12~~29577~~

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C.

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
SEPTEMBER 24, 1984

STATEMENT OF

ALLAN I. MENDELOWITZ
ASSOCIATE DIRECTOR, NATIONAL SECURITY
AND INTERNATIONAL AFFAIRS DIVISION

BEFORE THE

JOINT ECONOMIC COMMITTEE

ON

JAPANESE TAX INCENTIVES TO SAVE AND INVEST

030336

Mr. Chairman and Members of the Committee:

In response to your request, we are providing this overview of the Japanese tax system, concentrating on tax preferences for savings and investment. You requested this information to better understand how other nations use tax laws to pursue saving and investment objectives and to help determine whether the United States would benefit by adopting tax provisions employed elsewhere.

The first part of my statement this morning summarizes the major features of Japan's tax system and its incentives for savings and industrial development. The second part outlines the overall tax system and explains the incentives to save and invest in greater detail. We based our work on published analyses of Japanese and U.S. tax practices and on interviews with U.S. and Japanese government officials and with academic researchers.

OVERVIEW

Over the past 20 years, Japan's growth rate has generally exceeded that of other developed nations, including the United States. A tax policy favoring saving and investment has frequently been cited as an important part of Japan's policies favoring economic growth.

In general design, however, the U.S. and Japanese tax systems are strikingly similar. Both rely on individual and corporate income taxes as the primary revenue sources rather than the indirect taxes (such as the value-added tax) frequently employed elsewhere.

Both nations provide some type of tax preference to encourage saving. In Japan, interest earned by individuals on deposits up to Y 3 million in the Postal Savings System, on bank deposits and certain other assets up to Y 3 million, and on holdings of certain government bonds valued up to Y 3 million is not taxed. These amounts are each equivalent to $12,500.[1] Examples of tax preferences for savings in the United States include deductions for contributions to individual retirement accounts (IRAs) and Keogh plans and an extensive tax-exempt municipal bond market.

Similarly, both nations provide businesses with tax incentives to invest. Each allows some type of accelerated depreciation or capital cost recovery allowance on industrial investment. In addition, both tax systems offer some form of investment tax credit (ITC). Japan's use of the ITC has been a temporary provision, limited to depressed industries and to particular investments, such as energy conservation equipment. In its fiscal year 1981 tax reform, for instance, Japan allowed an ITC for investment in energy-saving equipment for a 3-year period, with the credit limited to 20 percent of tax liability and carryover of unused credits only for the next tax year. In the U.S. tax system, a broad range of investment is eligible for the credit. Taxpayers are allowed more generous carryover allowances and may use the credit to offset as much as their full tax liability.

---

[1]Dollar equivalents in this testimony are calculated using Y 240 to $1.00 as the exchange rate.

While the two systems are similar in many regards, they differ in the specific tax practices used to meet their objectives and in their burdens.

Japan has sought to keep its tax burden under 20 percent of its gross national product. Rapid economic growth and an even faster increase in tax revenue enabled Japan to adhere to this limit until the mid-1970s and still provide virtually annual tax cuts. Since the mid-1970s, however, Japan has run budget deficits and has not been able to meet this objective. Although total taxes (including social security contributions) had risen to 26 percent of GNP by 1980, this remains well below the average tax burden for OECD nations, which was 35.8 percent in 1980. In that year, the U.S. tax burden was 30.7 percent of GNP.

Japan, furthermore, relies more heavily on revenues from the corporate income tax than does the United States. In Japan's budget for its fiscal year 1983, for instance, the corporate income tax was estimated to generate 27.8 percent of the national government's tax revenue and the individual income tax 40.5 percent. In the U.S. budget estimate for its 1984 fiscal year, the corporate income tax accounts for 17.7 percent of government receipts (excluding social security taxes) and individual income taxes 77.8 percent.

I would now like to turn to differences in the tax practices in the two nations. While the U.S. tax system is relatively neutral regarding alternative uses of borrowed funds, Japan's tax system is not. Japan's treatment of interest expense is intended to favor business use of borrowed funds, while the United States allows an interest deduction from personal income for funds borrowed for virtually any purpose.[2] Individuals in Japan can deduct interest only on debt incurred to buy corporate equity or to finance business activities. Taxpayers in Japan generally cannot deduct interest expenses on home mortgages or consumer debt. In the United States, the mortgage and consumer debt interest deductions are among the largest tax expenditures.

Japan's treatment of capital gains realized by individuals also reflects a desire to promote investment in securities. Individuals are not subject to tax on capital gains realized on the sale of securities but are subject to tax on other capital gains. Their other long-term gains, however, are generally taxed at one-half normal rates. In the United States, the tax on long-term capital gains is 40 percent of normal rates. Assets must be held for longer periods in Japan than in the United States to qualify gains as long-term gains.

Unlike the U.S. corporate income tax, Japan's corporate income tax seeks to avoid double taxation of corporate earnings. Japan does this by assessing a lower rate on distributed earnings than on retained earnings (33.3 percent versus 43.3 percent) and allowing individuals receiving corporate divi-

---

[2]Interest paid on loans taken to purchase tax-exempt securities is not deductible under the U.S. federal income tax.

dends to take a tax credit of up to 10 percent of dividends received. (The corporate tax rates were changed by the 1984 tax package. They had been 32 and 42 percent, respectively; the current rates are in effect during Japan's 1984 and 1985 fiscal years.)

CAN THE UNITED STATES LEARN FROM JAPAN'S TAX SYSTEM?

Lessons from Japan's experience with its tax system may not simply or neatly transfer to the United States. Observations of how Japan's tax system treats saving and investment and how that compares with U.S. taxation must be tempered by understanding how the two economies differ.

While we have examined tax incentives that Japan employs at the national level in this testimony, taxes imposed by any level of government may influence decisions by taxpayers. In Japan, prefecture and municipal governments impose taxes, but do so under the control of the national government. By contrast, state and, to a lesser degree, local governments in the United States have independent taxing power and impose a broad range of taxes. The types of taxes and rates vary across states, complicating comparisons with the uniform Japanese system.

Another important difference is the nature of corporate financing in the two nations. U.S. corporations rely much more heavily on equity financing than do Japanese corporations. Bank debt was 230 percent of equity for Japanese manufacturing firms in the late 1970s according to one estimate, but only 68 percent of equity in the United States.[3] The greater reliance on debt by Japanese corporations changes the way that the corporate tax affects investments. Retained earnings are a less important source of investment funding in Japan than they are in the United States, for instance, so higher taxes on retained earnings in Japan may not have the same effect there as they might in the United States.

While we are not proposing that you consider adopting any aspects of Japan's tax system that differ from the U.S. system, our limited review indicates the three most significant differences between the two systems are:

--Japan's restriction of interest deductions by individuals to interest on funds borrowed for purchasing corporate securities or undertaking business activity,

--the tax-free status in Japan of capital gains realized by individuals in the sale of securities, and

--Japan's attempt to avoid double taxation of corporate income.

---

[3]R. Hofheinz and K. Calder: The Eastasia Edge (New York: Basic Books, 1982), p. 135.

OUTLINE OF JAPAN'S TAX SYSTEM

Japan, like the United States, raises most of its revenue through income taxes. Individual and corporate income taxes together yielded approximately 70 percent of all the central government taxes since 1973. Indirect taxes (commodity and excise) are secondary sources of tax revenue. Prefecture and municipal governments also collect taxes. In the Japanese fiscal year beginning April 1, 1983, these local governments collected 35 percent of all taxes. In contrast to local government taxes in the United States, property taxes are minor revenue sources in Japan.

Development of Japan's tax policy

Reliance on income taxes may be the most important legacy of U.S. efforts to create an ideal tax system in Japan. During the U.S. occupation, a commission headed by Carl S. Shoup, Professor of Economics at Columbia University, recommended that the tax system be completely restructured to repeal an existing quilt of income and turnover taxes. Comprehensive income taxation was to be a component of a tax system featuring net worth and inheritance taxes at the national level and locally imposed value-added taxes. The corporate and individual taxes were to be integrated, with the corporate tax functioning as a withholding tax on the earnings of shareholders. Capital gains were to be counted as income.

The tax system soon moved away from this prescription. While the Japanese Ministry of Finance indicates that the plans were "too idealistic to fit in with the reality of the Japanese economy and standard of living," other analysts believe that the evolution of the tax system stems from the government's orientation to business and industrial development. The unified tax on all sources of income was replaced by a schedular tax, imposing taxes that vary according to income source. The net worth tax was abolished, as was the tax on capital gains realized on the sale of securities. The local government value-added tax was never implemented. A tax on retained corporate earnings, designed to prevent the indefinite deferral of shareholders' tax liabilities, was removed. Finally, the government decided to use taxes selectively to promote economic growth rather than adhere consistently to principles of tax equity and efficiency.

Limits on tax burdens were of paramount importance to encourage economic growth through the tax system. Following the lead of its Tax Commission, the Japanese government sought to limit taxes to 20 percent of national income. Japan's economy experienced strong enough growth between the 1950s and early 1970s that tax revenues could grow steadily. Because of the system's reliance on progressive income taxation, tax revenues grew faster than income. For instance, in their analysis of the Japanese tax system, Joseph Pechman of the Brookings Institution and Keimei Kaizuka of Tokyo University found that tax revenues grew at 1.3 times the rate of income growth. From the early

1950s until 1977, Japanese taxes were cut annually in several ways, including rate reductions, increased exemptions, or special measures (generally tax expenditure items).

Since 1977, the picture has changed. Budget deficits have become contentious issues, so there has been an unwillingness to increase deficits through tax cuts. Individual income taxes were cut earlier this year, but corporate taxes were raised by virtually the full amount of the individual tax cut. As table 1 shows, furthermore, when social security contributions are included, taxes have started to take a larger share of GNP product than the 20-percent limit.

Table I

Tax revenue as a percent of Japan's
Gross National Product[a]

Year	Percent
1960	18.2
1965	17.8
1970	19.7
1975	21.0
1980	26.1

[a]Includes employers' and employees' social security contributions

Source: Organization for Economic Cooperation and Development: *Japan* (July 1983)

It would be misleading to conclude that sustained high rates of economic growth have been the only targets of Japanese tax policy. Energy conservation and pollution control are among its current objectives. Each objective is understandable in the context of Japan's economy, such as its severely limited energy supplies, but pursuing these goals has altered the growth orientation of the tax system.

Like any other tax system, Japan's system is subject to political pressures. Specific groups have been able to gain concessions, such as those who receive income from selling timber and owners of businesses, such as shopkeepers. Depressed regions and industries receive many special benefits, as do other industries targeted for aid. Industries investing in Okinawa or businesses that employ the handicapped as 25 percent or more of their work forces are eligible for special tax preferences. The result is a tax system that contains many features designed to encourage economic growth as well as special preferences given to achieve other goals.

Other taxes at the national level

While income taxes are its most important sources of revenue, Japan's national government also levies inheritance, commodity and transactions taxes. As table 2 shows, no other revenue source approaches the importance of the income taxes.

Table 2

Tax revenues in Japan

(Fiscal year 1983 budget estimate[a])

Type of tax	Percent of total revenue	
Income taxes:	68.3	
Corporate Income Tax		40.5
Individual Income Tax		27.8
Inheritance Tax	2.3	
Other taxes: (total)[b]	27.0	
Liquor		5.5
Gasoline		4.8
Petroleum		1.3
Commodity		3.9
Motor vehicle tonnage		1.4
Customs duties		2.1
Stamp tax revenue		3.8
Profits on state monopolies		2.9

[a]Fiscal year 1983 ran from April 1, 1983 to March 31, 1984; final data are not available.

[b]Includes other taxes contributing less' than 1 percent of general account revenue.

Source: Ministry of Finance, Tax Bureau, An Outline of Japanese Taxes 1983, pp. 294-5.

Some of these taxes were adopted with specific economic goals in mind. Petroleum tax revenues, for instance, finance projects to "secure [a] stable supply of petroleum and to develop and introduce alternative energy sources." Likewise, electric utilities pay a tax earmarked for measures promoting atomic, hydroelectric, and thermoelectric powerplant development in order to lessen use of oil-fired generators.[4] In the 1983 budget, petroleum tax revenues were estimated at Y 429 billion (approximately $1.8 billion) and the earmarked tax on utilities at Y 176 billion (approximately $732 million).

Local government taxes

The 1947 constitution provides for autonomous prefectural and municipal governments, but local taxes are subject to considerable central control. The "Local Tax Law" defines the basis of tax computation, collection method, and standard tax rate. Rates above the standard are allowed but cannot exceed specified limits. Any other taxes must be sanctioned by the Ministry of Home Affairs. Furthermore, the central government provides funding for local governments through transferred tax revenue (local road taxes, motor vehicle tonnage tax, and others), grants, and subsidies.

Both prefectures and municipalities collect their own inhabitants tax, assessed on individuals, businesses, and corpora-

[4]An Outline of Japanese Taxes 1983, pp. 143 and 158.

tions. The inhabitants tax is assessed on a per capita (per corporation) basis as well as on a taxable income basis for individuals and as a corporate income tax surcharge. National taxes are not deductible for computing this tax (nor are local inhabitants taxes deductible for calculating national income taxes).

Prefectures also collect enterprise taxes on corporation or business income and transfer and commodity taxes. Municipalities also collect property taxes and consumption taxes.

SAVINGS INCENTIVES IN JAPAN' INDIVIDUAL INCOME TAX

Pechman and Kaizuka have characterized the individual income tax in Japan as having a narrow base and steeply progressive rates. Deductions, such as an employment income deduction, and exclusions from income are substantial, including large allowances for tax-free interest income, while marginal tax rates reach 70 percent above Y 80,000,000 ($333,333) of taxable income. (See table 3.)

Table 3

Marginal Tax Rates in the Japanese
Individual Income Tax
Fiscal year 1984

Taxable income range (thousands of yen)	Dollar equivalent[a]	Marginal tax rate (percent)
under Y 500	under $2,033	10.5
Y500 - Y 1,200	$ 2,833 - $ 5,000	12
1,200 - 2,000	5,000 - 8,333	14
2,000 - 3,000	8,333 - 12,500	17
3,000 - 4,000	12,500 - 16,667	25
4,000 - 6,000	16,667 - 25,000	25
6,000 - 8,000	25,000 - 33,333	30
8,000 - 10,000	33,333 - 41,667	35
10,000 - 12,000	41,667 - 50,000	40
12,000 - 15,000	50,000 - 62,500	45
15,000 - 20,000	62,500 - 83,333	50
20,000 - 30,000	83,333 - 125,000	55
30,000 - 50,000	125,000 - 208,333	60
50,000 - 80,000	208,333 - 333,333	65
over 80,000	over 333,333	70

[a]Dollar equivalents calculated at Y 240 to $1.00.

Source: Embassy of Japan, January 30, 1984

While all income is, in principle, subject to taxation according to the same marginal tax rate schedule, Japan's tax law recognizes 10 forms of income[5] and sets out different ways to compute income and deductions for each. Taxpayers receiving employment income, for example, deduct a percent of their income as an "employment deduction." Those receiving business income have several ways to calculate their taxes, including an option to be taxed as a corporation rather than as an individual.

Several features of Japan's individual income tax either encourage savings over consumption or encourage investment in industry over other investments, such as investment in housing. Specific features that influence savings and investment decisions in the current tax system are:

--Allowing tax-free interest on savings, up to generous limits.

--Excluding from the tax base capital gains on sales of securities except for "continuous" traders.

--Restricting interest deductions to interest paid on debt incurred to finance the purchase of securities.

--Providing a credit for dividends received.

---

[5]Interest income, dividends, real estate income, business income, employment income, retirement income, timber sale or transfer income, capital gains, occasional, and miscellaneous income are the recognized categories.

Lax enforcement of the tax on interest earned on savings above the tax-free amount or on business income is an implicit preference to savings and business investment, according to some observers. This issue is impossible to assess, however, because the evidence of noncompliance is anecdotal rather than quantitative.

The importance of the tax limitation policy and the tax cuts on individual savings and investment is not clear. The tax cuts took several forms, including rate cuts, increases in allowable exclusions or deductions from income, and special provisions. There is no definitive analysis that we are aware of that attributes any particular share of savings to the tax cuts.

<u>Interest and capital gains exclusion</u>

Both the basic income tax law and related special provision laws establish categories of nontaxable income. While these categories cover a wide range of activities, several are intended as incentives for savings and business-related investment:

1. Interest earned on deposits up to Y 3 million in the postal savings system.
2. Interest on bank deposits or certain types of investment and bond trusts and holdings of debentures if the total principal does not exceed Y 3 million.
3. Interest earned on government bonds issued by either the central or local governments.

4. Contract savings plans for workers up to a principal of Y 5 million.

5. Capital gains realized on the sale of securities, except in specified situations or from "continuous trading in securities."

A temporary measure currently allows taxpayers to have taxable interest and dividends taxed separately from all other income at a rate far below the highest marginal tax rates. The importance of this provision, which usually requires withholding at the source, is not known. Until December 31, 1986, interest on time or ordinary deposits, profits from trusts, and certain other dividends (generally small amounts of dividends received by shareholders with small holdings) can be taxed, at the taxpayer's option, at 35 percent (20 percent for "ordinary deposits") or included as a part of the taxpayer's total income. If included in total income, the interest is subject to the normal marginal tax rate schedule, with marginal rates as high as 70 percent. Taxpayers start to pay a 35-percent marginal tax rate at a taxable income of Y 8 million ($33,333). Income distribution data do not permit accurately gauging how many taxpayers may benefit from this provision. In 1981, however, only 6.6 percent of all individual taxpayers filed returns reporting gross income over Y 10 million ($41,667). These taxpayers accounted for 36.1 percent of total reported income. Another reason preventing accurate assessment of how many taxpayers take advantage of the lower rate on taxable interest andand dividends is the uncertain extent of tax evasion. As noted earlier, taxpayers may establish anonymous accounts or otherwise evade the limits on tax-free interest entirely.

Capital gains on the sale of securities are not taxed in most situations, but other capital gains are subject to tax, with long-term capital gains taxed at lower rates. The general method of computing the tax on capital gains divides the gains into long and short-term gains, with 5 years being the dividing line. A Y 500,000 ($2,083) deduction is taken first from the short-term gain then the long-term gain. Taxable gains then are the sum of the post-deduction, short-term gains plus one-half the net long-term gains (net of any available deduction remaining after subtraction from short-term gains). Taxable capital gains are then added to taxable income from other sources to obtain total income for tax purposes.

Some other forms of capital gains are given preferential treatment. Long-term gains on land sales, for instance, are taxed at 20 percent of the capital gain, if the gain is Y 40 million or less. Larger capital gains are taxed according to a formula that essentially excludes one-half of the gain exceeding Y 40 million from taxation. Short-term capital gains are taxed at the higher of (1) 40 percent of the gain or (2) 110 percent of the difference between the tax computed on total income including the gain and total income excluding the capital gain. A Y 1 million ($4,166) deduction from capital gains is allowed, with the requirement that it be taken first from short-term gains and then from long-term gains. In the sale of a residence, up to Y 30 million ($125,000) may be deducted. If the taxpayer pays more for a replacement house than the sales price of his former residence, any capital gains realized are not taxed. (If the purchase price of the new residence is less than the selling price of the old, only the difference is a taxable gain.)

Limited interest deduction

Deductions of mortgage and consumer interest are among the largest tax expenditures in the U.S. tax system. It is generally accepted that this provision has had a substantial effect on household financial decisions and on the level of housing investment. Since no such deductibility exists in the Japanese tax system, the differences should be considerable.

Housing and mortgage markets in Japan and the United States are different in many ways. Housing in Japan is smaller than housing in the United States and mortgage debt is substantially lower. While the fact that Japan's tax law permits no deduction for mortgage interest probably plays some role in this, it would be a mistake to attribute all the differences in the housing and mortgage markets in Japan with those in the United States to the tax systems. Most of Japan's population lives in metropolitan areas, with high housing prices being the rule. This appears to be more the product of employment location than the tax treatment of housing or mortgage debt.

If a taxpayer buys a house before December 31, 1984, and finances the purchase with a loan for 10 or more years, however, Japanese tax law does allow a tax credit of 18 percent of loan repayments over Y 300,000 ($1,250). This credit may be taken during the year when the taxpayer occupies the house and two succeeding years. The tax credit cannot exceed Y 150,000 ($625) and is not available to taxpayers whose total income exceeds Y 8 million ($33,333) or to taxpayers who take advantage of the tax exemption of capital gains on the sale of a residence when a replacement of equal or greater value is purchased. (When the replacement value is less than the price of the former residence, the taxable capital gains on the sale are limited to the difference between the sales price and the cost of the replacement property.) Again, the effects of this are uncertain.

Japanese tax law allows an individual interest deduction for borrowing tied to business activities. Taxpayers reporting dividend income also may deduct interest paid on debt incurred to purchase the stock yielding dividend income, although this also reduces the credit that can be claimed on dividend income.

Dividend credit

As noted earlier, Japanese tax law considers a corporation to be a collection of individuals rather than a separate entity. Corporate taxes are thus looked at as advance payments of individual tax liabilities. The corporate tax is assessed by a split rate, with retained earnings taxed at 43.3 percent and distributed earnings at 33.3 percent. Individuals receiving dividends and whose total taxable income is under Y 10 million ($41,667), furthermore, may credit 10 percent of the dividends, less interest expense paid on debt used to buy the stock, against their tax liability. This credit is limited to 5 percent on those dividends that exceed the Y 10 million ceiling. This credit and split-rate system is an effort to avoid double taxation of a corporation's earnings. This credit is not refundable (i.e., the credit cannot exceed the taxpayer's total tax liability). The taxpayer is given the option of having 35 percent of the dividends withheld to satisfy any tax liability, which would be attractive to taxpayers in high marginal tax rate brackets.

Individual tax filing and compliance

Taxpayers do not have to file tax returns if their only source of taxable income is from employment; furthermore, employers are obligated to adjust tax withholding for the final salary, wage, or bonus payment earned during the year so that total withholding satisfies the tax liability. Taxpayers receiving business income (such as shopkeepers) are responsible for self-assessment of their tax bills. They are given the option of expensing salaries paid to family members and, if they meet certain standards for accurate bookkeeping, can file a "blue return" that provides preferential treatment. One preference allowed to taxpayers filing "blue returns" is the option of treating the proprietorship as a corporation for tax purposes. When this happens, the taxpayer may deduct his or her own salary as an expense of the quasi-corporation and gain other benefits of corporate tax treatment.

Given the different tax assessment practices for those receiving salaries and those owning a business, it is not surprising that tax differences are controversial. The ease with which some occupations may evade taxes has been captured in a common belief in a "9-6-4 system," with 90 percent of wage and salary income purportedly being reported to the tax authorities but only 60 percent of business income and 40 percent of farm income.

We must stress, however, that we know of no quantitative examination of Japanese taxpayer compliance. Appropriate data apparently are unavailable to analyze differences in reporting income by source. Evasion of taxes on interest income also is reputed to be extensive but difficult to gauge. Taxpayers are allowed only one tax-free account in the Postal Savings system (with interest earned on up to Y 3 million excluded from taxable income.) However, accounts are set up under ficticious names.

If the potential to evade taxes affects taxpayers' decisions, tax evasion may have economic consequences. Any consequences cannot be accurately assessed in the absence of data, but concern over compliance has appeared to be less than the concern that taxes in general be cut. Until the latter half of the 1970s, tax revenues grew so fast that revenue losses from evasion did not warrant increased enforcement.

INDUSTRIAL INVESTMENT AND DEVELOPMENT INCENTIVES IN JAPAN'S CORPORATE INCOME TAX

The Japanese system of taxing corporations contains provisions to promote industrial investment and development in two separate laws. One, the Corporation Tax Law, sets forth the general principles of corporate taxation. The other, the Special Taxation Measures Law, makes available to qualifying corporations the tax preferences and incentives deemed necessary by the Japanese government to help attain certain economic policy objectives.

While the Corporation Tax Law is considered to be permanent in nature, the Special Taxation Measures Law is considered to be temporary and is, in fact, periodically revised to reflect changing economic priorities. However, because the tax preferences contained in that law are generally narrowly drawn and amount only to about 3 percent of the tax due under the Corporation Tax Law, their importance to overall Japanese industrial development should not be overemphasized.

Rather, attention should be directed to the cumulative effects of the two laws; that is the income tax burden imposed on the corporate sector. In comparison to the United States, the relatively low rate of corporate taxation in effect prior to the mid 1970s may have stimulated Japanese industrial development more than the narrowly targeted tax preferences. Relative tax burdens have shifted since then, due in large part to 1981 changes in the U.S. corporate tax, but we feel that it is too early to conclusively assess the implications of the changes in corporate tax burden.

General principles of taxation under Japan's Corporation Tax Law

Essentially, the Japanese system of corporate taxation resembles that of the United States. The principal difference is that in Japan distributed corporate income is taxed at a lower rate than retained income. Also, the tax rates established are generally not progressive with respect to corporate income.

The Japanese corporate tax rates are set out in attachment I to my statement. Currently, the undistributed income of large Japanese corporations is taxed at a flat rate of 43.3 percent and the distributed income at a flat 33.3 percent. Smaller corporations are taxed at a lower rate on the first Y 8 million (about $33,333) of annual income but at the same rate on additional income. As we noted earlier, under individual income tax laws, individuals receiving corporate dividends are entitled to a tax credit of up to 10 percent of the amount of dividends received.

The reduction in the corporate tax rate taken in conjunction with the tax credit for individuals has the effect of reducing the double taxation of corporate profits. Furthermore, the tax credit may act as an incentive for individuals to invest in corporate stocks, while the reduced tax rate may act as an incentive for corporations to seek out investors as opposed to seeking out debt financing for capital investments, the traditional practice.[6]

[6] The split rate corporate tax system with tax credits available to individuals receiving dividends was adopted by the Japanese in 1961. It was introduced as an incentive to increase the equity capital of corporations in comparison with borrowed capital. Traditionally, Japanese corporations relied on debt to finance capital expenditures rather than using equity markets as is the customary practice in the United States. Even with the tax incentives, however, Japanese corporations rely more heavily on debt financing than do U.S. corporations. According to current estimates by the American Business Conference, the debt-to-equity ratios of Japanese and U.S. corporations are approximately 3 to 1 and 1 to 3, respectively.

To compute income subject to the tax rates, Japanese corporations begin with the profit figure reported on their financial statements that are prepared in accordance with generally accepted accounting principles in Japan.[7] Adjustments are then made to account for the differences between tax law and accounting principles, such as carrying losses forward for up to 5 years and back one, claiming accelerated depreciation allowances, and taking certain additional tax deductions.[8]

All categories of corporate income, no matter what their source, are taxed at the corporate tax rates shown in attachment I unless specifically excluded by law. As in the United States, for example, operating income resulting from sales (calculated as the excess of sales proceeds over the cost of goods sold) is included in taxable income. Also included in Japanese corporate taxable income are various categories of nonoperating income, such as interest and royalties; certain donation income, such as the value of assets received as gifts and the amount of loans forgiven; foreign currency gains and losses; and revaluation of assets in the course of a merger. As a general rule, capital

---

[7]In practice, however, many Japanese corporations prepare financial statements in accordance with tax laws.

[8]To take advantage of all favorable tax provisions, corporations must apply for the privilege of filing a "blue return." In part, this requires corporations to adopt a bookkeeping system approved by the appropriate Japanese tax office, keep accurate records, and report income following accrual basis accounting.

gains from the sale, exchange, or transfer of securities, real estate, and other capital assets are also included in taxable income and taxed at the applicable corporate tax rate. On the other hand, dividends received from domestic corporations are excluded from taxable income,[9] provided that the corporation pays out at least as large a sum in dividends.[10] For consistent application of tax law, interest expense attributable to the acquisition and holding of the corporate shares yielding the untaxed dividends may not be deducted as an expense for tax purposes.

Generally speaking, all ordinary expenses necessary to the conduct of corporate business and all losses realized in the conduct of such business are deductible in calculating taxable income, except as limited by law and regulations. As in U.S. tax practice, expenses that are unnecessary or excessive are not deductible. Below are some examples of tax deductible expenses.

--Payment of salaries, bonuses, and retirement allowances.

---

[9]Also excluded or deferred from inclusion in taxable income are certain gains from mergers, tax free spin-offs, exchange of certain real property, reinvestment of insurance proceeds, involuntary conversions, reinvestment of sales proceeds from certain real property and real property held long term, and refunds of nondeductible taxes.

[10]If the amount of dividends received exceeds the amount of dividends paid out by the recipient corporation, 25 percent of the excess must be included in taxable income of the recipient corporation.

--Cost of most employee fringe benefits such as housing and meal subsidies, transportation allowances, and medical treatment (employee fringe benefits are deductible expenses to the corporation even though the value of the benefits may not be included as taxable income to the employee).

--Losses resulting from the sale, exchange, or transfer of securities or real estate and other capital losses.

--Interest and royalty payments.

--Some, but not all, local taxes.

--Certain organizational expenses.

--Entertainment expenses only for corporations with paid-in capital of 50 million yen (about $208,000) or less and then only within specified limits.

--Donations within specified limits.

--Amounts credited to reserve accounts for bad debts, sales returns, employee bonuses, employee retirement allowances, special repairs, and warranty repairs.

--Depreciation and amortization.

In making plant and equipment investment decisions, the depreciation expenses allowed under the tax laws are of considerable interest to corporations. In general, the shorter the useful life prescribed under tax laws, the sooner the corporations may recover the full cost of the asset in computing their tax liabilities.

In Japan, depreciable assets are assigned a useful life in regulations issued by the Ministry of Finance. Generally, assets with a useful life of more than one year and costing over Y 100,000 (about $417) must be capitalized and depreciated over prescribed periods of time.[11] Some examples of the useful lives of plant and equipment prescribed by the Ministry are shown in attachment II to my statement. For example, automobiles may be depreciated over 4 years and automobile manufacturing plants over 10 years. These periods appear to be shorter than the economic lives of these assets.

In general, assets may be depreciated to a residual value of 5 percent of cost regardless of depreciation method.[12]Cost includes acquisition price plus other costs of putting the asset in service. Permissible methods for depreciating tangible fixed assets include the straight-line method, the declining balance method, or another method if it is specifically approved by the appropriate local tax office. However, the declining balance method is to be used unless advance notice is given to the local tax office.

The tax law permits corporations to write off the full cost of certain intangible assets and certain expenses in the year in which incurred. Most notably, in terms of tax provisions favoring industrial activity, corporations may write off certain

---

[11]Depreciation is not allowed for land, rights to land, and certain articles, such as precious stones and paintings.

[12]The remaining 5 percent of cost may be recognized as an expense at the time of asset disposal.

costs related to research and development; development of new markets, products, or production techniques; and corporate organizational activities during the year the costs are incurred or may amortize those costs over a period of up to 5 years. This option gives corporations the flexibility to postpone the recognition of certain costs to years when there are profits to offset instead of recognizing those costs before a product is developed for sale or before any sales are made.

Against this general framework of corporate income taxation, the Japanese have enacted special measures designed to help attain certain specific economic policy objectives. I would now like to turn to those special taxation measures.

Incentives for industrial investment and development under the Special Taxation Measures Law

To stimulate industrial activity, including the promotion of corporate investment and research activities, Japan's Special Taxation Measures Law makes available to qualifying corporations 3 categories of tax preferences: special depreciation allowances, tax credits and special deductions, and tax free reserves. The Japanese government estimates that these tax preferences reduced corporate tax revenues by Y 258 billion (about $1.1 billion) in 1983 or about 3 percent of the corporate tax that otherwise would have been collected.

While there are similarities between the types of tax preferences provided to corporations under Japanese and U.S. tax rules, the Japanese tax preferences are generally more-narrowly targeted to affect certain industries, geographic areas, or specific types of equipment. Also, the Japanese have tended to avoid tax credits as a general investment incentive.

Special depreciation allowances

As measured by foregone tax revenues, the most significant category of Japan's special taxation measures are the tax preferences entitling certain corporations to accelerate the depreciation of qualifying assets. The Japanese government estimates that these special depreciation measures cost about Y 153 billion (about $630 million) in foregone tax revenues in 1983, or almost 60 percent of the cost of all the tax preferences available to corporations through the Special Taxation Measures Law during that year.

The economic rationale for offering special depreciation measures is to stimulate the private sector to invest in particular types of assets. Certain corporations may depreciate qualifying assets by one of two accelerated methods specified by the Special Taxation Measures Law and thereby recover their costs sooner than they would by following the methods authorized by the Corporation Tax Law. This assumes, of course, that the corporations have earned profits in excess of the allowable depreciation expense.

Under one method, certain corporations are entitled to an extra depreciation allowance during the first year a qualifying asset is placed in service. As shown in attachment III, this allowance usually ranges from 8 to 30 percent of the cost of the asset. For example, air transportation enterprises are entitled to an additional first-year depreciation allowance of 11 percent of the cost of new aircraft. Also, very favorable treatment is provided for certain research and experimentation expenditures that, under normal tax rules, would be capitalized. Corporations are authorized to write off, in the year incurred, 100 percent of expenditures for research and development that are paid to specified associations engaged in a research work sanctioned by the government.

Under the second method, certain corporations investing in qualifying assets may deduct, during each authorized year, an additional percent of the regular depreciation computed under the Corporation Tax Law. Attachment IV summarizes these measures. For example, corporations acquiring certain newly constructed facilities storing liquified petroleum gas are authorized to deduct an additional 34 percent of the regular depreciation allowance during each of the first 5 years the storage tanks are in service.

An indication of the importance of any one special depreciation measure is the degree to which it is used. An analysis of available Ministry of Finance data shows the importance of favored depreciation treatment given to small and medium-sized businesses and emphasis given to anti-pollution and energy saving investments. Of the total tax revenues foregone in 1983 due to special depreciation measures

--48 percent was attributable to small and medium-sized corporations taking additional first year depreciation allowances for investments in machinery and equipment;

--22 percent was attributable to corporations taking additional first year depreciation allowances for investments in machinery and equipment preventing environmental pollution or promoting efficient resource use;

--11 percent was attributable to corporations taking additional first year depreciation allowances for investments in energy saving equipment;

--10 percent was attributable to corporations taking additional first year depreciation allowances for investments in manufacturing machinery used in underdeveloped areas; and

--9 percent was attributable to other provisions.

Before turning to the next largest component of special tax measures--tax credits and special deductions--I would like to again point out that, regardless of the special depreciation allowances taken by corporations, as a general rule those corporations may not depreciate tangible assets to less than a residual value of 5 percent.

Tax credits and special deductions

As measured by foregone tax revenues, the tax preferences entitling corporations to tax credits and additional tax deductions from taxable income are the second most significant category of Japan's special tax measures. The Japanese government estimates that corporate use of these tax preferences cost about Y 63 billion (about $263 million) in foregone tax revenues in 1983, or about 24 percent of the total tax preferences made available to corporations by the Special Taxation Measures Law during that year.

Among measures to help promote domestic industrial development, the Special Taxation Measures Law provides tax credits to corporations engaging in certain applied research and development activities, making certain energy-saving investments, and modernizing certain industrial facilities.[13] These tax credits allow qualifying corporations to directly reduce the amount of taxes owed under the Corporation Tax Law by a specified percent of the corporations' investment or research expense covered by the special measure. As such, the Japanese government is helping finance these desired corporate expenditures.

To stimulate certain research and development activities, the Special Taxation Measures Law entitles qualifying corpora-

[13]Other tax credits, such as those for withholding and foreign taxes paid, are also available to corporations.

tions to a tax credit equal to 20 percent of the amount of covered research and development expenses incurred during the tax year that exceeds the largest amount of such expenses incurred in any year since about 1965. Covered research and development expenses are generally defined as those incurred to develop new products, designs, and production techniques. These expenses may include employee salaries, equipment depreciation, and other related expenses such as overhead. However, the tax credit is limited to 10 percent of the corporate tax that would otherwise be due without the credit.

To promote corporate investment in certain energy-saving facilities, the Special Taxation Measures Law entitles corporations to take a tax credit equal to 7 percent of the acquisition cost of covered investments. These covered investments include machinery, equipment, and other depreciable assets that reduce energy consumption in the manufacturing process, use energy sources other than petroleum, and reduce pollution from the use of non-petroleum-based energy sources. The available energy credit, however, is limited to 20 percent of the corporate tax liability computed without the credit, but credits not taken because of the limit may be carried over to the following year.

This energy-related investment tax credit is an outgrowth of the tax credit concept first introduced in Japan in 1978. At that time, the investment tax credit was envisioned as a 1-year temporary measure to encourage investment in specific industrial facilities, such as energy-saving or anti-pollution facilities. From this beginning, and after substantial modification, the Japanese have retained an energy-related investment tax credit; and, beginning in 1984, a tax credit for small businesses investing in plant and equipment to increase efficiency. This tax credit is equal to 7 percent of the covered investments and is envisioned as a 2-year temporary measure.

The Special Taxation Measures Law also provides for additional deductions in computing corporate taxable income as an incentive for corporations to engage in certain business activities, primarily as follows.

--Corporations selling or licensing technical and industrial property rights to foreign parties may deduct 28 percent of the foreign transaction's gross proceeds from corporate taxable income otherwise computed.

--Corporations performing research or technical support for foreign parties may deduct 16 percent of the gross proceeds from corporate taxable income otherwise computed;[14]

--Corporations engaged in mineral exploration may deduct an additional amount equal to the amount of expenses and depreciation attributable to exploration activities from corporate taxable income otherwise computed.[15]

---

[14]The sum of this and the preceding deduction is limited to 40 percent of corporate taxable income computed without the deduction.

[15]The deduction is subject to certain limitations, such as that the deduction may not exceed corporate taxable income.

An analysis of available Ministry of Finance data shows the importance of the favorable treatment given to corporate research and experimentation expenditures. Of the total tax revenues foregone in 1983 due to the special tax credit and deduction measures:

--60 percent was attributable to corporations taking the tax credit for research and experimentation;

--30 percent was attributable to corporations taking the two special deductions for income derived from overseas technical service transactions; and

--10 percent was attributable to corporations taking other tax credits and special deductions.

I would now like to turn to the last category of special taxation measures--tax free reserves.

<u>Tax free reserves</u>

As measured by foregone tax revenues, the least significant of the tax preferences made available to corporations under the Special Taxation Measures Law are those that entitle corporations to defer taxation on part of their business proceeds by establishing tax free reserve accounts. The Japanese government estimates that corporate use of tax free reserves cost about Y 42 billion (about $175 million) in foregone tax revenue in 1983. This amounts to about 16 percent of the total tax preferences made available to corporations by the Special Taxation Measures Law.

In general, the tax free reserves authorized by the Special Taxation Measures Law are intended to encourage certain specific types of investments and business activities and to provide relief from certain potentially harsh business conditions. This is accomplished by providing corporations that are engaged in covered business activities or subject to extreme price fluctuations of certain commodities with a mechanism for taking a tax deduction for certain estimated business expenses before the expenses are actually incurred and before they would be recognized following generally accepted accounting principles.

In addition to providing relief from certain types of extreme price fluctuations, the types of business activities favored by the tax free reserve measures include

--overseas market development;

--overseas investment;

--nuclear fuel reprocessing;

--designated economic cooperation investments; and

--certain specified industrial activities, such as mineral exploration, computer development and sales, nuclear power plant construction, and other miscellaneous activities.

Data from the Ministry of Finance shows that about 20 percent of the estimated tax revenue loss is attributable to the recognition of computer repurchase losses. All other provisions cost much less.

In general, the computer repurchase loss reserve provides that corporations engaged in the manufacture or sale of electronic computers to qualified leasing corporations under compulsory repurchase sales agreements may recognize as a current expense for tax purposes an estimated amount equal to 20 percent of the gross proceeds received. However, as is generally true for all the reserve accounts, if actual loss expense differs from that estimated, an appropriate adjustment to income is made in subsequent years.

This completes my detailed presentation of the various tax preferences used by the Japanese government to stimulate desired corporate industrial activity. I will conclude my statement with an examination of the corporate tax burden in Japan.

Japanese corporate tax burden

Gaining some insights into the cumulative effect of all the special taxation measures and the basic provisions of the Corporation Tax Law may be more important when considering overall industrial development than the merits of each of the individual provisions. This becomes particularly evident when it is recognized that many of the taxation measures have been instituted to meet many objectives, such as promoting energy efficiency to compensate for a lack of natural resources, coping with enironmental pollution, aiding underdeveloped areas, restructuring depressed industries, or advancing the development of new industries such as computers. Moreover, the point has been advanced by some academic studies that Japanese industrial growth may have been affected more by lower tax burdens--corporate and individual tax burdens on a national and subnational basis--than by any single tax preference or combination of tax preferences.[16]

The tax rates specified in Japan's national tax laws do not, however, provide a comprehensive measure of the tax burden on corporations. For example, the tax preferences--accelerated depreciation allowances, tax credits and special deductions, and tax free reserves--used by the Japanese government as incentives for industrial investment and research and development, reduce taxes paid by Japanese corporations. (These incentives reduced corporate tax revenues by about 2.7 percent in 1983). Other factors may also substantially affect the tax burden imposed on corporate business activities. Most notably, dividends are taxed at a lower rate than retained earnings. Also, a reduced

---

[16]This is one of a number of observations made by J. Pechman and K. Kaizuka in Asia's New Giant. Further, the authors concluded that "In total, the erosion of the tax base through [special tax measures and other preferences] is much larger in Japan than it is in the United States and most other developed countries (even though some of the special measures have been abolished in recent years). The few studies that have been made have concluded that the tax preferences promoted modernization of plant and equipment in the steel and machinery industries but had little influence either on savings of households or on investment in other industries. On the basis of the evidence, the Japanese would probably be better off with a broader tax base and lower nominal tax rates."

tax rate is applied to certain portions of income earned by smaller corporations.

Corporate taxes paid to municipal and prefecture governments also affect the total tax burden on corporations, just like state and local taxes in the United States. Municipal and prefecture taxes, which are controlled by the central government, are essentially computed on the basis of corporate taxable income as determined under the Corporation Tax Law. Attachment V provides an overview of the corporate income tax rates imposed by these tax laws. In general, the subnational income taxes may increase corporate taxes by as much as one-third. For 1982, according to Japanese national income account data, total corporate income taxes under national and subnational tax laws amounted to Y 11.6 trillion (about $48 billion).

To develop a measure of the tax burden imposed on Japanese corporations, we adopted a technique followed by Pechman and Kaizuka in their 1976 study of Japanese taxation.[17] That technique directly takes into account the tax preferences involved in corporate recognition of asset depreciation expense by computing tax burdens as the rate of taxes paid by corporations on gross profits; that is, profits before the deduction of depreciation expense allowances.

---

[17]J. Pechman and K. Kaizuka, "Taxation," in Asia's New Giant (Washington, D.C.: The Brookings Institution 1976.)

Also, to establish a benchmark to show the relative Japanese corporate tax burden computed in accordance with the Pechman and Kaizuka methodology, we compared the results with a similarly computed U.S. corporate tax burden. The data to make these comparative analyses were obtained from the national income account data of both countries. The results are shown in attachment VI.

Japanese corporations did experience lower tax burdens than U.S. corporations during the 1960s and into the early 1970s. In 1970, for example, Japanese corporations paid about 17 percent of their total gross profits in taxes while U.S. corporations paid about 25 percent. Accordingly, this may have had a stimulative effect on Japan's overall industrial growth when compared to that of the United States. However, as shown in attachment VI, the tax burden on Japanese corporations has been increasing in recent years, while in the United States the corporate tax burden has been substantially reduced. By 1982, following this analytical methodology, the total U.S. corporate tax burden was about one-half that of Japan's.

The reversal in corporate tax burdens between the two countries has been borne out by a recent stůdy completed by the Congressional Research Service that compared the tax burdens on manufacturing.[18] Using a different analytical method, one that examines how the tax structure affects the profitability of investment, the Congressional Research Service estimates that, at least since 1977, the effective corporate tax burden on marginal investment in Japan has exceeded that in the United States. With respect to national corporate income taxes, the Congressional Research Service analysis shows that this corporate tax burden in Japan rose from 33.8 percent in 1977 to 35.8 percent in 1981 while in the United States it dropped from 37.5 percent to 25.3 percent. Moreover, when considering national and subnational corporate income taxes, the Congressional Research Service estimates that the effective tax rate in Japan is about twice that of the United States.

Accordingly, the stimulative impact of Japan's lower corporate tax burden may very well have run its course and been overcome by the need to finance government programs and services. Since 1975, Japan has been faced with increasing national budget deficits. In recent years, these deficits have amounted to about one-third of the central government's budgets.

To solve the deficit problem, the Japanese government, in part, has turned to corporations as a source of additional tax

[18] Comparative Corporate Tax Burdens in the United States and Japan and Implications for Relative Economic Growth, HJ4625, Jane Gravelle, Congressional Research Service, Washington, D.C., Sept. 6, 1982.

revenues. Since 1975, while the system for taxing corporations has remained unchanged, the tax rates have been increased and the value of tax preferences curtailed. In 1981, the corporation tax rates were increased from 40 percent on undistributed profits and 30 percent on distributed profits to 42 percent and 32 percent, respectively. In 1984, the rates were again adjusted upward to 43.3 percent and 33.3 percent, respectively. This latest increase is planned to be effective for two tax years beginning April 1, 1984. At the same time, tax preferences have been curtailed. In 1975, the special measures affecting corporations amounted to about 7.4 percent of corporate tax revenues. By 1983, the special measures had been reduced to 2.7 percent of corporate tax revenues.

In view of these changes and aside from Japan's split rate tax system with its attendant lower tax rate on distributed profits, our limited research of current Japanese corporate tax rules did not contradict a view held by many researchers that corporate tax preferences are not the leading cause of Japan's industrial development.

This concludes my statement on Japan's tax system. I will be happy to answer any questions that you may have.

ATTACHMENT I

CORPORATE TAX RATES UNDER JAPAN'S CORPORATION TAX LAW 1984

Description of Corporate Taxpayer	Percentage Tax Rates: Taxable income earmarked for dividends	Percentage Tax Rates: Taxable income retained
Corporations with paid-in capital in excess of 100 million yen (about $416,666)	33.3	43.3
Corporations with paid-in capital of 100 million yen (about $416,666) or less:		
First 8 million yen (about $33,333) of annual taxable income	25.0	31.0
Remainder of taxable income	33.3	43.3

The corporate tax rates shown are to be effective from April 1, 1984 to March 31, 1986. This represents a planned temporary increase from the previous 42-percent tax on retained earnings and 32 percent tax on earnings earmarked for dividends. Also, the tax rates on the first $33,333 of small corporation taxable income, whether retained or distributed as dividends, were previously one percent lower. Exchange rate used to compute dollar amounts is 1 U.S. dollar equals 240 yen.

Source: Information provided by the Japanese Embassy, Washington, D.C., September 1984.

USEFUL LIVES OF SELECTED ASSETS
UNDER JAPAN'S CORPORATION TAX LAW
1984

Description of Asset	Useful life (years)
Tangible fixed assets other than machinery and equipment	
1. Reinforced concrete buildings (for office)	65
2. Wooden buildings (for office)	26
3. Elevators	17
4. Air conditioners or heaters	15
5. Steel vessels (2,000 tons or more)	15
6. Steel tankers (2,000 tons or more)	13
7. Steel fishing vessels (500 tons or more)	12
8. Airplanes (for international service)	10
9. Trucks (for transport business)	4
10. Passenger automobiles (taxis)	4
11. Electronic computers	6
12. Desks, chairs, or cabinets made of metal	15
13. Typewriters	5
Machinery and equipment	
1. Chemical condiment manufacturing plants	7
2. Sugar refinery plants	13
3. Beer brewery plants	14
4. Raw silk manufacturing plants	10
5. Worsted spinning plants	10

Description of Asset (cont.)	Useful Life (years)
6. Pulp manufacturing plants	12
7. Chemical fertilizer manufacturing plants	10
8. Polyethylene manufacturing plants	8
9. Synthetic fiber manufacturing plants	7
10. Rayon yarn or rayon staple manufacturing plants	9
11. Plate or sheet glass manufacturing plants	14
12. Cement furnaces	13
13. Iron and steel manufacturing plants	14
14. Metallic machine tool manufacturing plants	10
15. Electrical machinery and appliance manufacturing plants	11
16. Automobile manufacturing plants	10
17. Lens or other optical instrument manufacturing plants	11
18. Radio or television broadcasting equipment	6
19. Hydraulic power generation plant for electric utilities	22
Intangible fixed assets	
1. Patent rights	8
2. Utility model rights	5

Source: Information provided by the Japanese Embassy, Washington, D.C., September 1984.

INCREASED INITIAL YEAR DEPRECIATION AND AMORTIZATION EXPENSE RECOGNITION UNDER JAPAN'S SPECIAL TAXATION MEASURES LAW 1984

Description of qualifying asset	Allowance computed as a percent of acquisition cost
Initial depreciation for qualifying machinery and equipment acquired and placed in service within prescribed periods:	
1. Machinery and equipment to prevent environmental pollution	25
2. Machinery and equipment designed not to cause environmental pollution	18
3. Specified water-supply equipment	18
4. Machinery and equipment for recycling which may promote efficient resource use	16
5. Machinery and equipment for saving energy	18
6. Certain assets used for the structural adjustment of specific basic material industries	
a. machinery	18
b. assets other than machinery	8
7. Steel vessels used by ocean transportation enterprises	15
8. Aircraft used by air transportation enterprises	11
9. Buildings for stores and shops jointly operated by retailers	8

 ATTACHMENT III

Description of qualifying asset (cont.)	Allowance computed as a percent of acquisition cost
B. Initial depreciation of assets used for earthquake disaster prevention	18
C. Initial depreciation for machinery, equipment, and factories whose prices exceed 15 million yen and are located in	
1. Underdeveloped areas or certain industrial development areas	
a. machinery and equipment	16
b. factory building	8
2. Coal mining regions, depopulated areas or depressed local industrial areas	
a. machinery and equipment	18
b. factory building	8
3. Okinawa industrial development areas	
a. machinery and equipment	34
b. factory building	20
4. Okinawa free trade zone	
a. machinery and equipment	50
b. factory building	25
D. Initial depreciation for machinery and equipment acquired by small or medium sized enterprises or agricultural cooperative associations and costing over 1.4 million yen	30 /a
E. Initial depreciation of specific shafts and lifts for mining use	100
F. Initial amortization of forestation expenses	27 /b

Description of qualifying asset (cont.)		Allowance computed as a percent of acquisition cost
G.	Initial depreciation of facilities for members mutual benefits	/c
H.	Amortization of expenditures for research and development purposes paid to specified associations mainly engaged in research work	100/b
I.	Initial depreciation of machinery and equipment acquired by small and medium-sized firms located together in specific areas in accordance with certain government programs	
	a. machinery and equipment	18
	b. building	8
J.	Initial depreciation of machinery and equipment for medical use acquired by medical corporations and costing over 1.4 million yen	18
K.	Initial depreciation of certain machinery and equipment used by high-technology firms in designated "technopolis" areas	
	a. machinery and equipment	30
	b. building	15

---

a. Computed on the excess of the cost over the average yearly investment for the past 5 years.

b. Computed on the basis of covered expenses incurred during the year.

c. Varies between 8 and 23 percent depending on certain circumstances.

Source: Information provided by the Japanese Embassy, Washington, D.C., September 1984.

 ATTACHMENT IV

ADDITIONAL DEPRECIATION EXPENSE RECOGNITION UNDER JAPAN'S SPECIAL TAXATION MEASURES LAW 1984

Description of Qualifying Asset	Allowance[a]
Machinery used to promote rationalization of small and medium sized enterprises or the textile industry improvement project	30% for the first 5[b] years
Machinery, equipment, and buildings of enterprises employing handicapped individuals	
machinery and equipment	18% each year
building	25% each year
Houses newly built for rent with	
useful life of less than 45 years	47% for the first 5 years
useful life over 45 years	70% for the first 5 years
Building construction covered by the law concerning redevelopment of metropolitan areas	14% for first 5 years
Facilities for storing liquified petroleum gas	34% for first 5 years
Certain warehouses	27% for first 5 years
Silos for grains	27% for first 5 years

Notes: [a]The additional depreciation allowances shown are computed on the basis of the depreciation allowance determined under the Corporation Tax Law. Other provisions provide for the shortening of the useful lives of certain hotels.

[b]For structural improvement of small and medium-size enterprises in the fishing industry, the additional depreciation allowance is 27 percent.

Source: Information provided by the Japanese Embassy, Washington, D.C., September 1984

NATIONAL AND SUBNATIONAL CORPORATE INCOME TAX RATES IN JAPAN 1984

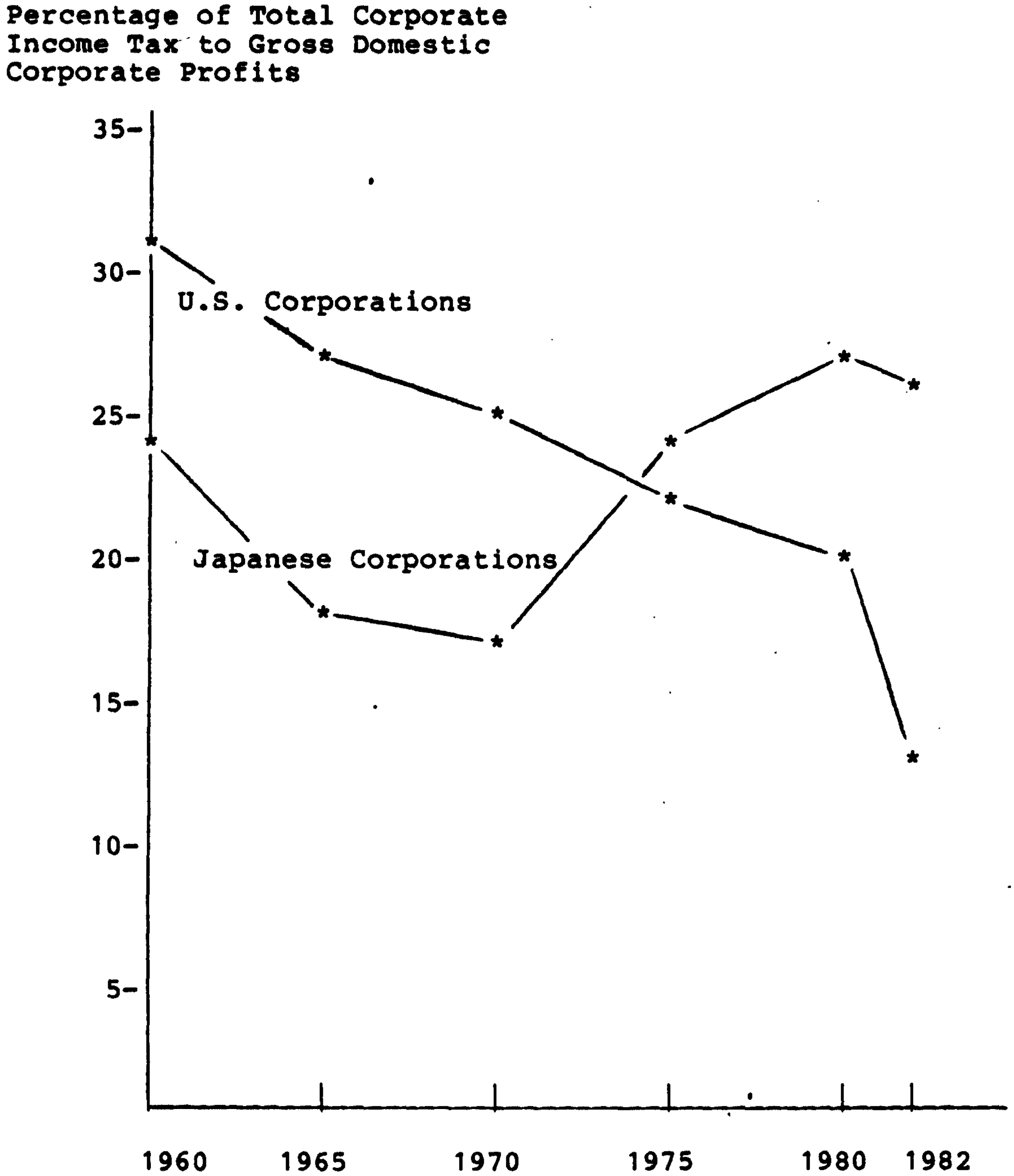
	Percentage Tax Rates	
	Taxable income earmarked for dividends	Taxable income retained
National Corporate Tax	33.3	43.3
Local Enterprise Tax	13.2	13.2
Local Inhabitants Tax	6.6	8.7
Estimated Adjustment for deductibility of local enterprise tax from National Corporate Tax	- 7.5	- 7.5
Estimated Aggregate Tax Rate	45.6	57.7

Note: The national corporate tax, local enterprise tax, and local inhabitants tax rates shown reflect only the maximum tax rates. With certain exceptions the local taxes are based on taxable income as determined under the Corporation Tax Law--the national corporate income tax.

Source: Tax Management Inc.: Foreign Income Portfolios, Business Operations in Japan; 1984, updated with the national corporate tax rate increase of 1984.

ATTACHMENT VI

COMPARISON OF TOTAL CORPORATE
INCOME TAX BURDEN IN JAPAN
AND THE UNITED STATES
1960 THROUGH 1982



Source: National income accounts as reported by the U.S. Department of Commerce and Japan's Ministry of Finance. U.S. data adjusted to account for Federal Reserve Bank data in national account totals.