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**PENETRATION OF THE SELF-ASSESSMENT SYSTEM FOR INCOME TAX
HALF-A-CENTURY'S EXPERIENCE IN POSTWAR JAPAN**

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1. Introduction

Today Japan's "income tax" program based on the self-assessment system is being operated smoothly to contribute to national finance through the stable supply of a huge amount of tax revenue.¹

When we review the changes in revenues from "income tax" since 1940 when income tax was exclusively applied to taxation on personal income,² we find that "income tax" has attained the status of the most dominant tax item during this period except for a few years. In particular, for more than 30 years from the 1970s, it accounted for approximately 40 percent of total national tax revenues. Recently, this percentage has declined slightly to some 36 percent in fiscal 2000 (final figure), which still far surpassed the second largest percentage of 22 percent achieved by "corporation tax".

The number of taxpayers supporting this "income tax" scheme increased, with some ups and downs, from approximately 5.3 million in 1940 to approximately 52 million (based on 1999 data).³ In terms of the percentage of taxpayers to total population, this represented an increase from less than 7 percent to more than 40 percent. Of these taxpayers, employment income earners (who pay income tax by withholding tax at source) and entrepreneurs (who pay tax under the self-assessment system⁴) were formerly almost balanced in number, but recent figures show that this ratio has changed 6 to 1 through the rapid increase in the number of employment income earners.

The modern tax system for personal income started in Japan with the implementation of Income Tax Law on July 1887, 115 years ago, which was one of the earliest records of income tax in the world. For the first sixty years, official assessment⁵ was adopted in "income tax". It was not until April 1947, two years after Japan's defeat in the war, that Japan changed its assessment method to the self-assessment system, a system currently employed for taxation in which taxpayers are expected to file their tax returns voluntarily.

What are the reasons behind the smooth operation of "income tax" under the self-assessment system now used in Japan, in spite of the fact that so many taxpayers are using this system to meet their tax obligations? It may be said that the Japanese tax payment environment, including the high compliance of taxpayers with their tax obligations, lies behind the smooth functioning of the self-assessment system. Did taxpayers have a high regard for compliance in today's meaning of the term, and was there a sophisticated tax payment environment in place from the adoption of this system? Of course not.

When the self-assessment system was launched in Japan, small businesses were

¹ Revenue from income tax in fiscal 2000 was ¥18,788.9 billion as of the closing of accounts, or US\$157.9 billion at the exchange rate of US\$1=¥119.

² Just before this change, "income tax" was imposed not only on personal income but also on corporate income.

³ As of 1999, the number of taxpayers utilizing the withholding formula for their income tax on employment income was estimated at 44.74 million, while the number of taxpayers filing tax returns to tax offices was 7.4 million. Since it is impossible to determine the number of taxpayers included in both figures, a simple addition of the two figures gives us a total of 52.14 million taxpayers paying income tax.

⁴ This includes entrepreneurs, employment income earners, pension income earners and others that filed tax returns.

⁵ For the official assessment system, see page 4

hardly accustomed to the practices of keeping books systematically, so they had difficulties filing tax returns based on their books and records. In addition, they could not easily abandon the long-established idea of the official assessment period that “tax authorities should inform us of the income tax payable.” To make matters worse, taxpayers led a wretched daily life at that time, poor and unstable beyond comparison with that of today, suffering from the social chaos, damaged economy and sharp inflation following the war.

This paper analyzes why Japan introduced the self-assessment system for “income tax” in such adverse circumstances, what problems it faced as a result of its implementation, and how the country overcame these difficulties to achieve the stable operation of today’s income tax system.⁶ I would be delighted if this case study sheds some light on the development of taxpayers’ compliance with tax liability in postwar Japan.

2. Income tax and Official Assessment before the Adoption of the Self-assessment System

To understand the impact on the self-assessment system on taxpayers, it would be helpful to know something about the previous system and administration of “income tax”. In this section, I will outline the official assessment system and the history of “income tax” up to the adoption of self-assessment system.

Throughout the Meiji Era (1868 – 1912), the nation depended mainly on taxation on land holding called “land tax (chiso)” as the source of revenue for its government. In the early years of the Meiji Era, land tax accounted for more than 90 percent of the national tax revenue, and even in the middle of the era when “income tax” was launched, it accounted for approximately 60 percent of the revenue. Other revenue sources following “land tax (chiso)” included “liquor manufacturing tax (syuzo-zei)”, “customs duty (umikan-zei)” and “stamp revenue”, while the percentage of “income tax” in the national tax revenue was only 1 to 2 percent at the beginning.

In the late Meiji Era, the percentage of revenue from “income tax” grew increasingly, benefiting from the comprehensive modernization of the Japanese economy and expansion of the scope of the income tax system.⁷ In the last year of the Meiji Era, revenue from “income tax” reached approximately 10 percent of national tax revenue for the first time in 25 years since the launch of this taxation. The top tax item of the year was “liquor tax (syu-zei)” (approximately 24 percent of the national tax revenue), followed by “land tax (chiso)” and “customs duty (kan-zei)”, with “income tax” ranking fourth.

Soon after this year, the First World War (1914 – 1919) broke out, triggering a boom and bringing a substantial increase in income tax revenue. In 1917, the proportion of revenue from income tax was nearly 20 percent, and it topped this figure for the first time in the following year. However, it should be noted that indirect taxes still had more weight in the Japanese tax system.

For about 20 years thereafter (~ 1936), the overall revenue grew steadily without any remarkable change in the tax system. Either income tax or “liquor tax, both accounting for about 20 percent of the national tax revenue, ranked at the top every

⁶ When discussing taxation by self-assessment, it is important to note how tax claims were received and how the collection procedure was managed. These aspects are omitted here, however, to focus the issues to be discussed in this paper.

⁷ In the beginning, “income tax” was imposed only on personal income, but in 1899 it was extended to cover corporate income. During the Sino-Japanese War (1894-5) and Russo-Japanese War (1904-5), tax rates were raised to finance the war.

year through this period.⁸

After the occurrence of the Northern China Incident in 1937, Japan increasingly reinforced its armament, and upon the start of the Pacific War in 1941, entered a nationwide war regime. In order to meet the need to procure huge funding sources for the war, the government implemented a series of revenue-increasing measures from 1937, including tax increases on existing tax items such as “income tax,” and the introduction of ‘broader’ excise tax. In fiscal 1940, the government effected the following revisions that altered the basic structure of “income tax”. First, a portion of the tax imposed on corporate income was separated and reclassified as “corporation tax”. Secondly, the remaining portion of taxation on personal income was restructured into a two-layer scheme consisting of scheduler income tax and comprehensive income tax.⁹ Thirdly, the scope of withholding taxation, formerly used for interest on bonds and debentures, was extended to cover employment income and others.¹⁰

Various measures taken by the wartime government increased revenue from “income tax” sharply to reach nearly 35 percent of the domestic revenue in 1944 (the year preceding the end of the war).

In August 1945, Japan was defeated in the Pacific War. Amid an extremely impoverished economy and hit by rampant inflation, living standard of the people dropped to the lowest level. To overcome this situation, the General Headquarters of the Supreme Commander for the Allied Powers (GHQ) directed the Japanese Government to implement such measures as maintenance of balanced finance to eliminate inflation, procurement of tax revenue sources necessary for economic recovery and reconstruction of the nation, and democratization of the financial and tax systems.

With respect to taxation, while the government depended on the existing “income tax” system as a source to meet financial needs in the postwar period, it initiated a study for a desirable tax system suitable for the new era. The result of this study was embodied in the 1947 revisions. These revisions brought some changes to the income tax system: taxation methods were integrated into comprehensive income tax (progressive tax rate), and the assessment method was changed from official assessment to self-assessment. Under these changes, the income tax system retained its dominant place in the whole national tax system.¹¹

The official assessment approach had been employed since the establishment of the income tax system, and underwent some minor changes according to needs of the time. In the following paragraphs I will outline how this tax system operated in wartime Japan.

In the official assessment system, tax authorities assessed the amount of a taxpayer’s income and the tax thereon using their own data and referring to information

⁸ These two tax items were followed by “customs duty”, “stamp revenue”, and “sugar consumption tax”, but the percentage of “land tax” dropped sharply.

⁹ Personal income was classified in six groups, each of which was imposed on scheduler income tax (with different exemptions including the basic exemption and a proportional tax rate), and comprehensive income tax (with the threshold of ¥5,000 and progressive tax rates) was imposed on the total income.

¹⁰ At the time, this was called “earned income” but here I use the term employed in the current tax system for the sake of convenience.

¹¹ To supplement income taxation, taxation on general consumption was considered, and “turnover tax” with a one percent tax rate was implemented in September 1948. This tax met with strong opposition from the people and was abolished at the end of 1949.

submitted from the taxpayer, determined the tax amount with the approval of the income assessment committee (shotoku chosa iinkai), and notified the taxpayer of the amount assessed.¹² The assessment was made mainly by “taxation by estimate” or the “Kenko-saan (balanced assessment formula)” because investigating all the taxpayers was impossible at that time and most entrepreneurs, due to absence of the practice of keeping books/records, submitted insufficient accounting data, which impeded assessment based on the accounting statement of each taxpayer.

The “taxation by estimate” method focused on income estimation. In order to estimate the income of entrepreneurs who had positive data only on their revenues, this method used the gross profit ratio (shotoku-ritsu), which represented the proportion of income to revenue by area and industry as determined by sampling surveys. The incomes of entrepreneurs who had no positive data on their revenues were estimated by applying this ratio to their estimated revenues determined by a method known as the pro forma standard formula¹³ specific to their industry¹⁴.

The “Kenko-saan (balanced assessment formula)” approach was intended to achieve balanced assessments among a number of entrepreneurs belonging to the same industry. Tax officials assessed the income of each entrepreneur, relying mainly on data obtained from detailed field examinations of past cases, adding individual characteristics of the entrepreneur, such as business size and management characteristics. This method also used income ratings of entrepreneurs prepared by the industry associations to which they belonged.

As mentioned above, taxation of entrepreneurs and other entities of similar status was done on the basis of estimates from various indexes, taking into consideration the balance among entrepreneurs in the same business, which greatly deviated from taxation based on the accounting statement of each taxpayer. The reasons for the successful implementation of this method without provoking bitter complaints from taxpayers might be that society was economically unsophisticated and slow to change, and that the income tax liability of taxpayers was limited and not so heavy. After the transition to the self-assessment system, taxpayers failing to keep sufficient books/records were subject to taxation by estimate.

The number of taxpayers categorized as employment income earners increased as a result of the revenue-increasing policy adopted in wartime Japan. To meet this increase, the 1940 revisions introduced a scheduler income tax, which adopted a proportional tax rate of 6 percent for employment income, while applying withholding taxation to employment income so that ordinary employment income earners without other income tax liability might complete tax payment procedures through the withholding system. This meant that ordinary employment income earners were excluded from assessment by the tax authorities.

3. Introduction of the Self-Assessment System and Ensuing Chaos

¹² This statement relates to the status after the revisions in 1901. Before the revision, the amount of income tax of each taxpayer was determined by the resolution of the income assessment committee (shotoku chosa iinkai) based on an examination of income conducted by its investigators.

¹³ For example, the income of hotel business taxpayers was estimated by a pro forma standard formula using factors such as the number of rooms and consumption of utilities.

¹⁴ As for farmers, since there was little difference in quality and crop yields in the same district and under the same conditions, detailed per area standard rates for estimation of income, etc. were prepared for each district to estimate the incomes of farmers.

As mentioned above, in the 1947 revisions made soon after the end of the war, “income tax” was determined to keep its status as an essential taxation scheme in the national tax system. This was the most realistic judgment and entailed the least risk considering the fact that finances at that time were in effect, materially dependent on this tax. At the same time, it may reflect the importance placed on taxation of personal income stressed in the theory of taxation in those days and influenced by the US federal tax system that placed personal income tax at the core of the tax system. The Japanese government and GHQ thus agreed on the importance of “income tax”.

Behind the adoption of the self-assessment system for income tax lay the strong wishes of GHQ and rapid inflation. The traditional official assessment system that determined the tax amount exclusively through administrative proceedings based on the income assessment committees (shotoku chosa iinkai) appeared undemocratic to GHQ, which insisted on the adoption of the self-assessment system utilized in US Federal personal income tax. GHQ believed that adoption of the voluntary self-assessment system was desirable because it served as proof of democratization of the Japanese tax system. In addition, rapid inflation in Japan made it very difficult for the government to secure the tax revenues estimated in the budget because, under the official assessment system, income tax was imposed on the income of the preceding year. The self-assessment system seemed the most appropriate because it had the advantage of imposing tax on the current year’s income.

The Japanese Government strongly objected to the adoption of the self-assessment system, alleging that an immediate adoption of the system was too early and would cause confusion if Japan were compelled to implement the new system without being well prepared for it. However, pushed by GHQ’s strong will and backed by the government’s awareness of the need to impose tax on the current year’s income, the government accepted the change, considering that it had no reason to reject adoption of the self-assessment system if sufficient supplementary measures could be taken at the same time.

Since the transition to the self-assessment system and taxation on the current year’s income involved changes to the basic structure of “income tax”, the government took a series of measures in connection with the transition and revised systems to minimize the confusion arising from the transition.

First, in line with the transfer of primary responsibility for tax assessment from the tax authorities to taxpayers, it was clarified that “tax returns by taxpayers may be corrected through an examination by the tax authorities, and subjected to an assessment procedure based on the result of examination.” Secondly, an administrative penalty system was introduced in the current “delinquent tax (entai-zei), “interest tax (rishi-zei)” and “additional tax (kasan-zei)” procedures, and this penalty system was to be developed further later. Furthermore, provisions were made for severer punishment such as imprisonment for criminal offenses involving direct taxes including “income tax”, which had formerly been imposed only in connection with criminal offences concerning indirect taxes. Thirdly, compulsory investigation, which was initiated in the form of criminal investigation program formerly used only in criminal offences for indirect taxes, was introduced for cases of direct taxes in order to ensure that tax obligations were met.¹⁵ All of these measures were requisite in light of the essence of the self-assessment system, and they have contributed to keeping the system up to date.

¹⁵ The criminal investigation program deals with malicious tax fraud that cannot be determined by voluntary examination alone. Investigations are carried out using coercive measures similar to other criminal investigations, and the results are reported to public prosecutors for criminal prosecution of the offenders.

The year-end adjustment scheme under the withholding system, though not directly related to the self-assessment system, was introduced for taxation of employment income. This scheme allows an employer to settle annual income tax of an employment income earner under its employment by comparing the total amount of taxes monthly withheld from his wage/salary his annual income tax due on such employment income and making an adjustment at the last payment of wage for the year. Ordinary employment income earners can complete tax payment by this formula, so they need not file tax returns individually.

If the government had introduced comprehensive income tax using the progressive tax rate together with the self-assessment system, not only entrepreneurs but also a number of ordinary employment income earners paying their income taxes by the withholding taxation would have been required to file tax returns. Considering the situation at the time, the government devised the year-end tax adjustment scheme under the withholding system to address its concern that such a change would cause disorder at the frontlines of taxation. This scheme played a very important part in promoting the penetration of the self-assessment system in that it produced an environment for all-out efforts to pave the way for self-assessment by entrepreneurs.¹⁶

The adoption of the self-assessment system for "income tax" with taxable income shifted to the current year required taxpayers such as entrepreneurs to submit their provisional and final tax returns according to the following schedule.

? Submit provisional return in April every year according to estimated income for the year;

? Pay in installments one quarter of the estimated tax prepayment by the end of April, July and October; and

? Submit a tax return relating to the tax amount settled for the year by the end of January of the following year. If the amount of prepaid tax was less than the amount of annual tax, taxpayers had to pay the remaining amount, and if the prepaid amount exceeded the amount of annual tax, they were entitled to a refund.¹⁷

The new system started with provisional returns by taxpayers in April 1947. However, the amount of self-assessed income tax paid by the end of December 1947 totaled only 11.4 percent of the amount estimated in the final budget. Records show that in some fiscal years the national treasury dropped to the brink of zero during the year. Surprised by this outcome, GHQ encouraged the tax authorities to reinforce audit and criminal investigations and impose correction or determination on non/under-filers. An extreme example was the so-called "goal system," whereby an amount of desirable tax revenue was allotted to each tax office, and tax administration was carried out focusing on attainment of the target.

This policy brought the following results in connection with taxpayers' income for 1948: Approximately 70 percent of taxpayers who were required to file tax returns were subjected to correction or determination by the tax authorities for non-filing or under-filing of returns, which is said to have resulted in additional yield amounting to nearly half of the total revenue from self-assessed income tax. The consequences were a large number of appeals ("requests for reinvestigation" in Japanese term) by taxpayers and a huge amount of tax delinquency.¹⁸ This abnormal situation as well as the

¹⁶ The year-end adjustment system under the withholding system contributed greatly to lesson compliance costs concerning employment income earners whose number increased more rapidly than expected after the war. The combination of these systems has now become established as the basic formula for income taxation.

¹⁷ Thereafter, the provisional return scheme was changed to the estimated tax prepayment scheme (to be paid by the end of July, end of November).

¹⁸ The percentage of tax delinquency to the assessed tax amount exceeded 40 percent in fiscal 1948.

increasing number of taxpayers after the war and the many hurriedly-employed inexperienced tax officers threw the tax administration front line into terrible confusion .

As a financial source for providing public services, taxes may be viewed as “membership fees.” “Income tax”, symbolic of all taxes, are reported according to self-assessment, a voluntary tax return scheme adaptable to each taxpayer under which tax is calculated and paid in a very natural and democratic way. However, no theoretically excellent tax procedure will function in practice if either taxpayers or tax authorities lack sufficient understanding of the aims of the system or the administrative ability to implement it. Unfortunately, the self-assessment system was introduced too abruptly, without sufficient time to prepare for the shift. Moreover, strained relations between taxpayers and the tax authorities due to excessive tax burden on the Japanese people in the immediate aftermath of the war undermined implementation of the self-assessment system.

4. Establishment of the National Tax Agency and Shoup’s Tax Reforms

Both GHQ and the Japanese government were shocked at the unexpected confusion resulting from the adoption of the self-assessment system. Realizing the necessity to build a tax system and tax administration structure that both reflected the reality of contemporary Japan and was oriented towards a new Japan, the government started to consider possible system and structure for future tax administration.

The first result was embodied in the National Tax Agency (NTA).

Formerly, tax administration was mainly carried out by around 500 tax offices located throughout Japan. These tax offices were controlled and supervised by the Tax Bureau of the Ministry of Finance from a national viewpoint, and by each regional finance bureau from a regional viewpoint. This structure lacked consistency and efficiency in tax administration because the Tax Bureau assumed other responsibilities such as planning and drafting of the tax system, while local finance bureaus were burdened with works other than their tax-related duties. In addition, the structure had the disadvantage that tax administration could be influenced by financial conditions, especially trends of tax revenues, instead of adherence to tax laws as was expected of tax administration.

Concluding that this dual structure contributed to the confusion in tax offices, GHQ strongly urged the restructuring of the organization for tax administration. As a result, the NTA was launched in June 1949 as the specialized organization for comprehensive control and management of tax administration. The NTA was established as an external organ of the Ministry of Finance, and consisted of the head office, 11 regional taxation bureaus¹⁹ and 497 tax offices.

The NTA started its business headed by the first Commissioner of the agency, committed to the firm principle that a relationship of mutual trust between taxpayers and NTA was essential for the efficient operation of tax administration.²⁰ This concept was also sought in subsequent recommendations made by Dr. Carl S. Shoup, head of a mission set up to study and recommended revisions to the system of tax administration

¹⁹ The Okinawa Regional Taxation office was added when Okinawa was returned to Japan. The number of tax offices is now 524.

²⁰ At the same time, aware of the importance of having qualified officers, the NTA exerted its efforts in the recruitment and training of tax officials . Organized and systematic training programs were provided at the Tax Training Center (Zeimu Koshujo) (changed to The National Tax College from 1964) belonging to the NTA.

NTA managed to deal with the pressing issue of curbing —the panic surrounding the income tax administration by improving operational policy, and actively promoted tax administration that suited the current situation of the times while keeping as close as possible to the original form of the self-assessment system. These efforts were successful mostly because the tax authorities significantly strengthened their ability to identify risks and to cope with them through the birth of the new agency.

The second result of the study was the 1950 tax reform, which covered the tax system and tax administration generally and was implemented on the basis of Shoup's recommendations.

The Shoup Mission visited Japan upon the invitation by the Supreme Commander of the Allied Powers in May 1949, and conducted a detailed examination of the actual conditions of the Japanese tax system and tax administration, completing its "Report on Japanese Taxation by the Shoup Mission" (referred to below as "Shoup's recommendations") in September of the same year. Shoup recommendations maintained the view that "income tax" was more appropriate than indirect taxes as a tax to be borne by the general public, and supported the self-assessment system and taxation on a current year basis adopted in 1947. At the same time, the report expressed concern about the vicious circle affecting the administration that originated from taxpayers' distrust of the tax authorities. Stressing the importance of enhancing taxpayers' compliance with tax obligations even if it would take five to ten years, the report recommended the following two approaches.

The first approach was to modernize the mechanism for "income tax"²¹ and to reduce the income tax burden. The underlying idea was that mitigation of the tax burden would be necessary to eliminate taxpayers' distrust of taxation. The other approach focused on the introduction of inducements for substantially enhancing taxpayers' compliance with their obligations under the self-assessment system. Both of these approaches were incorporated in the 1950 revisions and implemented with little changes to Shoup's recommendations, since they agreed with the intentions of the Japanese government and were strongly supported by GHQ.

Mitigation of the income tax burden took the form of a substantial increase in basic exemption (from ¥15,000 to ¥25,000) and a drastic flattening of the tax rate structure²² (the maximum tax rate was lowered from 85 percent to 55 percent). These measures dramatically decreased the total amount of income tax revenue to ¥92.6 billion in 1950 as compared with ¥137.3 billion in 1949. The number of self-assessment taxpayers also dropped from 9,450 thousand in 1949 to 4,320 thousand in 1950.²³

To encourage extensive use of the self-assessment system in Japan, the following measures were taken. First, the so-called "goal system" was abolished. The government was convinced that assessment based on each taxpayer's accounting statement according to the tax laws should be the basis of the self-assessment system. Secondly, the tax amount of the provisional return was changed to "an amount no less than the finalized income tax of the previous year" instead of "an amount to be imposed on the estimated amount of the current year income," on condition that if a provisional return was filed according to the revised formula, no provisional correction would be required. This action eliminated unnecessary bargaining, simplified the

²¹ Theoretically it resembled comprehensive income taxation. Capital gains were taxed without deductions.

²² This involved the expansion of tax rate brackets, with the minimum tax rate being maintained at 20 percent as before. The classes of applicable tax rates were reduced from 14 to 8.

²³ The number of taxpayers that paid taxes on their business income and income from other business activities decreased from 2.76 million to 1.8 million.

administrative and compliance burden of both tax authorities and taxpayers, realized timely payment of tax, and helped to avoid frequent disputes involving provisional returns. Thirdly, the tax return format was simplified for the convenience of many small-sized taxpayers. Fourthly, the government abolished the “reporting-by-third party” scheme for mutual monitoring adopted soon after the end of the war and the perusal scheme allowing access to tax returns upon request, replacing them with a scheme to disclose the incomes of high-income earners.²⁴ The government considered the new scheme would work better to obtain the cooperation of taxpayers in Japan. Fifthly, a certified tax accountant system was developed by improving the existing tax proxy system since the assistance of many tax and accounting experts was considered essential to facilitate self-assessment by taxpayers.

The sixth item of the reform was intended to promote the diffusion of the practice of bookkeeping among taxpayers, for which an incentive program was established to give tax benefits to taxpayers if they filed tax returns based on records maintained according to prescribed bookkeeping standards. This program was known as “blue return system,” where taxpayers who systematically maintained books and kept continuous accounting records according to prescribed standards could file tax returns by using blue tax return format with the approval of the district director (general tax returns were filed in the white format), blue return taxpayers were entitled to the benefits that their returns would not, in principle, be subjected to correction or correction by estimates of the tax authorities, or corrected without clear reasons being given, unless an audit of their books and records revealed an erroneous entry in their tax return.²⁵

All of the above measures helped small and medium-sized enterprises with little knowledge of accounting and taxation to become familiar with the self-assessment system. The unique blue return system, which did not have an immediate effect, contributed greatly to the establishment of self-assessment through the enhancement of bookkeeping standards among small and medium-sized enterprises.

5. Adoption of the “Guided Return (Shinkoku Shido)” Method and Subsequent Income Tax Administration

As for taxpayer’s income in fiscal 1950, only 4 percent of taxpayers required to file returns by self-assessment were subjected to correction or determination, or only 5 percent in terms of their tax amount,²⁶ marking a dramatic fall compared with the two previous years. Though implementation of Shoup’s tax reform in this year may have contributed to some extent, the reform alone could not completely account for this change. While the mitigation of the tax burden and decreased number of taxpayers may have significantly reduced the number of corrections or determinations, other measures of the reform, including the blue return system, were all medium- or long-term policies for establishing the intended tax system.

In 1950 the long period of inflation was coming to an end, and people’s lives were becoming more stable. Also, the substantial reduction of income tax burden brought about by the Shoup tax reform had changed taxpayers’ awareness of their tax

²⁴ According to this system, the address, name and amount of income of high-income earners are published after final return. This public notification system, under which the tax authorities disclose data of taxpayers whose income tax exceeds ¥10 million, still remains today.

²⁵ Subsequently, a number of benefits have been added for this system, including carrying-over of net loss, refund by carry-back of net loss, and allowance of various reserves.

²⁶ The percentages of correction and determination involving operating income earners were 8 percent in terms of the number of cases and 7 percent in terms of tax amount.

obligations. To take full advantage of this opportunity, the NTA drastically changed its administration policy relating to income tax, leading to a sharp decrease in the percentage of corrections and determinations.

In what respects was administration policy changed? Tax offices began to request taxpayers to visit the office and prepare their tax returns with the guidance of tax official, instead of waiting for taxpayers to file tax returns and then performing audit or corrections as necessary. The new method was developed taking into consideration the fact that entrepreneurs operate their businesses on a recurrent basis. One example was the “prior notification method (oshirase hoshiki),” which consisted of four phases: ? To audit before the relevant tax season (preparatory audit); ? To give prior written notice to taxpayers regarding the expected income amount to be used for return obtained by their preparatory audit; ? To send by mail an appointment letter requesting taxpayers to visit their tax office, specifying the date and hour for the visit; and ? To provide guidance to taxpayers on how to prepare tax returns based on that expected income amount.

The “guided return (shinkoku shido)” method greatly raised the level of income filed by taxpayers, and decreased the number of non/under-filers. Accordingly, a remarkable reduction was attained in the number of corrections/determinations, or appeals (requests for reinvestigation), which promptly resolved the confusion at the frontlines, and led to the abatement of taxpayers’ distrust of the tax authorities.

Thus the tax authorities could secure a reasonable level of tax revenue through self-assessment by taxpayers without depending on the goal system. In this sense, the self-assessment system for “income tax” can be said to have made a full-fledged start with this major change in the administration policy. However, even at that time the tax authorities were aware of the inherent problems of the above approach, and felt the necessity to take action towards the next step. These problems were: ? the “guided return (shinkoku shido)” method tended to be a compromise with taxpayers since it put too much weight on avoidance of correction or determination; and ? similar to the former official assessment system, this method might undermine taxpayers’ will to file tax returns voluntarily.

As stated above, the fundamental framework for “income tax” according to the self-assessment system was established and started to function comprehensively in the tax administration at the beginning of the 1950s. Here I will outline how the whole administration of “income tax” was operated.

With respect to employment income, salary payers (withholding agents) withheld taxes at source for each payment of salaries based on the detailed data of employment income earners, including their family structure, and paid the amount equivalent to such withholding taxes by the 10th of the following month. Annual income tax of employment income earners whose annual revenue was within the specified amount²⁷ was adjusted at the time of the last payment of their salaries in a calendar year. Since ordinary employment income earners could complete their tax payment procedure through this year-end adjustment, they did not need to calculate the amounts of their income or tax, nor file tax returns to tax offices. However, employment income earners needed to file tax returns within the specified period and pay the shortage or receive a refund with respect to the taxes already paid if they had received annual revenue in excess of the specified amount, had other income sources, or were eligible for the deduction of medical expense, etc.

If necessary, tax authorities conducted audits²⁸ with respect to tax returns filed by

²⁷ Under the current system this amount is fixed at ¥20 million annually for salaries.

²⁸ The tax authorities correct the tax amount in cases of under-filing, or determine the

employment income earners. Regarding employment income earners that had completed tax payment by withholding, the authorities provided guidance to their withholding agents regarding the withholding procedure, and audited regularly to determine whether withholding or its payment had been managed properly.²⁹

The withholding system was becoming an important factor in tax administration. It was applied extensively to employment income, retirement income, interest income, and dividend income and, after the war, to a variety of remunerations for personal services.³⁰ By the middle of the 1950s, the amount of tax withheld at source had reached around 70 percent of the total income tax revenue.³¹

Business income was classified into two groups depending on whether the entrepreneur was a blue return taxpayer or not. Blue return taxpayers kept books and records daily, and prepared and filed tax returns by themselves based on the accounting records. At the beginning of the blue return system, tax authorities focused their efforts on instructing blue return taxpayers how to keep books and records properly, but as time went by they conducted audit based on tax returns when necessary, and if any error was found in the investigation they corrected or determined the tax amount, indicating their reasons for doing so. On the other hand, since few white return taxpayers kept accounting books or records at that time, the tax authorities requested white return taxpayers to visit the appropriate tax office where tax official responded to their questions or provided consultation services, and instructed them how to file a tax return by self-assessment. The tax authorities later conducted audit, if necessary, and corrected erroneous entries in the tax return.

The number of employment income earners who were subject to withholding formula remained around the 10 million level until 1960, then increased steadily to reach about 25 million in the middle of the 1970s. The number of taxpayers according to self-assessment³² decreased from about 4 million to 2 million in the 1950s, and then rebounded to reach nearly 5 million in the middle of the 1970s.³³

As can be seen from the above analysis, income tax administration was operated very efficiently and smoothly as far as ordinary employment income earners was concerned, as it was supported by the year-end adjustment under withholding system as well as the high compliance of salary payers. Though the number of employment income earners filing tax returns increased with time, tax offices could handle these filings until a few years ago by encouraging earlier submission or submission by mail of tax returns, and providing tax consultation upon request from taxpayers. For withholding taxes on incomes other than employment income, a certain portion of these taxes has been collected without fail by withholding.

Therefore, from the 1950s, the emphasis of income tax administration was put on familiarizing self-assessment taxpayers consisting mainly of entrepreneurs with the

tax amount in cases of non-filing.

²⁹ A program for periodical contact with all withholding agents was established in fiscal 1953, which aimed at conducting an audit over withholding agents every three years.

³⁰ The withholding system applies to incomes extensively, including manuscript fees and lecturer's fees, fees of free-lance professionals, such as lawyers and certified public accountants, medical service fees of doctors received from social security funds, remuneration and contract moneys of artists and athletes, and commissions of sales representatives and bill collectors.

³¹ As of today (1999), this figure exceeds 80 percent.

³² This term includes not only entrepreneurs but also employment income earners filing tax returns for their income from additional sources.

³³ See footnote (3) for the number of taxpayers in 1999.

self-assessment system and realizing appropriate and fair taxation, as embodied, in particular, in the following two goals:

? To raise the ratio of blue returns among entrepreneurs in order to increase the number of taxpayers voluntarily filing tax returns by self assessment based on their accounting books and records; and

? To minimize dependence on the “guided return (shinkoku shido)” practice employed mainly for white return entrepreneurs.

These two challenges developed thereafter while influencing each other. In the following sections, I will outline how each project has been promoted.

6. Improvement of the Blue Return System and Return Ratio

How many taxpayers elected to file blue returns in the first year of this system? Of business income earners except taxpayers whose source of income was solely from agriculture (referred to below as “business income earners”)³⁴ who filed/paid tax by self-assessment, only 4 percent selected the blue return formula (referred to below as “blue return ratio of business income earners”).³⁵ It is not surprising that the blue return ratio of business income earners was rather low, considering the fact that this system was originally devised for small businesses that had little practice in keeping books and records. Nevertheless, this low percentage is thought to have reflected taxpayers’ unwillingness to change from the familiar practices of the official assessment system as well as their distrust of the tax authorities.

Convinced that increasing the blue return ratio by powerful incentives was essential to overcome this situation, the government adopted the following two measures: (1) The program to allow deduction of wages for family employees of blue return taxpayers (1952). This program permitted only blue return taxpayers to deduct salaries/wages paid to their family employees up to ¥50,000 a year, which was a considerable change from previous taxation conventions allowing no deduction of this sort of expense. The limit of ¥50,000 was raised every year until 1956.

(2) Substantial relaxation of the bookkeeping requirements for blue return (1953). As a result, small businesses which declared income of ¥1 million or less two years before could select the blue return formula if they kept simple books such as cashbooks for profit and loss accounting, instead of those books based on double-entry bookkeeping as previously required. As for administration, the government strengthened bookkeeping guidance programs for taxpayers to encourage blue return.

These tax incentives and administrative efforts had such a remarkable impact that in 1955 the total number of individual blue return taxpayers reached nearly 520,000 (of which the number of business income earners was 490,000) and the blue return ratio of business income earners jumped to 32 percent. The NTA then shifted its administrative emphasis to the next step: to enhance the quality of blue return. This change in the NTA’s attitude to the blue return system was keenly sensed by taxpayers, and adversely affected further diffusion of the system for several years during which the total number of blue return taxpayers could not reach 600,000 and the blue return

³⁴ This term means business income earners under the definition of the Japanese Income Tax Law (Act) except those income earners whose sole source of business income is agricultural income. For example, merchants, craftsmen, doctors, and attorneys are classified in this category.

³⁵ The number of individual blue return taxpayers was approximately 110,000, (of which the number of business income earners was around 90,000). In the same year, approximately 50 percent of corporate taxpayers filed blue returns. This difference derived from the different levels of bookkeeping practice among corporations and individuals.

ratio of business income earners could not exceed the ceiling of one third (1/3).

In 1963, the NTA developed policies aimed at increasing of the number of blue return taxpayers in order to surmount this plateau, embarking upon activities to promote the nationwide diffusion of the blue return system. At the same time, the agency eagerly provided bookkeeping guidance services to elevate the bookkeeping standards of the increasing number of blue return taxpayers. From this year, the NTA requested related private organizations³⁶ to assist it with bookkeeping guidance for small businesses.

At the same time, the blue return incentive programs were enhanced legislatively. The maximum amount of family employees' wages deductible by blue return taxpayers began to increase every year from 1961³⁷ after years of being frozen, and in 1968 the restriction on the maximum deductible amount of family employees' wages was abolished as long as such wages were acceptable under normal social conventions. In 1968, bookkeeping requirements for the blue return were further eased to allow extremely small entrepreneurs to calculate income on a cash basis and to file blue returns if they kept cashbooks.³⁸

These incentives had a tremendous effect: The total number of blue return taxpayers began to increase from 1964, exceeded 1 million in 1967, and reached 1.61 million in 1970 (of which the number of business income earners was 1.54 million). The blue return ratio of business income earners also increased mainly among high-income earners, and accounted for 48 percent in 1970.

In proportion to the powerful growth of the Japanese economy in the 1970s, the number of income taxpayers rose sharply. The number of blue return taxpayers also increased owing to blue return promotion efforts in both the public and private sectors as well as new incentive programs introduced in the early 1970s, such as deduction for blue return and taxation on deemed corporations, which allowed the deduction of the remuneration of the taxpayer (business owner) him/herself.³⁹ In 1975, 2.42 million taxpayers filed blue returns (of which the number of business income earners was 2.17 million). The blue return ratio of business income earners exceeded 50 percent for the first time in 1973, and then leveled off at a slightly higher level.

A breakdown of taxpayers by income bracket showed that the blue return ratio of taxpayers with incomes exceeding ¥2 million was more than 70 percent, while most white return taxpayers were found in lower income brackets. In addition, approximately 95 percent of the total income tax by self-assessment was filed/paid not through the actions by the tax administration (i.e. audit) but on a voluntary basis. All these figures reflect a considerable increase in taxpayers' awareness of the bookkeeping requirements.

³⁶ In October 1963, the NTA requested the cooperation of the Federation of Blue Return Association and the Japan Federation of Certified Tax Accountants' Association. Subsequently, the NTA also obtained assistance from Chamber of Commerce, Association of Commerce and Industry, and Japan Tax Association. The diffusion and development of the blue return system owed much to the contributions of these private non-profit organizations.

³⁷ From this year, white return taxpayers were also entitled to deduct the wages of their family employees. However, the maximum deductible wage was set lower than for blue return taxpayers.

³⁸ In 1974, the maximum income was increased to ¥3 million for taxpayers who were able to file tax returns on a cash basis, and ¥5 million for taxpayers using simplified bookkeeping. In 1975, the maximum income requirement of the latter was abolished.

³⁹ The deduction for blue return started in 1972 and taxation on deemed corporations in 1973. From the tax return for fiscal 1993, the former was replaced by the special deduction for blue return and the latter was abolished.

Judging that the time had come to take further steps, the government decided to adopt innovative measures in the 1984 revision to provide a better tax payment environment. In this revision, the government adopted the following rules for white return taxpayers engaged in business income-producing businesses, with a view to promoting the self-assessment system and fair taxation.

- ? Taxpayers must keep simple records of their transactions if their income from business, etc. in the previous year or year before that exceeded ¥3 million ;
- ? Taxpayers who filed tax returns concerning their business or other income in the previous year or year before that are required to keep accounting books and records prepared/received by them in connection with their business;
- ? When taxpayers file their tax return, they must attach to the return documents stating the details of the total revenue and expenses; and
- ? Taxpayers who do not file tax returns must submit a statement of their total revenue if the revenue from business and other income exceeds ¥50 million⁴⁰ .

All of these rules had been sought at the time of the introduction of the self-assessment system and the implementation of Shoup's Tax Reform, but could not be realized due to unfavorable circumstances. Taxpayers (individuals) covered by Rule ? above exceeded one million in the middle of the 1990s, ten years after its adoption, demonstrating that the self-assessment system was taking root.

According to the latest information (2000), the total number of blue return taxpayers is approximately 4.82 million,⁴¹ and the blue return ratio of business income earners has reached 54 percent.

7. Transition from the Guided Return Method to the Tax Consultation Method

As mentioned above, the NTA began to employ a policy mainly focused on "guided return (shinkoku shido)" during the tax season together with the implementation of Shoup's Tax Reform in 1950 in order to eliminate the confusion at tax offices on the frontline. I will now outline the subsequent developments in tax administration.

Guided return (shinkoku shido) was, in fact, the second-best method under the social circumstances at the time. Intending to move on from this method as soon as conditions permitted, the NTA decided to abolish the guided return formula from the tax return for fiscal 1958, taking advantage of the improved tax payment environment reflected in the rising blue return ratio. The guided return scheme was replaced by the "tax consultation" method, which was improved through trial and error, and remained in use until recently.

Tax consultation was intended to provide a platform for the consultation services necessary for taxpayers to file their returns voluntarily and correctly. Although details of the scheme varied slightly with the times, the typical procedure of the program was characterized by the following steps: ? Tax offices requested mainly business income earners filing white returns to visit their office at a fixed date and time during the period prescribed for tax return; ? tax officials provided appropriate guidance and advice in response to questions regarding accounting procedure or tax laws asked by taxpayers, who visited the office with their accounting books and records to calculate their income; and ? if so requested, tax officials also instructed taxpayers on how to fill in the return form or filled in the form on their behalf.

⁴⁰ This amount was lowered from ¥50 million to ¥30 million from fiscal 1987.

⁴¹ Of which the number of business income earners was 3.14 million, an increase of 0.45 million from the figure of the 1980 return, while the number of real estate and timber incomes earners was 1.33 million, an increase of 0.93 million.

Put simply the significance of the transition from the “guided return (shinkoku shido)” to the tax consultation scheme lay in eliminating the influence of the official assessment system as demonstrated in the “prior notification method (oshirase hoshiki)”, a typical example of guided return. In other words, after this change the tax authorities respected as much as possible the principle of voluntary filing by white return taxpayers and refrained from excessive involvement in the tax return process when they visited a tax office to prepare their tax return. This shift in basic stance did not quickly penetrate to the tax offices on the frontline, but at least it triggered a change in taxpayers’ and tax officials’ attitudes towards the self-assessment system.

As for audit, which is closely related to tax administration during the tax season, uniform preparatory auditing performed before the tax season at the time of “guided return (shinkoku shido)” was abolished almost simultaneously with the shift to the tax consultation approach. But preparatory auditing was resumed in 1966, targeting industries in which the audit was effective to increase the level of income voluntarily filed by those taxpayers, and was used for selecting cases subject to tax consultation or investigation. Since tax offices in big cities had difficulties in adopting this because of the large number of taxpayers, they used simplified preparatory auditing more broadly than before.

The operation of tax consultation underwent changes in the tax returns for fiscal 1973 and 1976. As mentioned above, the blue return ratio of business income earners reached nearly 50 percent in the 1970s, while tax revenue from taxpayers’ voluntary returns accounted for approximately 9 percent of the total amount of self-assessed income tax. In view of the changed circumstances, the NTA expected tax returns to be filed based on voluntary accounting of taxpayers from 1973 onwards, and started to provide consultation services primarily on how to fill in tax returns. At the same time, the agency decided to abolish the “request for visit” letter sent mainly to white return entrepreneurs specifying the date and time to visit the tax office.

These changes, however, did not bring favorable results. Instead, the move significantly lowered the level of income voluntarily filed by taxpayers as compared with the previous year. The NTA therefore resumed the request for visit method the following fiscal year and, after a review of administration policy, it expressly recognized “tax consultation” as a scheme helpful to increase the level of income voluntarily filed by taxpayers from the fiscal 1976 tax season onwards. In short, “tax consultation” was defined as a scheme to provide appropriate guidance and advice to individual taxpayers to enable them to file proper returns that reflected their “real” situation. In this context, the significance of the “request for visit” procedure was recognized again.

As far as auditing is concerned, the NTA shifted its emphasis to the post-filing audit system again in 1974 to deal with the increasing number of taxpayers filing returns by self-assessment, the growing urban concentration, geographical area and complexity of economic transactions and the increasing assertiveness of taxpayers concerning their rights. In particular, the tax authorities monitored the risks of taxpayers from the qualitative point of view, started intensive post-filing auditing from taxpayers with higher prospective incomes downwards, tried to give prior notification of auditing to other taxpayers in principle, and limited third-party investigation to inevitable cases. Later, in order to find potential high-income earners that filed returns with small income or failed to file returns, a very short-term post-filing audit⁴² was conducted targeting low/medium-income earners. Since the underlying idea conformed with the purpose of self-assessment system, the essence of this approach still survives in present-day taxation.

⁴² After 1989, the name “post-filing audit (*jigo chosa*)” was replaced by “field examination (*jitchi chosa*)”.

Since the new tax consultation method introduced from the tax return for fiscal 1976 was adjusted in response to the failure of the method adopted three years earlier, it was accepted by the staff of tax offices and has been maintained without any major modifications until recently. But the NTA was not just standing still during this period. It was studying ways of outperforming the existing operational approach based on personal contact with taxpayers. The study produced innovative programs, including the introduction of the above-mentioned bookkeeping rule in 1984.

8. Increase of Income Tax Refund Claims and Pension Recipients, and Promotion of “Self-Made Tax Return”

In the 1990s, new factors were added to the environment of tax administration, prompting a drastic review of the existing organization and operation of NTA and substantially pushing the self-assessment system of “income tax” towards its original form: the then dominant approach of face-to-face tax consultation with taxpayers.

The first factor was the “consumption tax” system (value added tax in Japan) introduced in April 1989. The consumption tax required entrepreneurs and corporate businesses to file tax returns concerning their consumption tax in addition to the existing “income tax” or “corporation tax”. With this change, it became apparent that administration by the agency according to the existing classification by tax items used since the start of tax offices in 1896 lacked convenience and efficiency for both taxpayers and tax authorities. Therefore, in July 1991, the organization and administration were reclassified by type of taxpayers (namely, the personal taxation division and corporation taxation division). For example, tax consultation for income tax was modified to deal with both taxes.⁴³ However, the direct impact of the change was not so serious as the effect of increased operations of the consumption tax (for individuals and corporations), which reduced the available labor formerly allocated to self-assessed income tax administration. In this respect, this factor had something in common with the second factor.

The second factor was the growing number of tax returns filed (both for payment and refund claims) and the increasing administrative burden relating to taxes on corporations.

The following trends can be identified from the time series data on the number of tax returns filed for tax payment and refund claims (the data available relates to fiscal 1978 and subsequent years):

- ? The total number of returns continued to rise from 11 million for fiscal 1978 and reached nearly 18 million at the beginning of the 1990s (20.39 million in fiscal 2000⁴⁴)
- ? The number of income tax returns with tax due⁴⁵ continued to rise from 5.37

⁴³ “One tax consultation for one taxpayer” or “simultaneous examination of three taxes” (both taxes and withholding income tax) rules were adopted. Since the threshold of the “consumption tax” is set so high (annual taxable sales of ¥30 million) that the number of taxpayers who are reclassified as individuals is relatively small (0.6 million in fiscal 2000).

⁴⁴ This number included cases not classified in ? and ? below. (In 2000, the number of such cases was 3.11 million, or 15 percent of the total number.)

⁴⁵ Of “persons having income tax liability by self-assessment” with tax due, the number of “other income earners” (employment income earners and others) was 1.65 million in 1968 and below that of business income earners, which was 1.77 million. However, in 1998, thirty years thereafter the number of the former increased to 4.45

million to nearly 8.60 million at the beginning of the 1990s (and then it leveled off for a while, and decreased⁴⁶ to 7.27 million in fiscal 2000).

The number of claims for a refund of withholding tax continued to increase with slight ups and downs⁴⁷ from 4.05 million to 8.67 million in 1994, exceeding the number of tax returns with tax due referred to in [?] above for the first time (10 million in fiscal 2000).

This tendency was particularly marked in suburban tax offices adjacent to large cities. Because of the growing number of taxpayers visiting tax offices for tax consultation, taxpayers frequently had to wait for hours to receive the service at some offices. In the first half of the 1990s, since there was concern about an explosion of taxpayer complaints concerning this congestion, the solution of this problem became the biggest issue of income tax administration.

On the other hand, another problem had been pointed out quite a few years earlier concerning the allocation of operational resources regarding national taxes; that is, tax administration put too much weight on self-assessed income tax administration in spite of the expanding economic activities of corporations. Moreover, "consumption tax" brought an additional administrative burden on the tax administration.

Therefore each tax office and regional taxation bureau launched a comprehensive review of the administrative approach of tax consultation. The first point was to replace the "face-to-face" method with the "group consultation" method⁴⁸ for tax consultation relating to refund claims, because although this did not involve complicated cases, the number of claimants continued to increase every year.⁴⁹ Some tax offices started to apply the group consultation formula to all consultations beyond the frame of refund claims, where they endeavored to promote and encourage "self-made tax return."⁵⁰ Self-made tax return meant that taxpayers prepared and filed tax returns by themselves with the support of tax offices whose role was limited to providing assistance for the return. Accordingly tax offices did not send letters of requests for visits or conduct preparatory audits any more. Taxpayers visiting tax offices voluntarily were provided with instructions so that they could fill in their returns by themselves and send them by mail at an early stage from the next year onwards.

Self-made tax return was a natural outgrowth from the original idea of the self-assessment system. Since the taxation environment did not permit the use of this formula in the past, however, tax administration was supported by unorthodox approaches such as "guided return" and "tax consultation". At the beginning of this initiative to promote self-made tax return, there was a concern that the implementation was so early that it might provoke the anger of taxpayers due to the

million, and greatly exceeded 1.65 million of the latter.

⁴⁶ The decline seems to reflect frequent tax reductions and a sluggish economy that has lasted for more than 10 years. On the other hand, the number of pension recipients with income tax liability seems to have increased with the aging of the population.

⁴⁷ This was attributed to the increasing number of employment income earners and pension recipients as well as the increase in the number of taxpayers claiming deductions for medical expense, etc.

⁴⁸ One tax official in charge simultaneously instructed two or more taxpayers on how to prepare their tax returns through a question-and-answer approach.

⁴⁹ According to the tax return data for fiscal 1998, the number of taxpayers visiting tax offices or free consultation centers for "tax consultation" was 9.83 million, of which the number of income tax refund claimants was 5.05 million, constituting more than half.

⁵⁰ The first attempt started with the tax return for 1995 in tax offices of the Kanto Shin-etsu Regional Taxation Bureau.

perception that it entailed a lowering of the quality of taxpayer services.

However, tax offices that tried the new approach generally received more favorable reactions from taxpayers than they had anticipated. This was partly because taxpayers no longer had to wait so long, but also, one may suppose, because they felt satisfied and proud of having prepared their tax returns by themselves. Contrary to the above-mentioned concern, taxpayers correctly understood the purpose of the self-assessment system, and the tax payment environment, including taxpayers' compliance with their obligation, was now ready for the operation of the self-assessment system in its original form.

The tax administration was now prepared to move on from the existing tax consultation approach with respect to self-assessed income tax and shift its emphasis towards the promotion and encouragement of self-made tax return, which would lead to the solution of ongoing problems. Since future taxpayers will ordinarily prepare their tax returns at their home or office and use personal computers to file them, self-made tax return is a requirement of the times. With this prospect, the NTA initiated promotional activities for self-made tax return nationwide from the tax return for fiscal 1998.

Since then, self-made tax return for self-assessed income tax has developed steadily, gradually changing the tax consultation scene during the period for tax return.⁵¹ In addition, since self-made tax return has been sought for self-assessment taxpayers as was originally intended in the self-assessment system, the ideal relationship between taxpayers and tax authorities has been reconsidered. For example, a variety of taxpayer service packages have been made available because tax authorities should provide systems and facilities that allow taxpayers to consult with a tax official from their home or office, as long as they encourage taxpayers to prepare their tax returns there.⁵²

9. Conclusion

The Japanese self-assessment system for "income tax" was introduced at the behest of GHQ under the unusual circumstances after Japan's defeat in the war at a time when it was not yet ready for such a system. After half a century, however, income taxation has come to be supported by the original style of self-assessment based on taxpayers' voluntary compliance, and functions effectively as the fundamental tax system.

My argument has essentially been concerned with how the above two facts are connected. The main points can be summarized as follows.

Firstly, effective supplementary measures were taken legislatively with the launch of self-assessment system, as demonstrated by the adoption of year-end adjustment under the withholding system for employment income.

Secondly, appropriate administrative actions reflecting the actual status of taxpayers were taken from an early stage of implementation, as represented by the adoption of the "prior notification method (oshirase hoshiki)". These appropriate legislative and administrative actions helped the tax authorities to obtain people's understanding

⁵¹ The tax return form and manual were fundamentally revised from the tax return for fiscal 2001 for the first time in 30 years, although minor changes were made every year. This revision increased, albeit temporarily, the number of taxpayers visiting tax offices compared with the previous year.

⁵² Tax consultation services are now available by phone, facsimile and the Internet. Each tax office is equipped with computer terminals (touch panel) that allow taxpayers to output their tax returns just by touching the necessary items on the computer screen when they file simple returns.

concerning the self-assessment system for “income tax”, making it possible for the self-assessment system to take off successfully in spite of the expected obstacles.

Thirdly, the establishment of the blue return system and a number of enhancements of its incentive packages as well as efforts by tax authorities and related private organizations to promote the diffusion of blue return elevated the bookkeeping standards of taxpayers and enhanced their compliance level. This program improved the tax payment environment substantially and brought the following results: by the middle of the 1970s, more than 50 percent of entrepreneurs selected the blue return system based on their accounting books/records, and by the middle of the 1980s, bookkeeping or simplified bookkeeping became obligatory for tax returns in general.

Fourthly, we can point out the recent activities to promote and encourage self-made tax return. The long-continued tax administration supported by tax consultation has shifted its emphasis to the promotion and encouragement of self-made tax return, triggered by rapidly increasing income tax refund claims and other factors. As the original form of the self-assessment system, self-made tax return meets the need of the times.

The Japanese self-assessment system for “income tax” has become widely diffused by undergoing the above-mentioned process in the circumstances peculiar to Japan. Needless to say, we still have a long way to go to achieve further compliance with bookkeeping requirements and more extensive use of self-made tax return. In addition to these challenges, issues to be addressed with respect to taxpayers’ compliance with the self-assessment system or tax obligations include the following:

- ? How should we evaluate the year-end adjustment scheme of employment income?
- ? How should we view the introduction of a taxpayer identification number system?
- ? What are desirable services for taxpayers in a highly advanced computerized society?

I hope to discuss these issues on another occasion. All of them are important and will involve complicated problems, as they have to be addressed on the basis of the present situation.

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