it introduced at a double rate in the first place? The double rate meant an effective interest charge on deferred taxes of 6.6% p/a on a 55% rate (national and local combined) taxpayer and as much as 13.2% on someone paying at 40%.[3] Moreover, doubling the rate exacerbated the regressiveness of this tax as noted by Hayashi.[4] One is almost tempted to conclude that the tax was deliberately made harsh in order to make it easier to repeal later."

3. Pechman and Kaizuka

The most negative appraisal of the Report's influence that has come to my attention was that written in 1976 by Pechman and Kaizuka. Their assessment was embedded, in bits and pieces, in their detailed description and analysis of the Japanese tax system. "Japan began its postwar recovery with a blueprint by the Shoup Mission that would have made its tax system a model for the rest of the world. But the Shoup blueprint was quickly dismantled, and a Japanese brand of taxation was substituted" (p. 371). As to local finance, "The Shoup Mission recommended a greater local autonomy than was traditional in Japan, but this advice was virtually disregarded" (p. 336). On the positive side, "The major legacies of the Shoup proposals have been to make income taxation acceptable as the basic source of revenue in Japan, to raise the level of tax sophistication, and to improve tax administration" (p.321).

4. Tax Bureau, Japanese Ministry of Finance

In their annual Outline of Japanese Taxes, the Tax Bureau of the Japanese Ministry of Finance, in reviewing the history of Japan's tax system, have commented on the influence of the Report. In the 1986 edition, they say

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[2]. Nakamura Takafusa. "Sengo no Sangyo Seisaku" (Postwar Industrial Policy). In Niida H. and Ono A., eds., Nihon no Sangyo Soshiki (Japan's Industrial Organisation). Tokyo: Iwanami Shoten, 1969.

[3]. Outline, p. 8.

[3]. These calculations use the method described at First Report, pp. 109-10.

[4]. Op. cit., p. 229.

that "the intentions [of the Tax Mission] seemed somewhat too idealistic to fit in with the reality of the Japanese economy and standard of living of the Japanese people. The tax reforms made year to year since 1951 have represented the efforts to readjust the taxation system to actual conditions prevailing in the country" (pp. 7-8). They continue: "The Shoup recommendations were founded on the general principle of equitable share of the burden to meet government expenditures.... Many concerned persons in the Government, however, felt that, in view of the conditions of the Japanese economy then prevailing, vital economic policies might override certain general principles of taxation" (p. 8).

5. Other Appraisals

Other appraisals of the Tax Mission's Report tend to view the present-day tax system of Japan as being, in some sense, based on that Report.

Yukio Noguchi (1986) puts it this way: "It is not easy to evaluate whether the Shoup reform has, in fact, formed the basic structure of the postwar Japanese tax system. Some recommendations, such as the wealth tax and the capital gain tax (on profits from sales of securities), were abolished a few years after they were implemented. Proposals such as the introduction of the value-added tax were not adopted at all. Also, some reforms were modified significantly by subsequent amendments which aimed at promoting capital accumulation. This is especially true for the corporate income tax. However, the implications of the Shoup reform were quite profound, especially in that the income tax did become the most important tax. In this sense, the reform established the basis of the Japanese tax system in the postwar period." (p.38).

John Curtis Perry, in his description and appraisal of the Occupation, devotes a few pages to describing the Tax Mission and the conditions under which it worked, and, without going into technicalities, concludes that "The tax system in any nation is likely to change in thirty years, and Japan is no exception. Yet 'the spirit or essence' of the Shoup recommendations remains...." (p.155).

News dispatches in United States journals, dealing with current tax reform efforts in Japan, have on occasion described the existing system as being based on the Report's recommendations: "Advocates of tax revision point out that Japan's tax system has changed little from the one established by the Shoup Commission in 1950..." (Chira); "Japanese know their current tax code as the Shoup system..." (Burgess). In fact, the truth may be closer to the reverse of such statements. The current tax reform movement in Japan seems in large part an effort to remove most of the tax preferences that have been introduced into the income tax in the period sincce 1950.

VI. Some Retrospective Observations

A tax mission is a technical assistance group. Its chief task is to lay before the relevant government officials and the public the tax problems that they face and the solutions to those problems that the Mission favors, with a full explanation of why these particular measures are recommended. In addition, the Mission should stimulate interest in improving what has been called here the tax "atmosphere" so that tax policy becomes a widely discussed and well understood part of the political and social arena of debate.

Of course, education is not enough, or, rather, it should be informed education. No matter how lucid and widely read the Report turns out to be, it is a failure if its authors so misunderstand the environment they are dealing with that virtually none of the recommendations are ever accepted. At the other extreme, however, can one say that success is marked by almost complete and immediate acceptance of the Report's recommendations? Perhaps not; after all, no foreign-staffed Mission, however capable its members, is likely to learn enough about the country in question to be right, in one sense or another, on all issues. Complete and immediate acceptance would seem to imply that the Mission has failed in its educational aim. It has not taught the country to think for itself, and think clearly, on tax matters. (I was not only surprised, but somewhat uneasy, when, shortly after returning to the United States in 1949, I learned that almost all the Mission's recommendations had, it was said, been put into law. As it turned out, I need not have been quite so uneasy.)

Another test for success or failure of the Mission might be the degree to which the Mission's recommendations, if adopted, did achieve the goals the Mission had said they were aimed at. Here, answers are hard to get. Japan's economic recovery after the war is a matter of record. But would it have been much the same, if the Tax Mission's recommendations had been ignored? Perhaps the only assertion we should make is the very modest one that at least those of the Mission's measures that were adopted did not block a strong and rapid recovery.

Economic consequences, however, are not the only measure of success or failure. If gross inequities, as perceived by taxpayers, are greatly reduced by the tax reform, there is a corresponding increase in well being, or decrease in dissatisfaction, that is as important, in its own way, as a measurable increase in economic well being. Whether a tax restructuring accomplished this aim is something that has to be inferred; the data are not usually among those collected and publicized. A fair inference here would seem to be that, yes, Japanese taxpayers as a whole felt better about their tax system, or less hostile toward it, as a result of the reform.

This feeling, however, has probably weakened over the nearly four decades since 1950. The income tax, as noted above, has been studded with a number of exemptions and low rates, to stimulate certain types of economic activity. Apparently, also, application of the tax law has been much less effective with regard to the self-employed (professions, small business, farming in general) than with respect to the wage and salary earners, whose tax is collected largely by withholding. One gets the impression that the tax reform movement that has been sweeping Japan for the past year or so reflects a desire to end tax inequities rather than to tailor the income tax still further to stimulate economic growth. In any event, an appraisal of the Tax Mission's Report must take account of the emphasis placed on fairness. In my brief Preface to the 1985 retranslation of the Report, I expressed the opinion that "Important though economic goals are, fairness (equity) in the tax system is even more important. 'A tax system can be successful only if it is equitable, and the taxpayer must realize that it is equitable.' (p. 16, Vol, I, 1949 Report). Without perceived equity, a tax system becomes prey to elaborate avoidance devices developed chiefly by disgruntled taxpayers, and to outright evasion. Then, no matter how efficient economically the tax system was initially, it soon loses this attribute, too, as evasion and avoidance alter the very structure of the system. Without a high degree of perceived equity, a tax system will ultimately fail to reach any of its goals." [pp. 5-6].

To say that a tax mission is a technical assistance group is not to imply that it shall concern itself only with the technical aspects of tax administration and compliance, offering no advice on the structure of the tax system or tax policy generally. Yet it now appears that just that point of view was held by some high-ranking Japanese officials in 1949. The Minister of Finance at that time, Ikeda, in a book called "Kinko Zaisei" ("Balanced Budget"), wrote: "I had no particular intention that Shoup should give me theoretical recommendations for the Japanese tax system. The tax <u>system</u> as such was based on a fairly careful study of various European systems, and its theoretical underpinnings were well developed, so there was no particular need to seek the guidance of foreigners on the system itself. But there was at that time quite a lot of confusion in the operation of the tax laws, that is, in tax administration. But this was the result not so much of defects in the tax system as of other factors, such as the general social disorder of the time, the fact that increases in the basic exemptions had lagged behind the severe inflation, thus greatly increasing the number of taxpayers, and the consequent fact that large numbers of new and inexperienced tax officials had to be employed." (Translated by Jason C. James, letter to Shoup, Jan. 20, 1987.)

This was certainly not the assignment outlined for the Tax Mission by Moss, on behalf of MacArthur, in October, 1948, at Columbia University, and nothing that I learned from conversations with Ikeda and other Japanese officials in 1949 (conversations carried on through interpreters) suggested that they thought the Mission's task should be so restricted in scope.

Looking back from the vantage point of nearly four decades later, what do lwe see that appears dubious or erroneous in the Mission's activities and recommendations?

Among the recommendations, that of a value-added tax for the prefectures now seems at least dubious.[1] First, the Mission's fears that the cumulated income tax charge of three levels of government would dampen enterprise unduly have been proved unwarranted. Second, to the tax administrator and taxpayer, the value-added tax was the great unknown, however clear in concept and neutral in its economic pressures the tax may have appeared to Mission members. This prospective newcomer evoked uneasiness if not fear. Third, even the pure theory of the value-added tax had not yet been worked out completely; it was not until 1955 that the basic distinction between a consumption-type VAT and an income-type VAT was made evident. Finally, the question of just how to allocate a given firm's value-added between two or more prefectures in which the firm was active was not seriously addressed. On these and other points, the reader is referred to Bronfenbrenner's perceptive analysis of 1950, "The Japanese Value-Added Sales Tax."

Second, although the Mission went into considerable detail on how the personal income tax might best be administered, the existing pattern today is certainly not what had been hoped for. It was not intended that the bulk of personal income tax revenue should come from simple withholding without any filing of a personal return by wage earners and salaried persons. On the contrary, the Mission's aim was to get the average Japanese family closely engaged in the process of tax determination. Allied to this issue is that of unfairness as between these taxpayers and the self-assessed professionals, small businessmen, and farmers who are said to be evading or avoiding personal income tax to a considerable degree. What else might have been recommended, however, to assure the goals the Mission sought, is by no means evident.

Third, the minor innovations of the net wealth tax, the low-rate "interest charge" tax on undistributed profits, and the substitution of inheritance for estate in the death tax (and the cumulation with gift tax) might have been recommended only for some future year when these novelties could have been accommodated more readily than in the chaotic days of 1949-1950. These innovations were minor, not in the sense of principles at stake, but in the revenue implications, and so might have been postponed. Postponement, however, would probably have meant negation, in fact.

What of the four suggestions by Bronfenbrenner and Kogiku as to how the Tax Mission might have been more effective (1957, 359-360)? "1. The

[1]. The value-added tax proposed by Prime Minister Nakasone in 1986 was far more complicated that the one recommended by the Report, for the prefectures: for example, fifty-one categories of goods and services excluded (Darlin).

Mission should have been summoned earlier, before deterioration of relations between SCAP and the Japanese had set in." B-K recognize the difficulties such an earlier Mission would have encountered (e. g., inflation less close to control), and in my opinion those disadvantages would have far outweighed the "sociological" advantages they claim for an earlier Mission. "2. The Mission should have remained in Japan long enough to make the most pressing corrections" of "some technical defects" in the Report. Such defects, however, do not seem to have been numerous or important enough that correcting them before the Report was published would have made much difference in the outcome. Moreover, early publication of the Report, before public interest in the Tax Mission had subsided, was important. B-K recognize that it would have been impracticable for the entire Mission to have stayed in Japan longer, in view of their commitments elsewhere, but the alternatives they suggest seem to me also largely impracticable. "3. Had time permitted, the Shoup Report might have been more palatable if presented in the form of alternatives among which the Japanese might choose (perhaps within limits)." But we might have ended up with a textbook on taxation, which was not our assignment. Each recommendation was accompanied by arguments pro and con, and the tone was that of giving our own best judgement, not laying down a law that had to be accepted. "4. After SCAP had the Shoup Mission advertised to the Japanese as purveyors of tax reduction, the jurisdiction of the Mission should have included some over-all aggregative recommendations on the expenditure side...[and] on money, credit, and debt matters...." If indeed SCAP so advertised the Mission, it erred, but we were not aware of such advertising. Adding the other items to the Mission's task would have swamped it.

This rather unsympathetic appraisal of the B-K suggestions does not imply that they were completely off-target, but rather that the explanation of why the Mission was not (even?) more successful than it was must be sought elsewhere. But is that "elsewhere" clear?

Appendix A

MacArthur and Yoshida on Tax Mission Report

THE MAINICHI
Sunday, September 18, 1949

SCAP Hopes Japanese Government Would Form Appropriate Program to Effectuate Shoup Recommendations

Letter to Premier Virtually Assures Quick Diet Approval

TOKYO, Sept. 17--General Douglas MacArthur has told Japanese Premier Shigeru Yoshida in a letter dated September 15 that he hoped the Japanese Government will be able to "formulate an appropriate program for effectuating the broad principles Gen. MacArthur and objectives set forth in Dr. Shoup's recommendations."

This virtually assured quick passage by the Japanese Diet of the Shoup recommendations.

The text of General MacArthur's letter follows:

Dear Mr. Prime Minister:

I transmit herewith the report on Japanese taxation prepared by Dr. Carl Shoup and the members of his Mission, who were invited by me to come to Japan to conduct a comprehensive survey of the existing Japanese tax structure with the view of submitting recommendations which would assist in the establishment of a more equitable tax system.

This Special Minion, after four months of intensive study which included interviews with taxpayers in all walks of life and investigations of many different types of business or agricultural activities, has evolved a body of recommendations which, taken together, should provide a vehicle for placing the finances of the national and local governments of Japan on a sound foundation.

I trust that the Japanese Government will be able to formulate an appropriate program for effectuating the broad principles and objectives set forth in Dr. Shoup's recommendations in sufficient time to permit the Japanese Diet to consider that program simultaneously with the related budgetary and stabilization programs in order that the Japanese people may at the earliest possible time have the benefits of a sound fiscal system.

Sincerely yours,

DOUGLAS MACARTHUR

Yoshida Replies to SCAP

TOKYO, Sept. 17--Upon receiving General MacArthur's letter on the Shoup recommendations, Prime Minister Shigeru Yoshida sent a reply to SCAP today at noon.

Given below is the text of the Prime Minister's reply, which was later announced by the Cabinet:

My Dear General:

I desire to acknowledge the receipt of your letter of yesterday's date and the Report on Japanese Taxation by Dr. Carl Shoup and the members of his Mission.

The report is literally a monumental work, which is bound to mark a new era in Japan's fiscal policy. I fully realize the fact that the recommendations are not to be accepted electrically, but they should be taken as a whole if they are to serve as the basis for a rational and equitable tax system such as is envisaged by Dr. Shoup.

It is with this fact in mind that my Government will study the Report and formulate a taxation program to be submitted to the coming Diet.

On behalf of my Government I avail myself of this opportunity to express our profound appreciation of the arduous labors of the Shoup Mission as well as your unfailing solicitude toward the welfare of our nation.

Yours very sincerely,

SHIGERU YOSHIDA

Appendix B

Extracts from Letters by Shoup from Japan, May-August, 1949

The following extracts are from letters by Shoup to his family, from Japan, in the summer of 1949:

"At Guam at 10 a.m., then on another cargo plan [MATS] at noon, reaching Tokyo 8 p.m. Lots of newspaper men and flash bulbs, and the Finance Minister...and Moss and others. To the Imperial Hotel, where I have a 2-room suite, very comfortable. Wednesday morning I visited Moss' offices; at 12:30 I went alone to see MacArthur, and talked with him in his office for about an hour. He was very pleasant, informal, and promised full support of our mission. In the afternoon we had a courtesy-call meeting with Ikeda (Fin. Min.) and 3 other high Japanese officials in Moss' office--rather awkward at first, as it all had to be done through an interpreter, but we all relaxed a little after a few minutes. Polite expressions of appreciation, etc." May 12, 1949.

"...we are learning of the enormous gap between the tax laws on paper and how taxes are actually assessed and collected. It's more striking even than in France. Doctors in an area (say a city, or a part of Tokyo) belong to a "union," whose "boss" negotiates with the tax collector how much the doctors should pay as a group; then the members of the group divide up the tax bill among themselves somehow. Japanese firms either keep no books at all, or several sets of books (one for creditors, one for the tax collector, one for management purposes, etc.).... At noon today the four of us [Cohen, Hatfield, Shoup, Vickrey] and Moss and Gen. Marquat, have lunch with Gen. and Mrs. MacArthur." May 14, 1949.

"Saturday's lunch at the former American Embassy, now the MacArthurs' home, was easy and informal, mostly small talk, except they told us of the details of their escape from the Philippines and the General gave us his analysis of why Japan went to war and why she lost...." May 15, 1949.

"We've just returned from a trip to Osaka, Kyoto, and Nagoya.... The Japanese railroads run two trains south and two trains north per day restricted to Allied Forces Personnel. A Japanese official from the Finance Ministry who speaks English, a Mr. Hara, and an assistant of his came along on the Japanese section of the same train. Segregation is strictly enforced in all travel; ordinary trains, street cars and buses are marked "Off Limits to Occupation Personnel," some of the trains carry an "Allied Coach.".... At the Osaka station there were the Governor of the Prefecture, the Mayor, and other assorted officials; about a dozen news photographers and another dozen news correspondents. (This scene was substantially duplicated two days later at Nagoya). Also the U. S. Internal Revenue man in charge, and one or two other Military Government officials. At the hotel, deluxe as usual, breakfast was followed by a news conference I almost got out of, but the Military Gov't man said the papers had helped them in their drive for taxes and they wanted to keep on the good side of the press; also, he said this was the first thing he'd ever seen bring the Governor out to the station as early as 7 a.m....after this we got to work, talking with the Japanese tax officials in their tax offices most of the day. We dug into tax files, examining actual returns.

"That evening we all went to the Governor's house for dinner. It was an odd mixture of East and West. We sipped whiskey or sake in the living room and ate an American-style dinner in the dining room, sitting in chairs, but wearing slippers....while four geisha entertainers hovered around, pouring sake and later on doing tricks with matches....

"We engaged chiefly in light conversation with our Japanese hosts through an interpreter, which is not quite, but almost, as hard as it sounds. We also got in some tax discussion....That evening the Governor, the Vice-Mayor (the Mayor was ill) and various other officials gave a real Japanese dinner in a real Japanese restaurant. In a room about three times the size of our living room the Japanese hosts squat along one side of the room, their American guests along the other side. This effectually bars all conversation between hosts and guests....The next day, more courtesy calls; discussions with military Gov't men; a session with heads of large Japanese manufacturing concerns and department stores; and a meeting with a (Japanese) Kyoto Area Economic Development Committee, or something like that: 30 or so around a large table, reporters and news photographers in the back of the room. Too formal to be very informative. In the afternoon we wandered through the alley-ways of a district of small shops, picked one out at random (a retail tea store) and asked the owner what his chief tax problems were. We were surprised at the results. For nearly an hour he discussed the issues lucidly....Just as we started talking with him I noticed a young man grab the phone and talk earnestly for some minutes. Sure enough, the Kyoto paper next day carried a report on the interview. The reporter had been trailing us all afternoon....Next morning we went by train (coach) to Nagoya.... At the Nagoya station we were met by the Governor, the Mayor, and other assorted officials; about a dozen news photographers and (see previous description). I got by with a 5-minute press conference this time. The Governor invited us to his house for dinner." (May 25, 1949).

"We attended a special showing of a new Japanese film last night and were startled by its excellence....This was a pre-preview, given for our benefit, in the private projection room of the film company....Why the intense interest in our mission? There is a 150% (not 15%) tax on all movie admissions....Yesterday I was offered drinks at the formal opening of the new Japanese Internal Revenue Bureau (sake, beer, 3 p.m.), at the cocktail party for a visiting group of U. S. tax agents (cocktails, 5 p.m.), at a dinner given for us at a nearby club (7 p.m.), and in between the first and second parts of the movie (10 p.m.). Can't say that I'm not keeping in practice. Next week we have only 3 dinner engagements." (June 11, 1949).

"Bowen, Moss and I had an interesting week-end at the home of a well-to-do farmer (Hara along as interpreter). The weather cleared, and we tramped along the little levee-foot-paths interviewing paddy-field farmers of high and low degree. We ate dinner and breakfast at our host's, and slept, on pads on the floor, in one of his rooms." (June 13, 1949).

"The trip has been successful in gathering information, and our group has gotten along without friction, altho packed pretty close in the private car for 10 days. One of our group, Hatfield, had to leave us a couple of days ago, infection of lymph gland near shoulder. He is resting O.K. in Tokyo, we hear. Warren has a touch of food poisoning. So it goes. I've been quite well all the trip, altho pretty tired after some days of interviewing, especially when they were topped off by an official Japanese dinner.... This morning Surrey, Takahashi and I descended unannounced on the Communist headquarters at Nagano, this region being noted for Communist activity, and got their views on the tax problem. We came on them so suddenly they didn't even stick close to a party line--they weren't prepared.... Next week we have a series of discussions with the Finance Ministry experts at Tokyo." (June 30, 1949).

"Last night we had dinner at the Prince & Princess Takamatsu's. He is the second younger brother of the emperor...Mrs. Harada [wife of a family friend] was there, and since Mr. H. was out of town I was asked to drive her home in my car. It was only a few minutes from the Prince's. But she got completely lost, and the driver couldn't figure it out either. We drove around an hour before she found Avenue K. It's a good demonstration of what every one says of Tokyo--the most confusing city to find anything in." (July 9, 1949).

"In a few days I've learned what I could about the Okinawan tax system, and made some recommendations for change. This afternoon I presented them to a dozen or so army and civilian MG men, seated in two rows before me, just like the professor lecturing to the class, with questions afterward. (Time out while I kill a spider half a foot across). If I stayed here a day longer I'd learn too much to permit myself these snap judgments.... I talked with the Okinawan Minister of Finance a couple of afternoons.... I talked with Gen. Eagels here this afternoon, commanding Rycom (Ryukus Command). (July 12, 1949).

"Bowen, Surrey and Warren and I went to MacArthur's office today, to give them a chance to see him, especially Bowen and Surrey, who leave the 27th. The General seemed quite interested in our work, and intelligently so...He ended up by asking, then insisting, that our whole mission come back in a year for a short stay to check up on the results of our reform...It is getting really hot and humid now, like Washington at its worst. Luckily, all the big conference work is over by now. The Minister of Education today, the "Economic Stabilization Board" Monday. (July 24, 1949).

"We are meeting just with ourselves every day now, reaching conclusions. Today it was the transactions tax (sales tax), tomorrow the income tax.... All Saturday morning we spent 'talking' with Dodge and others in Washington over the "telecon" system, which uses typewriters and a screen something like a stock ticker screen.... We discussed (and argued) about the current financial situation in Japan--is it too deflationary or is inflation still the danger?... This week in Tokyo, then a week up at a hotel near Nikko. (July 24, 1949)

"We discussed the tax program among ourselves until 1 a.m. this morning, to cover all we could with the 3 departing members [Bowen, Cohen, Surrey] before they left.... Present idea is that Hatfield leaves Aug. 15, Warren and I on Aug. 27.... We leave Monday for a week at the hotel above Nikko, to write up the report, at least first draft. (July 27, 1949).

"We leave for Nikko in a few minutes--two cars, four people, several suitcases, and a mountain of files. All for six days. Also 3 typewriters.... We are a little uneasy as the deadline for completion of the report nears, and it's not done, to say the least. But somehow we'll get it finished. We've shown parts of our conclusions already to MacArthur & Marquat & Whitney, and have had a good reaction so far. (August 2, 1949).

"This is a very pleasant place--4000 ft. high, cool, quite away from the sweaty weather of Tokyo. The four of us have three rooms, and three typewriters, and we are using this chance, where it's cool and quiet, to work morning noon and night getting the report written. It is still going to be a tight squeeze but we'll make it all right. (August 3, 1949).

"We are still at the Nikko Kanko, working on the tax report all day and every evening. It is an ideal place for that sort of thing, since we have no interruptions at all. Representatives of a coal miner's union showed up at the hotel the other day to present their views on the tax system, but we just accepted their written memorandum and wouldn't even go into the lobby to say hello. We plan now to stay here until Wednesday. Today we sent by messenger to Tokyo the first part of Ch. 1, ready for translation into Japanese. (August 7, 1949).

Appendix C
Social Insurance Contributions: FY 1976 – 1985 (about)[1]

(in millions of yen)

Social Insurance Item	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 (Budget Est.)
Social Insurance Total	10,546,837	12,423,229	13,952,948	15,306,008	17,344,883	19,630,385	21,058,614	22,090,584	23,372,920	26,279,776
Government-managed health insurance	1,493,721	1,702,830	1,952,928	2,135,196	2,322,687	2,642,566	2,850,064	2,986,473	3,130,025	3,412,250
Society-managed health insurance	1,474,142	1,669,994	1,870,746	2,003,697	2,165,992	2,396,372	2,610,917	2,765,436	2,919,081	3,145,069
Day-laborers' health insurance	24,173	25,004	25,701	26,224	26,068	25,534	24,655	22,875	10,655	—
National health insurance	750,139	882,437	1,039,590	1,170,467	1,308,627	1,485,338	1,595,661	1,674,327	1,777,925	1,993,175
Employees' pension insurance	2,857,255	3,458,246	3,717,578	3,988,005	4,700,738	5,627,452	5,998,708	6,290,589	6,576,374	7,596,808
Employees' pension fund	433,686	507,558	569,305	637,462	734,919	854,324	935,808	1,003,511	1,082,942	1,168,663
National pension	411,116	629,347	832,409	1,005,868	1,182,371	1,240,447	1,376,101	1,460,372	1,500,687	1,943,685
Farmers pension fund	28,206	37,519	46,632	61,362	55,598	53,806	59,964	62,300	63,994	67,568
Employment insurance	639,134	722,980	807,064	918,848	1,011,274	1,063,139	1,171,946	1,231,192	1,276,397	1,387,845
Workmen's accident compensation insurance	489,490	538,397	593,059	646,119	841,675	945,325	9[illegible]3,071	960,896	991,159	1,070,042
Government employees' accident compensation	16,884	19,658	21,952	22,977	24,656	27,551	29,241	30,241	31,890	36,890
Seamen's insurance	119,836	137,115	141,985	143,897	154,447	174,946	185,318	185,145	187,235	208,793
National public service Mutual Aid Association	345,785	392,178	415,682	451,161	494,380	530,361	544,371	564,285	624,852	764,519
Public corporation employees M.A.A.	399,396	465,156	571,206	626,365	685,253	794,869	889,162	974,200	1,092,951	1,096,226
Local public service M.A.A.	928,763	1,051,028	1,169,857	1,269,444	1,416,367	1,519,645	1,545,787	1,596,765	1,781,079	2,077,422
Private school teachers' & employees' M.A.A.	71,921	82,982	98,972	114,361	128,827	141,197	152,586	161,767	171,011	179,908
Agricultural, forestry & fishery institutions	63,190	70,810	78,282	81,565	91,004	107,513	115,251	120,210	124,663	130,913

Appendix D

Comparison of Present-Day Income Tax Law in Japan with Recommendations in the Report: Certain Specific Issues

Present-day income tax law in Japan coincides, at least fairly closely (Y) or does not so coincide (N) with the following recommendations in the Report (for details, see Outline, and Price Waterhouse): (1) dependent allowance to be a deduction instead of a tax credit (Y); (2) deduction, at least partial, to be given for medical expenses (Y) and property loss through accident or theft (Y); (3) irregular incomes to be averaged over the years (N); (4) extra allowance to be given to the blind (N) and (5) disabled (N); (6) foreign nationals to be given no strongly favored treatment (Y); (7) corporation tax rate to stay at 35 percent (N); (8) withholding rate of 20 percent on dividends to be repealed (Y); (9) tax on liquidating corporations to be repealed (N); (10) tax of 66 2/3 percent on inventory profits to be repealed (Y); (11) losses to be carried back two years and then carried forward indefinitely (Y); (12) for inventory accounting, allow more methods than just average cost (Y); (13) for depreciation, allow more methods than just declining balance (Y).

The individual income tax law now allows several deductions or exemptions, completely or partially, that the Report opposed, explicitly or implicitly: social insurance premiums; premiums for small-scale enterprise mutual aid; premiums for life insurance and fire or other casualty insurance; extra personal exemption for the aged.

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