The Japanese Income Tax System and the Disparity of Income and Wealth Among People in Japan

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Abstract

As in many other countries, the disparity of income and wealth is one of the most important and serious problems in Japan. This paper describes how and to what extent the Japanese income tax system (in combination with the social security programs) mitigates this disparity, and how it should be reformed to increase that function. I believe that a non wastable tax credit should be adopted, and more redistributional elements introduced into the income tax system. In 1991, I proposed a dual-income tax system (a different type of dual-income tax from that in the Nordic countries), a combination of a flat rate income tax and a progressive net wealth tax (with a few non-steep progressive rates). If combined with an international taxpayer identification number system, which I have been proposing since around the turn of the century, such a proposal would be feasible even in a globalizing world with free capital flows, and could dramatically reduce income and wealth disparities.

In this paper, I can not take up the problem of the disparity of wealth because I could not find enough reliable statistics. I want to continue research and write a paper on this subject, too, in the near future.

I. Preface

For much of the period since the Second World War, Japan enjoyed a very egalitarian distribution of wealth. Before the War, it was a country with a high Gini coefficient, and great disparity between the rich and the poor.

However, after the war, as the result of such measures as the *zaibatsu* dissolution, agricultural land reform, and a progressive property tax (on net assets of individuals of more than 100,000 with progressive rates of 20% ~ 90%), that economic disparity fell dramatically. In effect, "economic democracy" became an implicit national policy.

As the rapid economic growth began in the mid- 1960s (Prime Minister Ikeda pledged to double incomes in a decade), many people came to believe that if they worked hard, their efforts would be economically compensated, and they could have a happy future. This perception, combined with the notion of economic democracy, became a mental driving force for further economic development. During the bubble economy of

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the 1980s, the majority of people, if asked, would have answered that they belonged to the middle or upper middle class. Professor Toshiki Sato calls this perception an "implicit social contract"[2].

In the years since 1990, this "social contract" has begun to unravel. Needless to say, the problem of poverty was less serious before the collapse of the bubble economy in 1990. As it broke down, the disparity of income and wealth increased tremendously. It increased on a wide variety of dimensions: between managers and ordinary employees, between those who owned land and those who did not, and so forth. Unemployment has started to increase as well, and incomes have started to fall. The "lost decade" has become the most common description of the years after the bubble economy.

Since the mid-2000s the Japanese economy has started to recover. On one hand, this has been supported by exports of cars, electronics and many other kinds of products and technologies. On the other hand, corporations have tried to maintain profits by reducing their labor expenses. Traditionally, most employees could depend on the Japanese corporate practice of retaining their employees until retirement. In recent years, however, this traditional system has broken down. To avoid the burden of retaining employees, corporations have increasingly relied on part-time and other irregular types of employment. In turn, this has increased unemployment, decreased income, and ultimately increased economic disparities.

The problem is serious. This increased tendency to depend on irregular employees was made possible by the Labor Supply Business Act of 1985. Until that time, labor supply firms (i.e., "head-hunters") had been generally prohibited. By this Act, the prohibition was removed. Initially, the industry remained heavily regulated. However, with the amendment of this Act in 1999, those regulations were relaxed. Corporations are now able to replace their full-time employees with temporary workers supplied by these firms. Needless to say, the status of the supplied employees is unstable, and their salaries are much lower than those of full-time employees. Even before the present recession caused by the financial crisis, in other words, the situation of both full-time and irregular employees had been steadily worsening.

II. A Short History of the Japanese Income Tax

The individual income tax was introduced in 1887 in Japan. Although the scope of income covered was not comprehensive, it was a global, not scheduler, system with five progressive tax rates.

By amendment in 1899, the interest on bonds started to be taxed separately at a low flat rate through withholding. In 1920, interest on fixed-term deposits became subject to separate taxation as well at the same rate as bond interest.

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[2] Toshiki Sato, Statement of Opinion at 9th Meeting (March 30, 2004) of the Basic Matters Examination Subcommittee of the Government Tax Policy Committee.

In 1940, the system was radically revised. Under the new regime, the global progressive tax was replaced with a combination of scheduler system and global, progressive system.

After World War II, the Japanese income tax system was replaced with an American-type system. The new regime was a global, and comprehensive system with progressive rates. It was further strengthened by amendment in 1950 based on the Shoup Mission Recommendations of 1949.

As the economy grew, the tax base was gradually eroded. Over time, a variety of preferential treatments were added. Some savings deposits were made nontaxable, interest was made subject to a separate flat rate, capital gains on the sale of shares were excluded, and so forth.

The so-called "fundamental tax reform" of 1986~88 attempted to recover the comprehensiveness of the earlier tax base. Many base-eroding measures were abolished or reformed. For instance, the provision for non-taxable deposits was abolished, as was the exclusion of capital gains on the sale of shares. However, interest income and capital gains on the sale of shares were now taxed separately at low flat rates. It would, the government explained, be administratively too difficult to include the income in the comprehensive base. To augment revenues further, the government adopted a value-added tax (VAT) as an entirely new revenue source.

Since the mid-2000s, an important reform has been taking place with regard to the taxation of income from financial assets: interest income, dividend income, and capital gains on the sale of shares. Under this reform, financial-assets income is taxed separately at a 20% rate (including the local income tax) – and starting in 2009, dividend income on listed stocks and capital gains on the sale of listed stocks will be taxed in the same manner as interest income. Losses from the sale of listed shares will be deductible against dividends from listed stocks. Because the separate taxation of financial income resembles the Nordic dual-income tax, the OECD classifies the Japanese system as a semi-dual income tax.[3] The government gives several rationales for this separate taxation regime; (1) administrative simplicity, (2) economic efficiency, and (3) the prevention of international capital flight. This subject will be discussed further below.

III. Income Disparities: Some Illustrative Statistics
1. Comparison with other countries

To understand the scope and degree of the current disparities in income compared with other countries, consider some simple statistics. In Figures 1-1-1 (30 OECD countries of mid-2000s), and 1-1-2 (27 OECD countries of 2000), and Table 1-1 (same as Figure 1-1-1), I report the Gini coefficient for income concentration in 27 OECD countries for 2000 and mid-2000s. The coefficient measures the inequality of income in the country, with the higher numbers indicating higher inequality. Countries like Mexico

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[3] OECD, Fundamental Reform of Personal Income Tax, Tax Policy Studies No. 13 P. 84 (2006).

and the U.S. are among the most unequal; Denmark, Sweden, and the Netherlands are the most equal. Among the 27, Japan is near the middle, with inequality that approaches the OECD average.

Figure 1-1-1: Gini Coefficients of Income In Inequality, 30 OECD Countries, Mid-2000s[4]

Gini coefficients of income inequality in OECD countries, mid-2000s
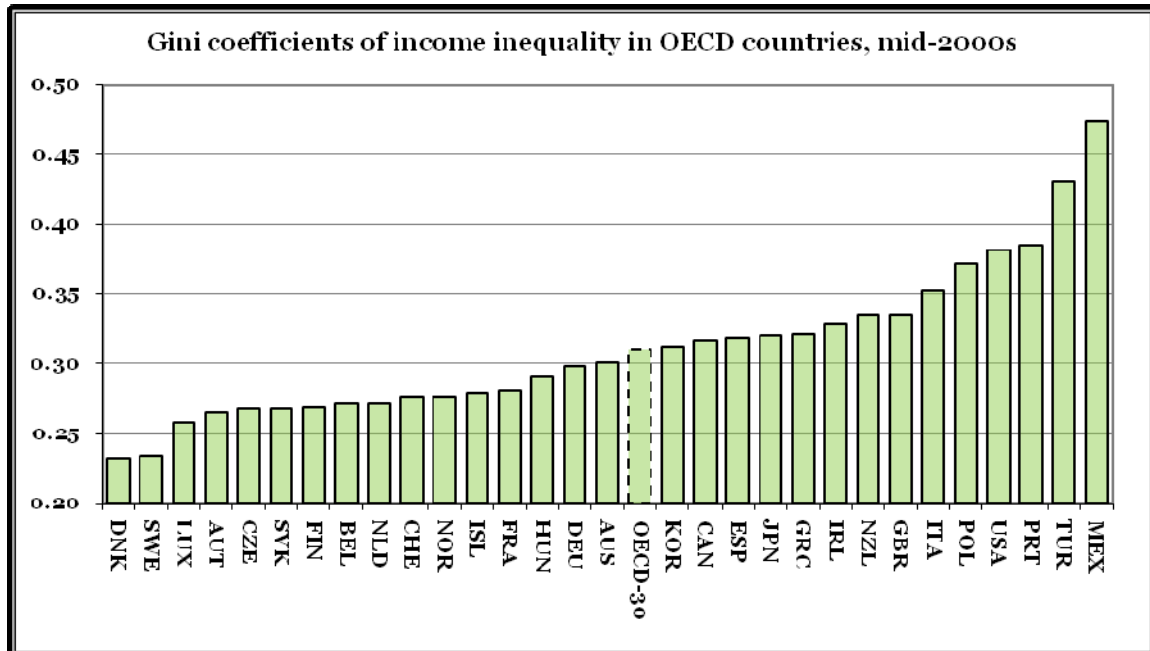
This inequality, however, has not been constant. Instead, as is shown on Figure 1-2 and 1-4, many countries experienced fluctuations. By contrast, the increase in the U.S. and Japan has continued steadily since the mid-1980s. Figures 1-3-1, 1-3-2 and Table 1-2 are also interesting, but I will omit the explanation.

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[4] OECD, Growing Unequal? Income Distribution and Poverty in OECD Countries (2008). Countries are ranked, from left to right, in increasing order in the Gini coefficient. The income concept used is that of disposable household income in cash, adjusted for household size with an elasticity of 0.5.
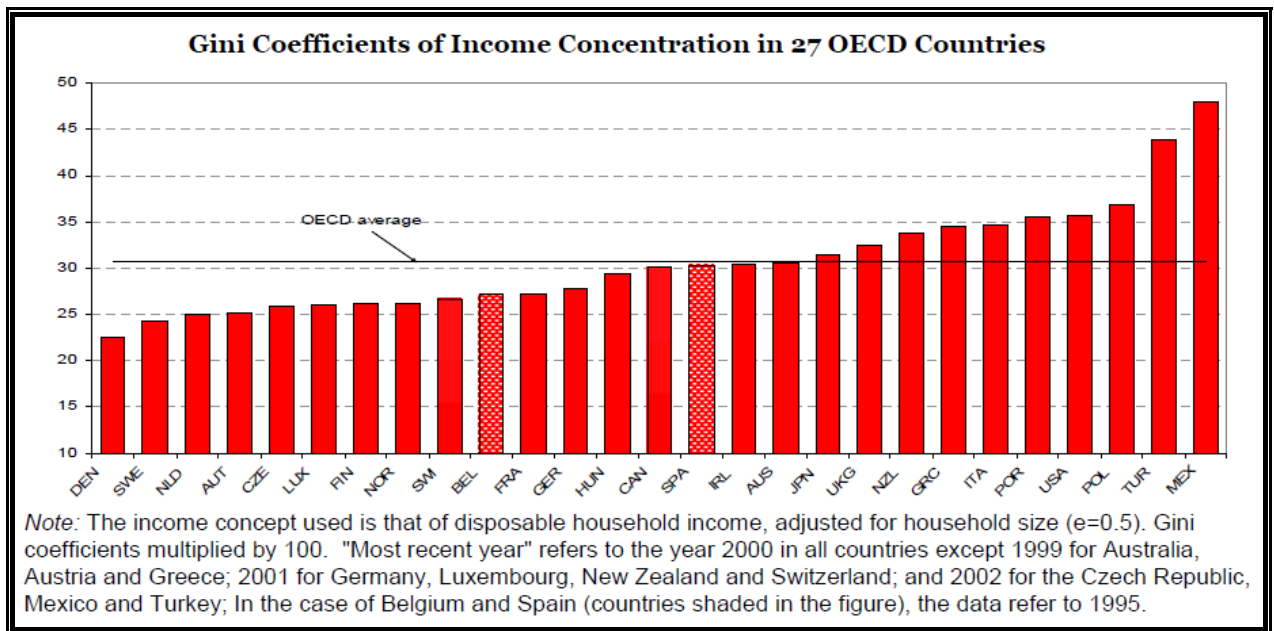
Table 1-1: Gini Coefficients of Income Inequality in OECD Countries, Mid-2000s[5]

	Gini coefficient	OECD-30 average	Difference with OECD average	% Change with OECD average	
	Coefficient Gini	Moyenne OCDE-30	Différence avec moyenne OCDE	Changement % avec moyenne OCDE	
DNK	0.232	0.311	-0.078	-0.25	DNK
SWE	0.234	0.311	-0.077	-0.25	SWE
LUX	0.258	0.311	-0.053	-0.17	LUX
AUT	0.265	0.311	-0.045	-0.15	AUT
CZE	0.268	0.311	-0.043	-0.14	CZE
SVK	0.268	0.311	-0.043	-0.14	SVK
FIN	0.269	0.311	-0.042	-0.13	FIN
BEL	0.271	0.311	-0.040	-0.13	BEL
NLD	0.271	0.311	-0.040	-0.13	NLD
CHE	0.276	0.311	-0.035	-0.11	CHE
NOR	0.276	0.311	-0.035	-0.11	NOR
ISL	0.280	0.311	-0.031	-0.10	ISL
FRA	0.281	0.311	-0.029	-0.09	FRA
HUN	0.291	0.311	-0.020	-0.06	HUN
DEU	0.298	0.311	-0.013	-0.04	DEU
AUS	0.301	0.311	-0.010	-0.03	AUS
OECD-30	**0.311**				**OCDE-30**
KOR	0.312	0.311	0.002	0.01	KOR
CAN	0.317	0.311	0.006	0.02	CAN
ESP	0.319	0.311	0.008	0.03	ESP
JPN	0.321	0.311	0.010	0.03	JPN
GRC	0.321	0.311	0.010	0.03	GRC
IRL	0.328	0.311	0.018	0.06	IRL
NZL	0.335	0.311	0.024	0.08	NZL
GBR	0.335	0.311	0.024	0.08	GBR
ITA	0.352	0.311	0.041	0.13	ITA
POL	0.372	0.311	0.061	0.20	POL
USA	0.381	0.311	0.071	0.23	USA
PRT	0.385	0.311	0.074	0.24	PRT
TUR	0.430	0.311	0.119	0.38	TUR
MEX	0.474	0.311	0.163	0.52	MEX
OECD-30	**0.311**				OCDE-30

Note: Countries are ranked, from left to right, in increasing order in the Gini coefficient. Data refer to the mid-2000s for all countries except for Japan and Switzerland, where they refer to 2000. The income concept used is that of disposable household income in cash, adjusted for household size with an elasticity of 0.5.

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[5] OECD, Income Distribution Questionnaire, Version 1 (12-Sep-2008).

Figure 1-1-2: Gini Coefficients of Income Concentration in 27 OECD Countries[6]

Gini Coefficients of Income Concentration in 27 OECD Countries

Note: The income concept used is that of disposable household income, adjusted for household size (e=0.5). Gini coefficients multiplied by 100. "Most recent year" refers to the year 2000 in all countries except 1999 for Australia, Austria and Greece; 2001 for Germany, Luxembourg, New Zealand and Switzerland; and 2002 for the Czech Republic, Mexico and Turkey; In the case of Belgium and Spain (countries shaded in the figure), the data refer to 1995.

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[6] OECD, Questionnaire on Distribution of Household Incomes (2000).

**Figure 1-2: International Comparison of Gini Coefficient;
Disposable Household Income Adjusted for Household Size**[7]
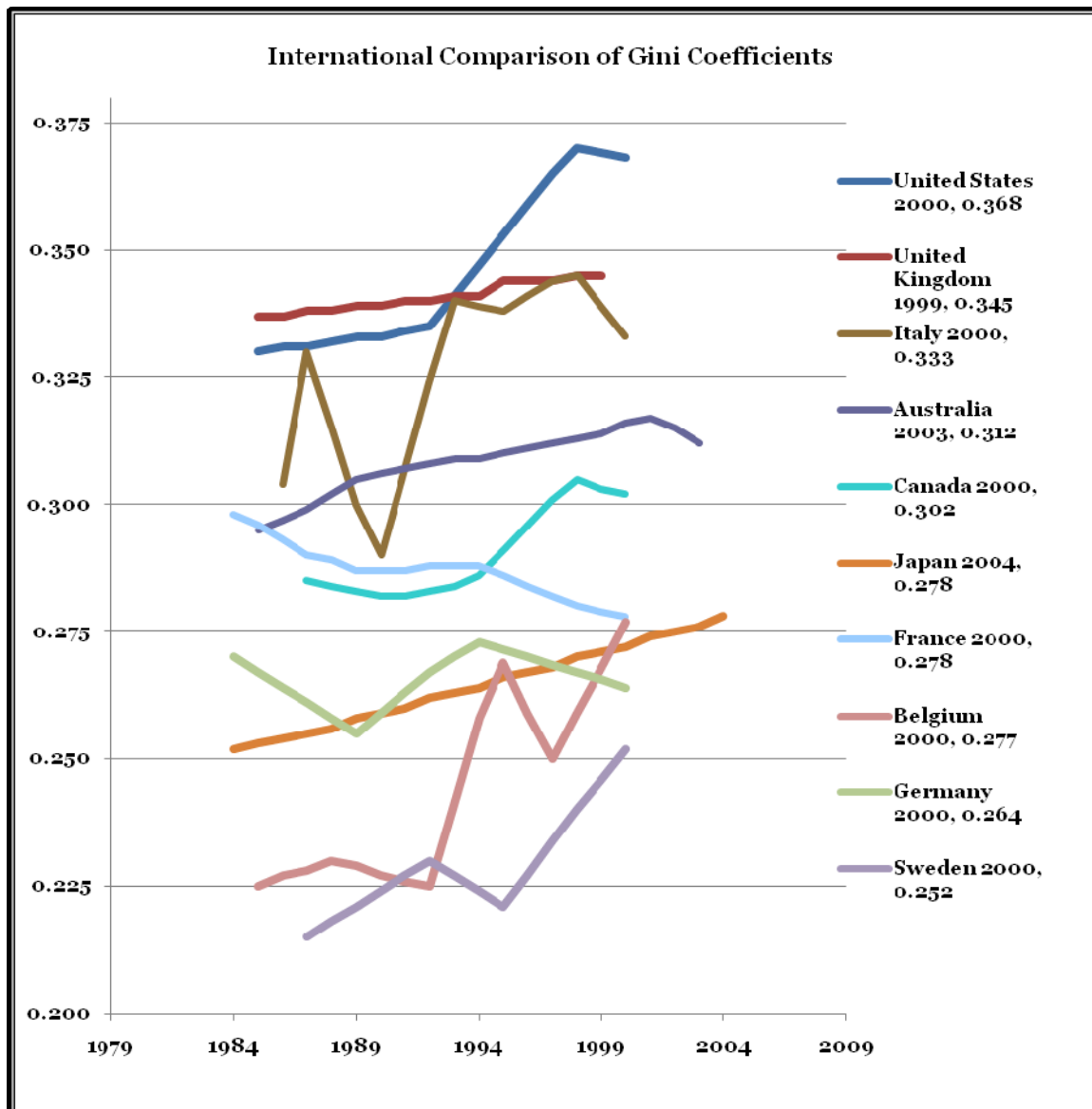
[7] Ministry of Internal Affairs and Communications. (*Image Reconstructed.*)

Figure 1-3-1: The Gap Between Rich and Poor in 2005[8]

The gap between Rich and Poor in 2005
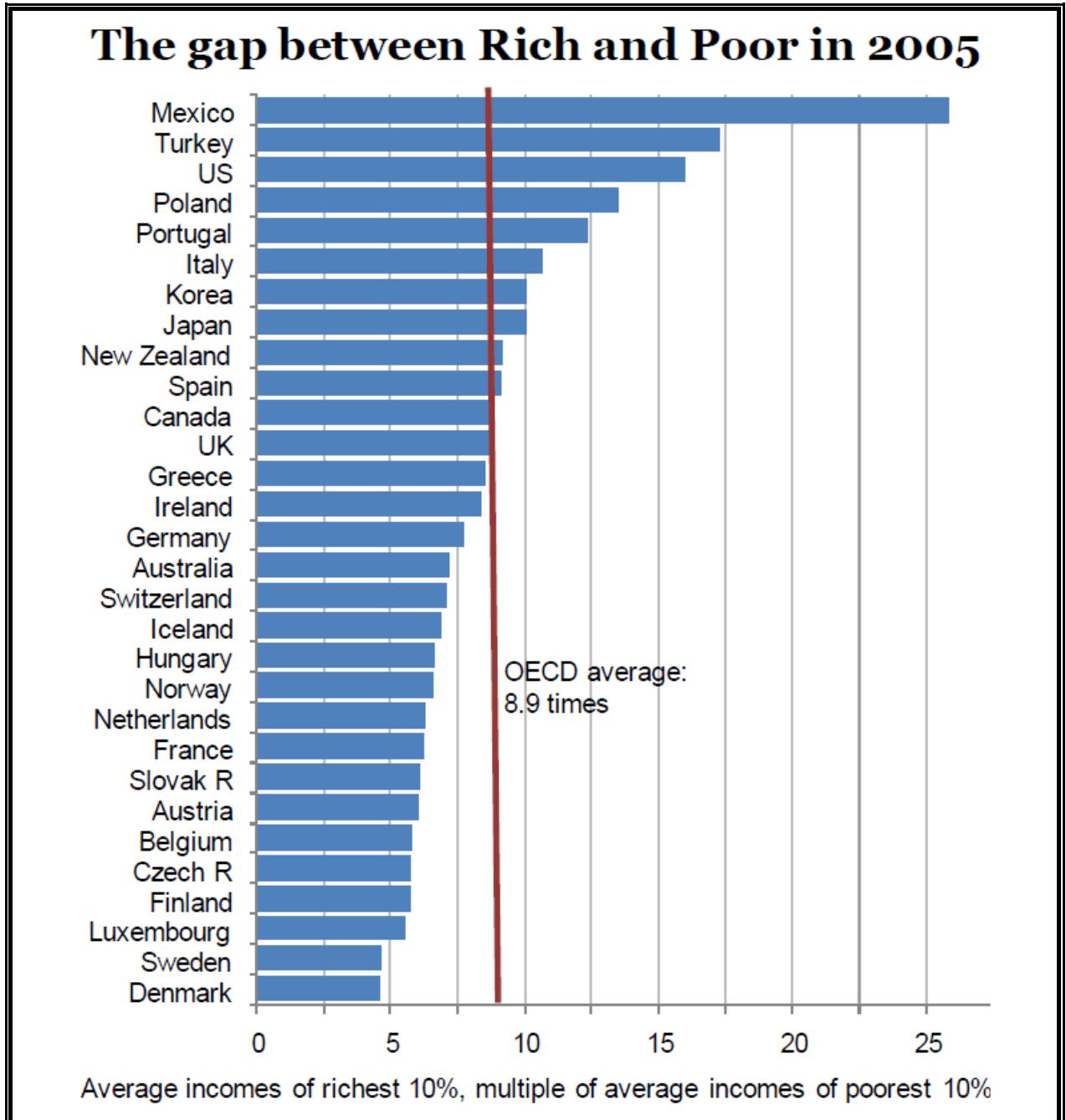
Average incomes of richest 10%, multiple of average incomes of poorest 10%

OECD average: 8.9 times

Mexico, Turkey, US, Poland, Portugal, Italy, Korea, Japan, New Zealand, Spain, Canada, UK, Greece, Ireland, Germany, Australia, Switzerland, Iceland, Hungary, Norway, Netherlands, France, Slovak R, Austria, Belgium, Czech R, Finland, Luxembourg, Sweden, Denmark

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[8] OECD, Growing Unequal? (2008)

Figure 1-3-2: Low and Middle Incomes in 2005[9]

Low and Middle Incomes in 2005

Average (median)

Poorest 10%

Luxembourg
Norway
Netherlands
Austria
Denmark
Sweden
UK
Switzerland
Belgium
Finland
France
Iceland
Australia
Canada
Ireland
Germany
New Zealand
Japan
Greece
US
Czech R
Italy
Spain
Korea
Hungary
Portugal
Slovakia
Poland
Turkey
Mexico

OECD average: US$ 19000

OECD average: US$ 7000

Median income (US$): 30000, 20000, 10000, 0

Income of poorest 10% (US$): 0, 5000, 10000, 15000

Note: left-hand and right-hand horizontal scales are different

[9] Id.

Figure 1-4: Trends in Income Inequality[10]

Point changes in the Gini coefficient over different time periods

Note: In the first panel, data refer to changes from around 1990 to the mid-1990s for the Czech Republic, Hungary and Portugal and to the western Länder of Germany (no data are available for Australia, Poland and Switzerland). In the second panel, data refer to changes from the mid-1990s to around 2000 for Austria, the Czech Republic, Belgium, Ireland, Portugal and Spain (where 2005 data, based on EU-SILC, are not deemed to be comparable with those for earlier years). OECD-24 refers to the simple average of OECD countries with data spanning the entire period (all countries shown above except Australia); OECD-22 refers to the same countries except Mexico and Turkey.

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[10] OECD, Income Distribution Questionnaire, Version 1 (9-Oct-2008).

Table 1-2: Trends in Real Household Income by Quintiles[11]

	Average annual change mid-1980s to mid-1990s					Average annual change mid-1990s to mid-2000s				
	Bottom quintile	Middle three quintiles	Top quintile	Median	Mean	Bottom quintile	Middle three quintiles	Top quintile	Median	Mean
Australia	..	..	..	..	..	2.4	2.0	1.9	2.2	2.0
Austria[1]	2.5	2.7	2.8	2.8	2.7	-2.1	-0.5	-0.4	-0.6	-0.6
Belgium[1]	1.2	0.5	1.2	0.4	0.8	1.4	1.3	1.7	1.2	1.5
Canada	0.3	-0.2	-0.1	-0.2	-0.1	0.2	1.2	2.1	1.1	1.4
Czech Republic	..	..	..	..	..	0.4	0.6	0.7	0.5	0.6
Denmark	1.3	0.9	0.8	0.9	0.9	0.6	0.9	1.5	0.9	1.1
Finland	0.9	0.9	1.0	0.8	1.2	1.6	2.5	4.6	2.5	2.9
France	1.0	0.5	-0.1	0.5	0.3	0.9	0.7	1.0	0.8	0.8
Germany	0.4	1.4	1.6	1.2	1.4	-0.3	0.5	1.3	0.6	0.7
Greece	0.3	0.1	0.1	0.3	0.1	3.6	3.0	2.7	2.9	2.9
Hungary	..	..	..	..	..	0.9	1.2	1.0	1.1	1.1
Ireland[1]	4.0	3.0	2.9	3.2	3.1	5.2	7.7	5.4	8.2	6.6
Italy	-1.3	0.5	1.5	0.6	0.8	2.2	1.0	1.6	1.0	1.3
Japan	0.8	1.8	2.1	1.8	1.9	-1.4	-1.0	-1.3	-1.0	-1.1
Luxembourg	2.3	2.5	3.0	2.4	2.7	1.5	1.5	1.7	1.5	1.6
Mexico	0.7	1.2	3.8	1.1	2.6	-0.1	-0.1	-0.6	-0.2	-0.4
Netherlands	1.1	2.7	3.9	2.8	3.0	1.8	2.0	1.4	2.0	1.8
New Zealand	-1.1	-0.5	1.6	-0.6	0.3	1.1	2.2	1.6	2.3	1.9
Norway	-0.3	0.3	1.0	0.4	0.5	4.4	3.9	5.1	3.8	4.3
Portugal[1]	5.7	6.5	8.7	6.2	7.3	5.0	4.1	4.4	4.2	4.3
Spain[1]	4.4	3.2	2.4	3.2	3.0	5.2	5.1	5.0	5.5	5.1
Sweden	0.5	0.9	1.2	0.9	0.9	1.4	2.2	2.8	2.2	2.3
Turkey	-0.6	-0.7	1.4	-0.8	0.4	-1.1	-0.5	-3.2	-0.3	-1.9
United Kingdom	0.7	2.0	4.3	1.9	2.8	2.4	2.1	1.5	2.1	1.9
United States	1.2	1.0	1.9	1.0	1.4	-0.2	0.5	1.1	0.4	0.7
OECD-22[2]	1.2	1.4	2.1	1.4	1.7	1.5	1.8	1.9	1.9	1.8
OECD-20[3]	1.3	1.5	2.1	1.5	1.7	1.7	2.0	2.2	2.1	2.1

1. Changes over the period mid-1990s to around 2000 for Austria, the Czech Republic, Belgium, Ireland, Portugal and Spain (where 2005 data, based on EU-SILC, are not deemed to be comparable with those for earlier years).

2. OECD-22 refers to the simple average for all countries with data spanning the entire period (i.e. excluding Australia, the Czech Republic and Hungary, as well as Iceland, Korea, Poland, the Slovak Republic and Switzerland).

3. OECD-20 refers to all countries mentioned above except Mexico and Turkey.

2. Income Distribution of Japan

In Japan, there are no reliable statistics of distribution of income including all kinds of income. Table 2.1 contains reliable statistics of distribution of employment income including both private and public sectors in 2006, which is made public by the National Tax Administration Agency (NTAA).

This Table shows the number of employees, the aggregate amount of the employment income and tax collected of each income class, and so on.

For instance, in the lowest classes whose income is less than one million yen, there are 3.6 million employees, their ratio to the total number of employees is 8.0 %, the number of taxpayers among them is 0.58 million (ratio is 1.5 %). The total amount of income of this class is about 2.93 trillion yen (1.5%), the total amount of taxable income is 4.54 billion yen (0.2%), and the total amount of tax collected is 160 million yen (0.2%).

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[11] OECD, Income Distribution Questionnaire, Version 1 (20-Oct-2008).

According to this Table, the income classes between 3 ~ 7 million yen are most important. They occupy 46.8 % of the total employees, 52.8 % of the tax paying employees, 50 % of the total amount of taxable employment income, and 32 % of the total amount of the tax collected from employment income.

Figure 2-1 shows the distribution of monthly income (before tax and social security contributions) of employee households in 2004. This Figure shows that income classes between 250 ~ 650 thousands yen (recalculated as annual amount, 3 ~ 7.8 million yen) are 70% of all employee households.

Table 2-1: Number of Employment Income Earners, Total Amount of Employment Income, and Amount of Income Tax of Each Income Class[12]

Class		Number of Employees				Total Amount of Employment Income				Tax Collected	
			Ratio	Number of Taxpayers	Ratio		Ratio	Taxable Income	Ratio		Ratio
	Income Class	Thousands	%	Thousands	%	100 m. Year	%	100 m. Year	%	100 m. Year	%
< 8 m. / year	< 1 m.	3,605	8.0	584	1.5	29,299	1.3	4,548	0.2	160	0.2
	1 ~ 2 m.	6,623	14.8	4,894	12.8	97,198	5.0	75,311	4.1	1,691	1.7
	2 ~ 3 m.	7,180	16.0	6,561	17.1	181,061	9.3	165,609	9.0	4,997	5.1
	3 ~ 4 m.	7,562	16.9	7,114	18.6	264,909	13.6	249,236	13.6	8,083	8.2
	4 ~ 5 m.	6,250	13.9	5,913	15.4	280,082	14.4	264,964	14.5	9,153	9.3
	5 ~ 6 m.	4,313	9.6	4,068	10.6	236,950	12.2	223,521	12.2	8,241	8.3
	6 ~ 7 m.	2,859	6.4	2,747	7.2	185,249	9.5	178,035	9.7	6,896	7.0
	7 ~ 8 m.	2,002	4.5	1,964	5.1	149,620	7.7	146,873	8.0	6,637	6.7
	Subtotal	**40,394**	**90.1**	**33,845**	**88.3**	**1,424,368**	**73.0**	**1,308,097**	**71.3**	**45,858**	**46.4**
> 8 m. / year	8 ~ 9 m.	1,329	3.0	1,322	3.5	112,708	5.8	112,125	6.1	6,115	6.2
	9 ~ 10 m.	881	2.0	880	2.3	83,593	4.3	83,668	4.6	5,373	5.4
	10 ~ 15 m.	1,666	3.7	1,655	4.3	196,045	10.1	196,044	10.7	16,992	17.2
	15 ~ 20 m.	364	0.8	364	1.0	62,409	3.2	62,409	3.4	8,635	8.7
	20 ~ 25 m.	112	0.2	112	0.3	25,344	1.3	25,344	1.4	4,549	4.6
	> 2500 m.	111	0.2	111	0.3	45,697	2.3	45,697	2.5	11,403	11.5
	Subtotal	**4,463**	**9.9**	**4,444**	**11.6**	**525,796**	**27.0**	**525,287**	**28.7**	**53,067**	**53.6**
Total		**44,857**	**100.0**	**38,289**	**100.0**	**1,920,153**	**100.0**	**1,833,281**	**100.0**	**98,925**	**100.0**

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[12] National Tax Administration Agency of Japan for 2006. (*Image Reconstructed.*)

Figure 2-1: Distribution of Employee Households to Income Classes[13]
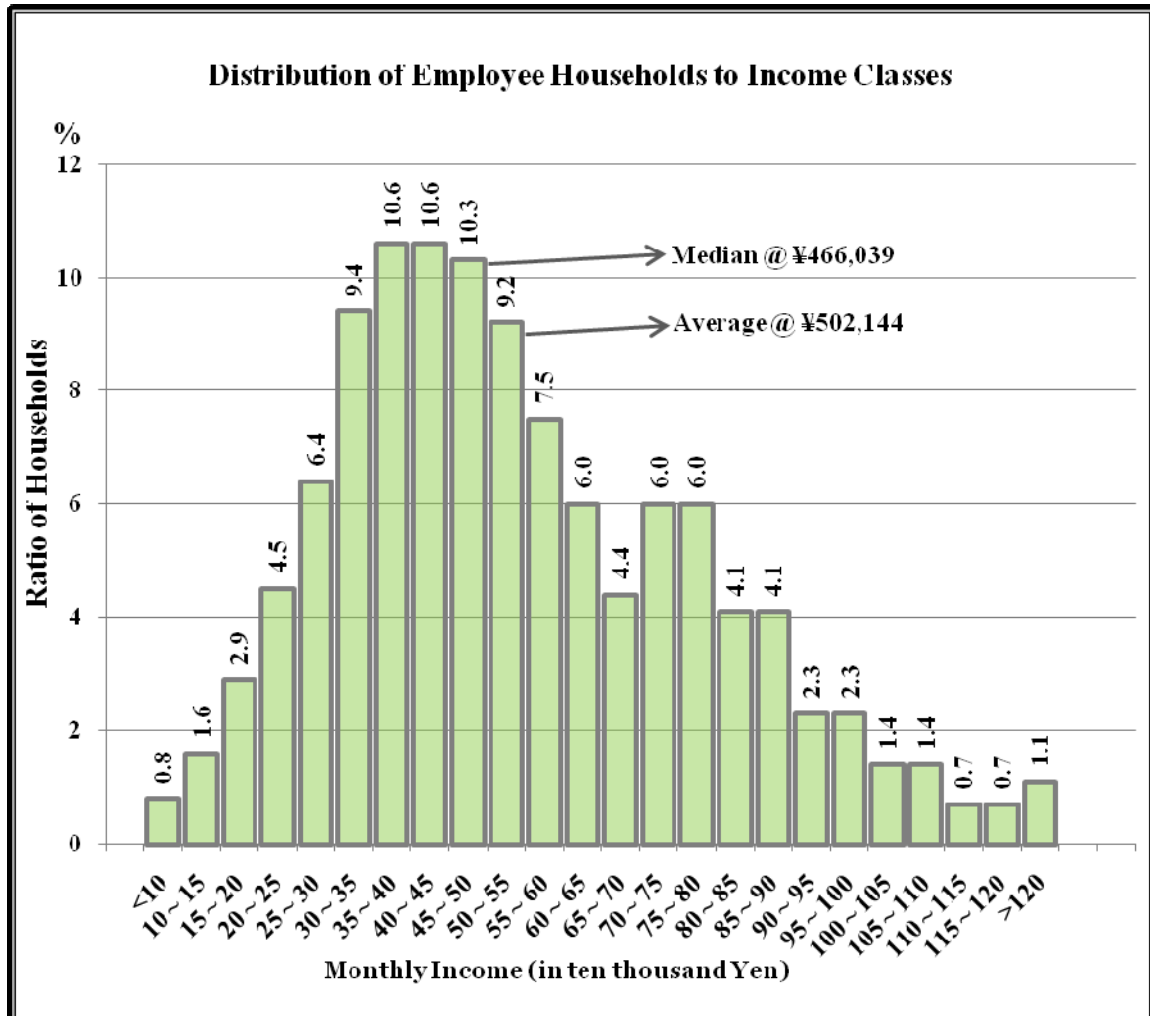
As is shown on Figure 2-2 and Table 2-2, if the income of 2006 is divided into quintiles, the income amount of the lowest class is 2.14 million yen or less (average income per household is 1.29 million yen), that of second class is 2.14~3.65 million yen (average: 2.89 million), that of third class is 3.65~5.54 million yen (average: 4.55 million), that of fourth class is 5.54~8.38 million yen (average: 6.82 million), and that of the highest class is 8.38 million yen and over (average: 12.77 million).

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[13] Ministry of Internal Affairs and Communications. (*Image Reconstructed.*)

Figure 2-2: Average Distribution of Household Income by Quintiles[14]

Amount of Income in Thousands of Yen

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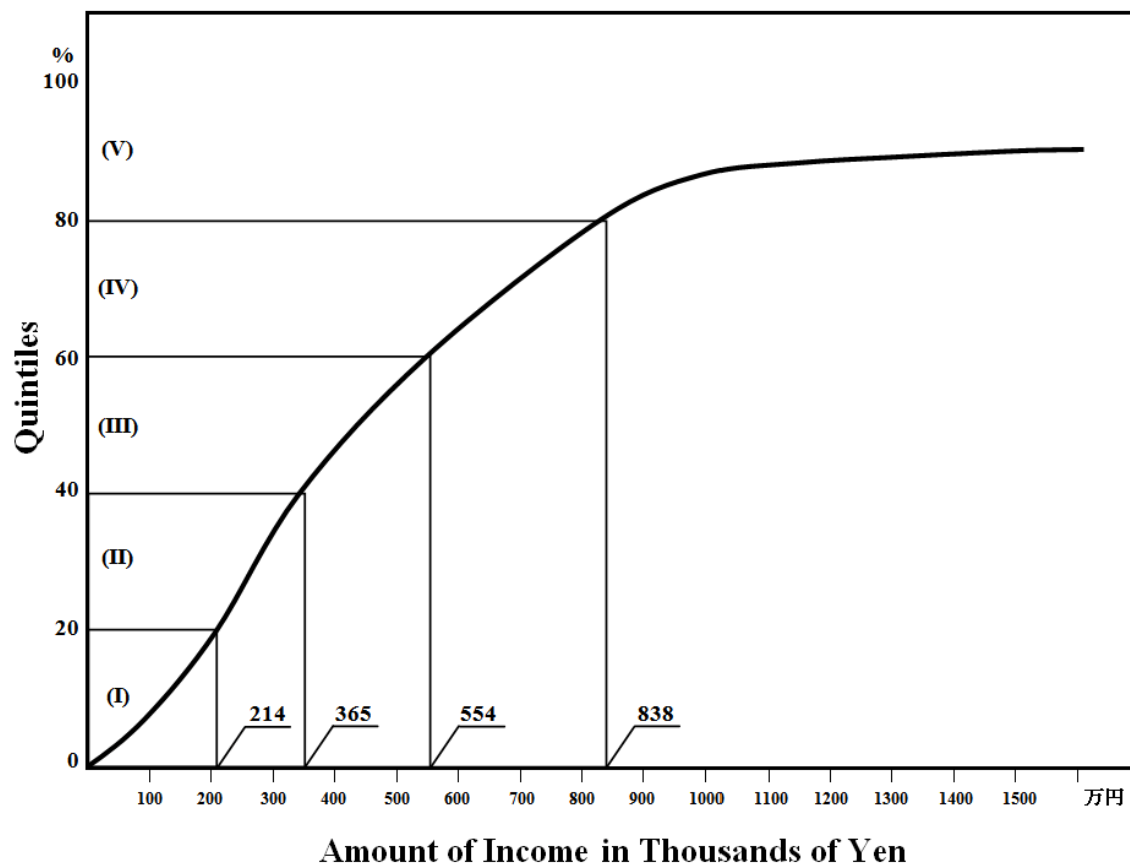
[14] Ministry of Health, Labor, and Welfare (Dec. 2007). (*Image Reconstructed.*)

Table 2-2: Trend of Average Amount of Income of Household by Quintiles
(per ¥10,000) [15]

Class of Quintiles	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Average	657.7	655.2	626.0	616.9	602.0	589.3	579.7	580.4	563.8	566.8
1st	146.9	153.8	141.9	136.5	135.0	126.9	131.4	123.9	129.0	129.0
2nd	340.8	354.9	320.0	316.0	310.4	303.4	305.4	291.7	289.8	289.8
3rd	538.5	545.8	507.1	497.4	486.1	477.6	478.1	465.8	459.5	455.1
4th	792.7	782.2	765.0	743.3	728.8	716.3	710.5	725.4	679.7	682.3
5th	1469.8	1439.5	1405.7	1391.2	1349.9	1322.0	1272.9	1295.1	1261.4	1277.8

3. Redistribution by tax and social security programs

As is shown on Figure 2-3, the amount of the average original income per household was 4.65 million yen in 2006. The amount of the redistributed income after the deduction of income tax (0.45 million yen) and social securities contribution (0.52 million yen) from this amount and the addition of social securities benefit to this amount is 0.83 million yen. The ratio of the amount of the social securities contribution and that of social securities benefit to the original income are 11.2% and 38.9% respectively. Therefore, 27.7% of the amount of the original income (1.29 million yen) worked for redistribution for the average household.

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[15] Id. (*Image Reconstructed.*)

Figure 2-3: Average Ratio (average amount) of:
(1) Tax and Social Security Contributions and
(2) Social Security Benefits to Original Income[16]

<= Original Income => (100%) ¥4,658,000.			¥1,814,000.		
Contributions (20.9%)			Benefits (38.9%)		
Tax (9.7%) ¥454,000.	Social Security Contributions (11.2%) ¥522,000.	Income	Pension (21.3%)	Medical Care (13.4%)	Others (4.2%)
A			B		
¥976,000.		<= Income After Redistribution => (118%) ¥5,495,000.			
B – A = 38.9% – 20.9% = 18.0% = ¥1,814,000. – ¥976,000. = ¥838,000.					

Table 2-3 shows the amounts of original income, the redistributed income, redistribution coefficient, amounts of tax, social securities contribution and social securities benefit for each income class of 2004. Figure 2-4 gives a concrete image of the relationship between burden and benefit. Table 2-4 and Figure 2-5 show the trend of the improvement of the distribution of income by burden of tax and the social securities contribution and the benefit of social security programs, and the change of Gini coefficient before and after the burden and the benefit.

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[16] Ministry of Health, Labor, and Welfare - Policy Planning Office, Report on Redistribution of Income p.7 (2005). (*Image Reconstructed*.)

Table 2-3: Redistribution in Each Original Income Class (in ¥ 10,000)[17]

Original Income Class	Original Income (A)	Income After Redistribution (B)	Redistribution Coefficient (B-A)/A (%)	Contribution		Social Security Benefit
				Tax	Social Security Contribution	
Aggregate	465.8	549.5	18.0	45.4	52.2	181.4
< 50	4.6	289.5	6220.2	6.8	12.3	304.0
50~100	73.9	264.9	258.5	8.3	15.0	214.3
100~150	121.4	292.7	141.0	10.7	18.2	200.1
150~200	173.8	307.3	76.9	13.4	24.8	171.8
200~250	224.2	330.0	47.2	16.2	29.0	151.0
250~300	272.0	368.1	35.3	18.7	33.8	148.5
300~350	320.6	400.3	24.9	21.9	39.4	141.0
350~400	373.9	414.5	10.9	24.8	45.9	111.3
400~450	421.3	468.8	11.3	29.0	47.7	124.3
450~500	472.9	510.3	7.9	33.4	54.5	125.4
500~550	522.4	577.3	10.5	38.9	58.7	152.5
550~600	574.7	581.5	1.2	41.7	66.4	115.0
600~650	621.5	624.6	0.5	44.8	70.5	118.4
650~700	673.5	662.1	-1.7	46.4	75.9	110.9
700~750	723.5	741.1	2.4	54.3	79.4	151.2
750~800	771.5	765.0	-0.8	57.3	84.0	134.8
800~850	821.6	775.1	-5.7	76.6	90.3	120.5
850~900	872.2	838.8	-3.8	72.4	92.7	131.7
900~950	924.0	918.4	-0.6	78.8	96.9	170.1
950~1000	970.8	879.5	-9.4	99.0	93.5	101.2
> 1000	1391.8	1225.0	-12.0	169.4	127.3	129.9

[17] Id. p.7. (*Image Reconstructed.*)

# Figure 2-4: Redistribution in Each Original Income Class[18]

Tax & Contributions

in ¥ Millions

Benefits

in ¥ Millions

Tax & Contributions	Income Class	Benefits
97.6	Aggregate	181.4
19.1	< 50	304.0
23.3	50 ~ 100	214.3
28.8	100 ~ 150	200.1
38.2	150 ~ 200	171.8
45.2	200 ~ 250	151.0
52.5	250 ~ 300	148.5
61.3	300 ~ 350	141.0
70.7	350 ~ 400	111.3
76.7	400 ~ 450	124.3
87.9	450 ~ 500	125.4
97.6	500 ~ 550	152.5
108.2	550 ~ 600	115.0
115.3	600 ~ 650	118.4
122.3	650 ~ 700	110.9
133.6	700 ~ 750	151.2
141.3	750 ~ 800	134.8
167.0	800 ~ 850	120.5
165.1	850 ~ 900	131.7
175.7	900 ~ 950	170.1
192.4	950 ~ 1,000	101.2
296.7	> 1,000	129.9

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[18] Id. p.8. (*Image Reconstructed.*)

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Table 2-4: Improvement Effect on Gini Coefficient of Redistribution[19]

Year	Gini Coefficient				Degree of Improvement of Gini Coefficient		
	①	②	③	④	(%)	(%)	(%)
	Original Income	Original Income + SS Benefits – SSC	Disposable Income ② – Tax	Redistributed Income ③ + Benefit in the Kind	By Redistribution (1 – ④ / ①)	By Social Security (1–②/①*④/③)	By Tax 1 – ③ / ②
1992	0.4394	0.3987	0.3593	0.3545	17	12.7	5
1995	0.4412	0.3798	0.365	0.3605	18.3	15.2	3.6
1998	0.472	0.4001	0.3984	0.3814	19.2	16.8	2.9
2001	0.4983	0.3989	0.3854	0.3812	23.5	20.8	3.4
2004	0.5283	0.4059	0.383	0.3873	25.4	24	3.2

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[19] Id. p.6. (*Image Reconstructed.*) Note: In-kind benefits prior to 1999 include only health and medical; after 2002 these are health and medical, nursing care, and child care.

Figure 2-5: Trend of the Change of Gini Coefficients by Redistribution[20]
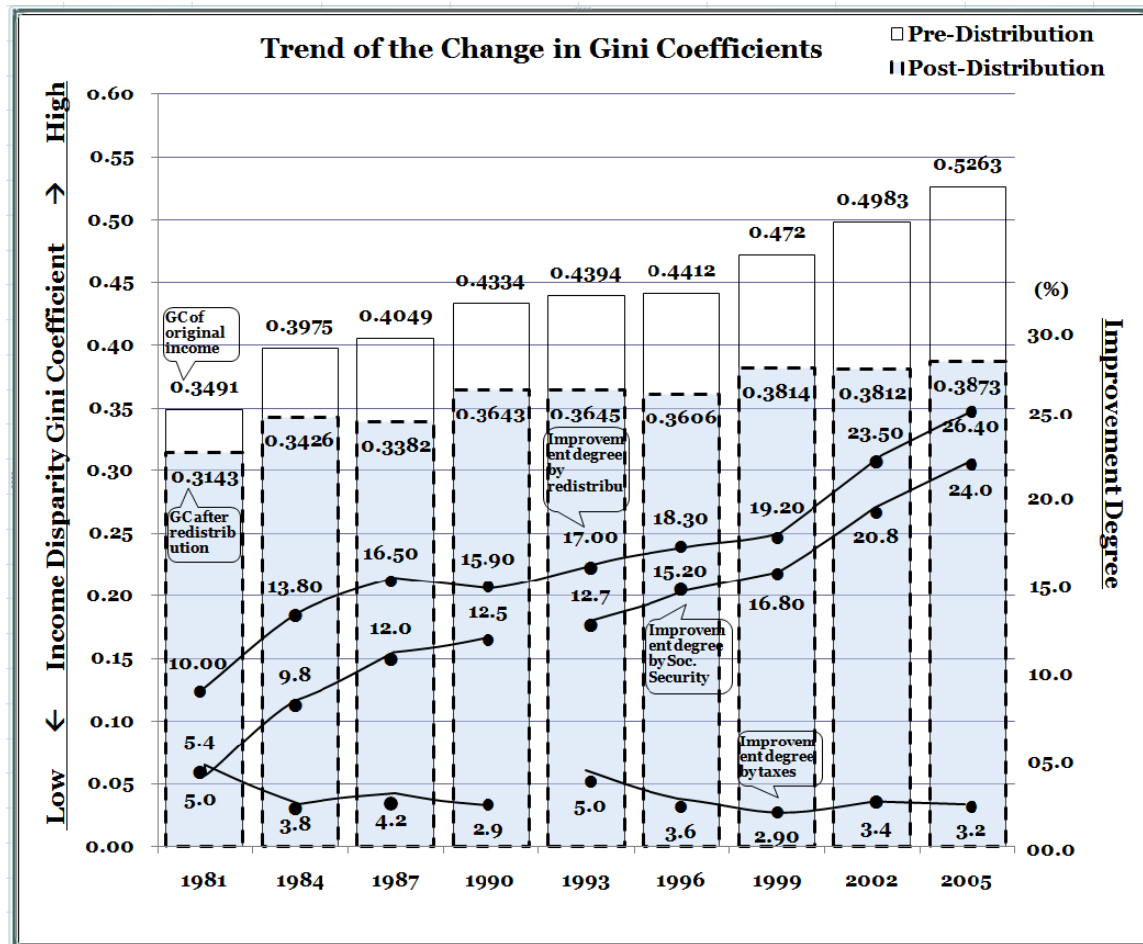
You can get a concrete image from the upper part of Figure 2-6 about the level (ratio) of tax and social securities contribution in each of 7 income classes, and from the lower part thereof about how the benefit of social security programs are distributed to each of 7 income classes (benefit ratio). It is apparent from the upper part that the income tax burden is progressive but that the burden of social securities contribution is

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[20] Material of Government Tax Policy Committee (submitted by Ministry of Health, Labor, and Welfare). (*Image Reconstructed.*) Notes: Original Income = Income not including public pension and other social security benefits (compensation from employer, etc.). Redistributed Income = Original Income + Social security benefits – Social security premiums – Taxes + In-kind benefits (Health and medical, nursing care, etc.). Income is by household unit. "Degree of Improvement due to Social Security" and "Degree of Improvement due to Taxes" prior to 1990 are discontinuous because the calculation method differs from the current method.

regressive, and that the consumption tax burden is also regressive. If you compare the statistics of 2004 with those of 1984, you will find that income tax was reduced, but the redistribution increased to a great extent. This was made possible by the reform of the social security programs.

Figure 2-6: Income Class before Tax and SSC Burden Ratio of Each Class, and SS Benefit Ration of Each Class (Comparison of 1984 & 2004)[21]
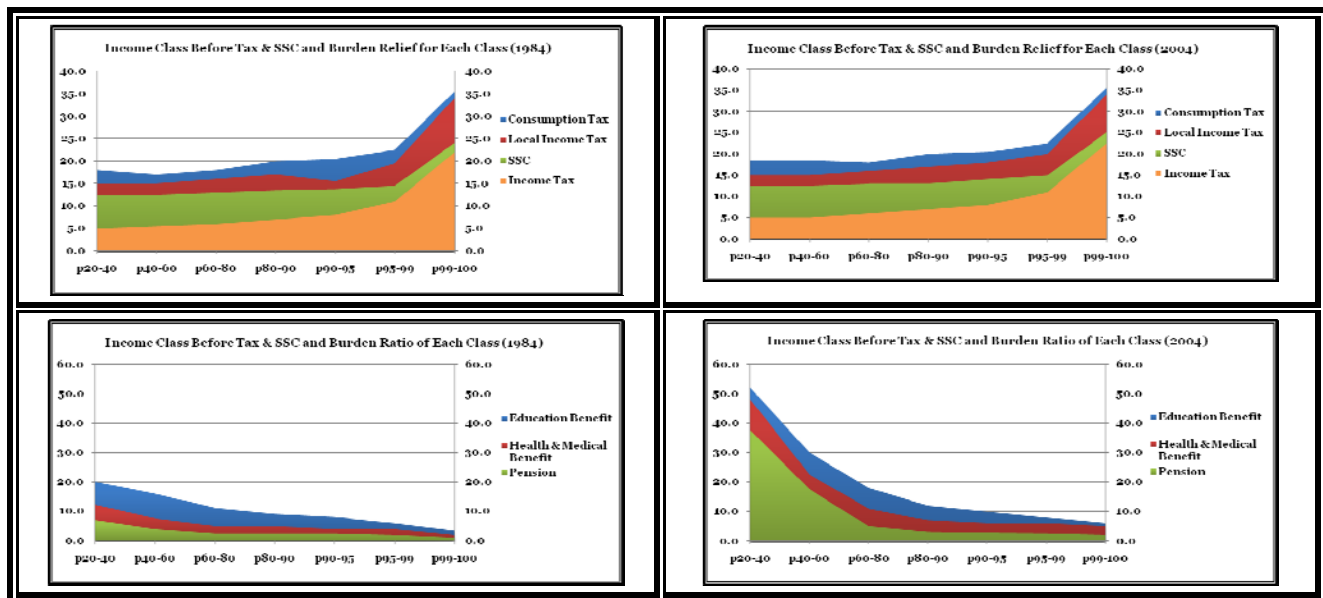
Figure 2-7 is made from different source statistics. By and large, two Figures show similar trend. However, it seems that Figure 2-7 is more accurate than Figure 2-6, because the local property tax is included in Figure 2-7, and 6 (1987) and 8 (2002), instead of 3, kinds of social securities benefit are included in Figure 2-7 (education benefit is included in public assistance in Figure 7).

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[21] Professor Fumio Ohtake (submitted to Government Tax Policy Committee of Japan in 2007). (*Images Reconstructed.*) SSC = Social Security Contributions; SS = Social Security.

**Figure 2-7: Burden Ratio and SS Benefit Ratio of Each Income Class
(using statistics different from that of Figure 2-6) (comparison of 1987 & 2002)**[22]
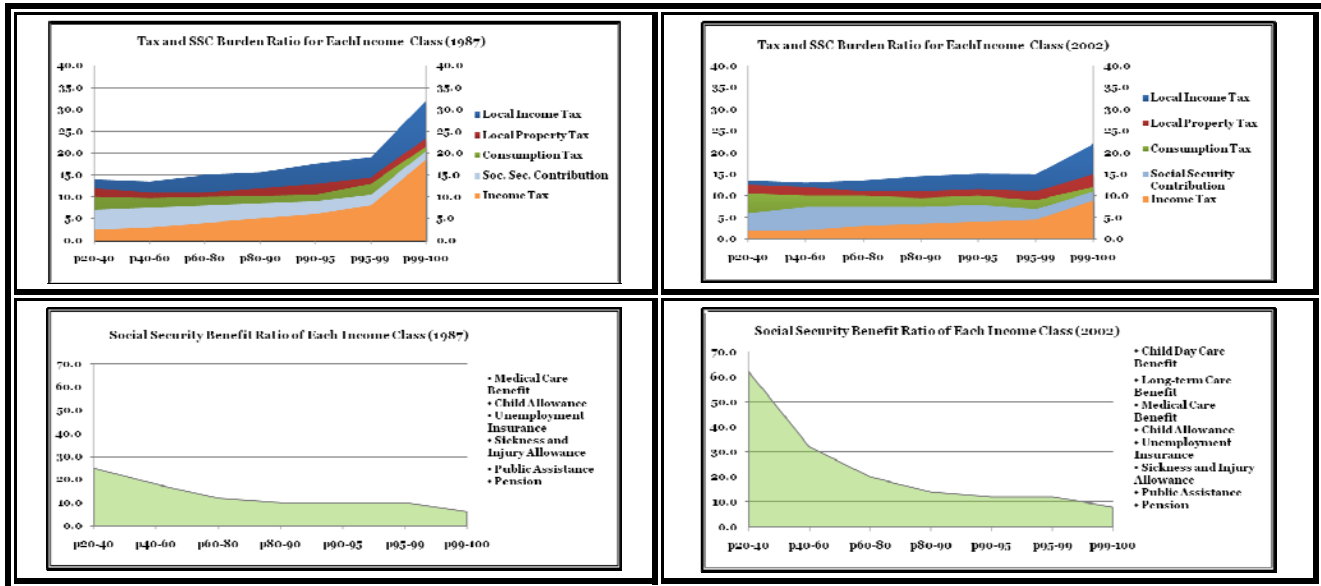
4. Problems of age and type of household

As is shown on Table 3-1 and Figure 3-1, the amount of income among households is very different according to age. In the case of households of ages 50~59, the amount of average income is highest, and the average amount per household member is also highest. In the case of households over the age of 70, both the average amount of household income and the average amount of income per member are among the lowest.

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[22] Id. (*Images Reconstructed.*)

**Table 3-1: Average Income of Heads of Households Grouped by Age,
and Average Income of Members of Households**
(2006, in ¥10,000) (*See Figure 3-1*)[23]

Age	Overall Averages	< 29	30 ~ 39	40 ~ 49	50 ~ 59	60 ~ 69	< 70	< 65
Average Income per Household	566.8	317.2	555.4	704.9	760.7	544	408.8	432
Average Income per Household Member	207.1	166.2	181.4	202.3	250.2	214.6	181.5	186.7

**Figure 3-1: Average Income of Heads of Households Grouped by Age, and
Average Income of Members of Households (*See table 3-1*)[24]**

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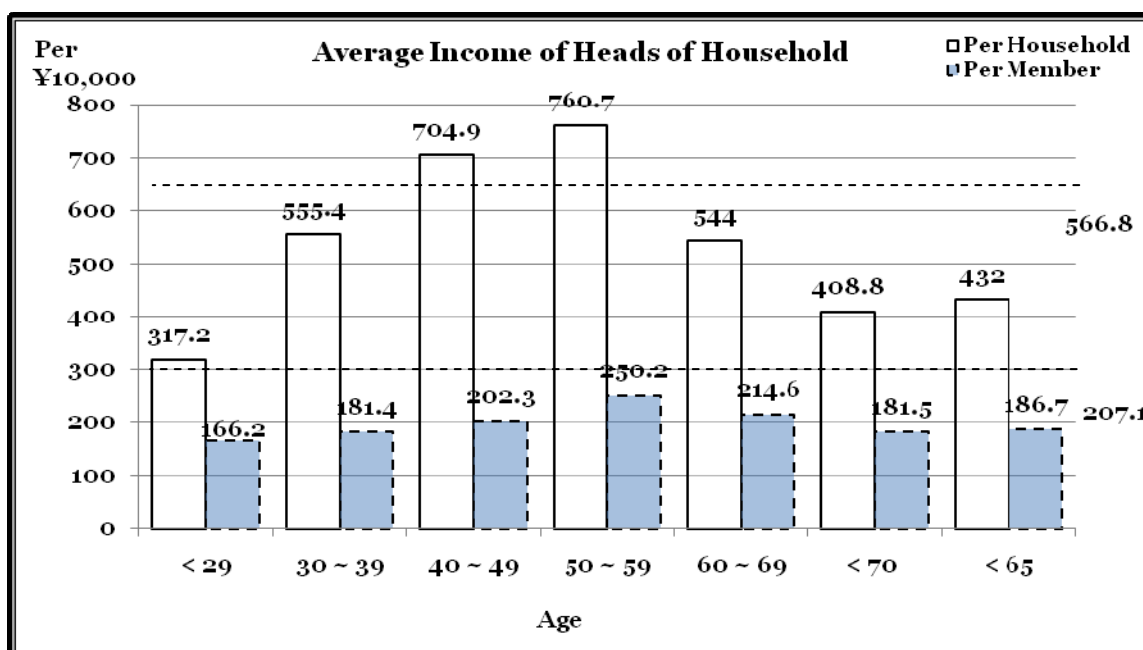
[23] Ministry of Health, Labor, and Welfare for 2006. (*Image Reconstructed.*)
[24] Id. (*Image Reconstructed.*)

Table 3-2 shows that the amount of average income of all the households in 2006 was 5.66 million yen (increase rate was 0.03%), that in the case of aged people (over 65) the average amount was 3.06 million yen, and that the average amount was 7.01 million yen in the case of the households with dependent children.

Table 3-2: Trend in Average Income Per Household
(Per ¥10,000)[25]

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Average Income per Household	657.7	655.2	626.0	616.9	602.0	589.3	579.7	580.4	563.8	566.8
Increase Rate (%)	Δ 0.5	Δ 0.4	Δ 4.5	Δ 1.5	Δ 2.4	Δ 2.1	Δ 1.6	0.1	Δ 2.9	0.6
Average Income per Household of Aged People	323.1	335.6	328.9	319.5	304.6	304.6	290.9	296.1	301.9	306.3
Increase Rate (%)	2.2	3.8	Δ 2.0	Δ 2.9	Δ 4.7	0.0	Δ 4.5	1.8	2.0	1.5
Average Income per Household with Children	767.1	747.4	721.4	725.8	727.2	702.7	702.6	714.9	718.0	701.2
Increase Rate (%)	Δ 1.9	Δ 2.6	Δ 3.5	0.6	0.2	Δ 3.4	0.0	1.8	0.4	Δ 2.3

Figure 3-2 is the statistics of the ratio of the number of the households of each income class in 2006. This Figure shows that 37.8% of all the households has income between 1.00~4.00 million yen. The median amount is 4.51 million yen, and 61.2% of all the households have income less than the average income (5.66 million yen).

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[25] Ministry of Health, Labor, and Welfare (2007). (*Image Reconstructed.*)

Figure 3-2: Distribution of Household in Each Income Class[26]

Distribution of Household in Each Income Class (in ¥ Millions)

- Median Income (¥ Million): 4.5
- Average Income (¥ Million): 5.6
- Pop. below Average Income (%): 61.2

% of population

Income

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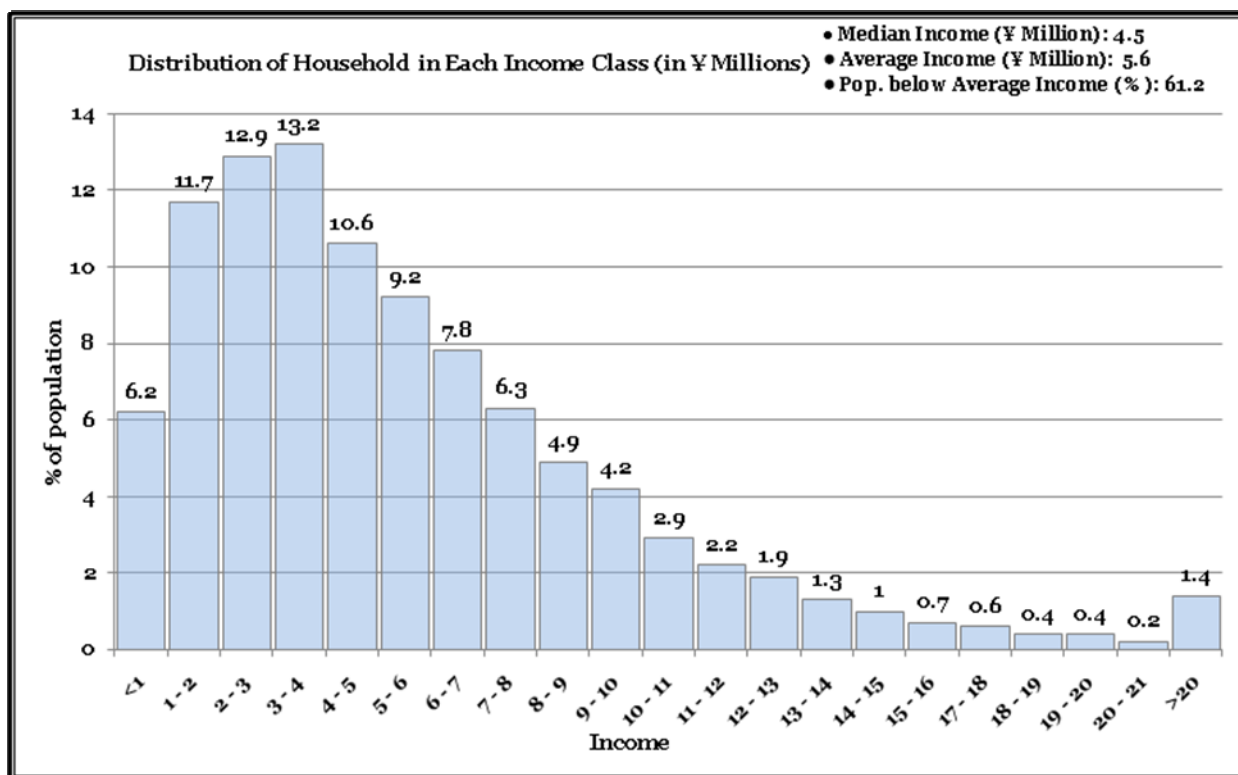
[26] Id. (2007). (*Image Reconstructed.*)

Table 3-3: Redistribution Status of Household Income by Age Group[27]

Age of Heads of Household	Number of Households	Original Income (A)	Disposable Income	Income After Redistribution (B)	Redistribution Coefficient (%) (B − A) / A
Total	5,698	465.8	472.2	549.5	18.0
≤ 29	258	274.7	242.0	259.0	−5.7
30 ~ 34	252	506.2	429.6	463.9	−8.4
35 ~ 39	343	560.1	474.4	516.4	−7.8
40 ~ 44	384	676.6	568.5	610.0	−9.9
45 ~ 49	448	732.3	624.8	672.2	−8.2
50 ~ 54	560	738.8	628.1	703.9	−4.7
55 ~ 59	690	730.2	605.4	673.4	−7.8
60 ~ 64	642	434.3	457.6	528.0	21.6
65 ~ 69	627	305.7	435.1	518.2	69.5
70 ~ 74	601	183.8	354.5	445.4	142.3
≥ 75	891	198.1	347.5	498.6	151.7

The situation of the income redistribution among age classes is an interesting problem. Table 3-3 is a statistics of how many households belong to each class, and then the average amount of the original income, disposable income, redistributed income, and finally the redistribution coefficient of each class in 2004. Figure 3-3 vividly shows the situation (these are statistics of the Ministry of Health, Labor, and Welfare).

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[27] Ministry of Health, Labor, and Welfare - Policy Planning Office, Report on Redistribution of Income p.10 (2005). (Per ¥10,000) (Total number includes households whose age is unknown.) (*Image Reconstructed.*)

Figure 3-3: Redistribution of Household Income by Age Group[28]
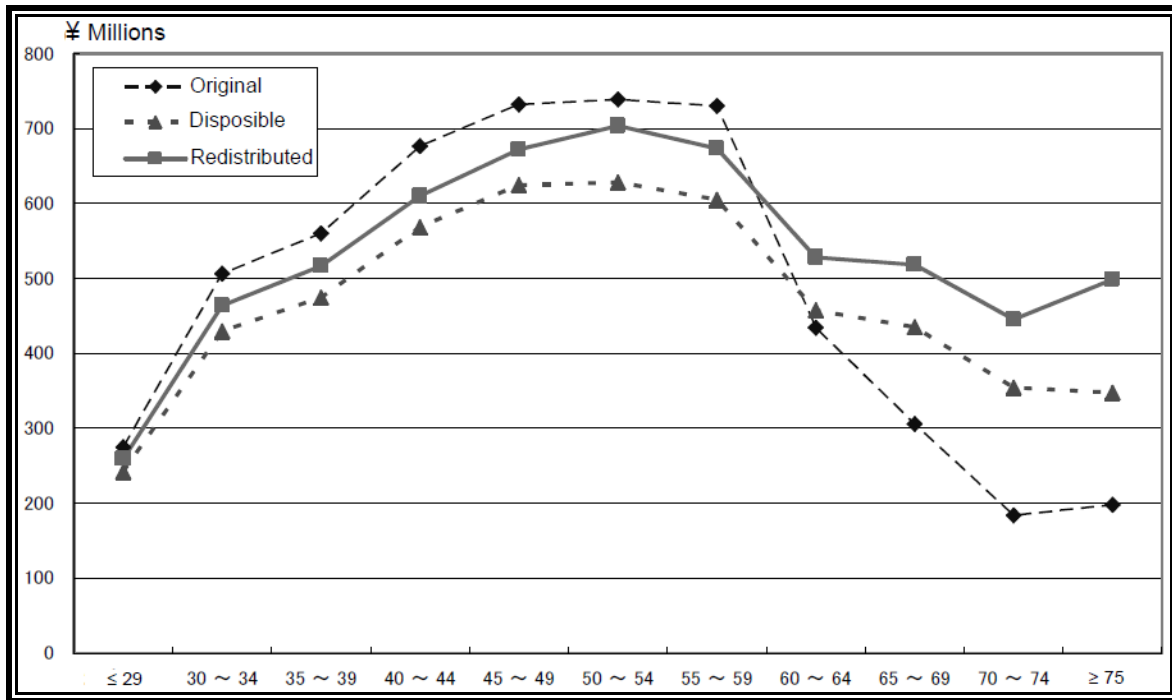
The statistics made by the Internal Affairs and Communications show similar results. Figure 3-4 and Table 3-4 shows that the improvement of the Gini coefficient for aged people (over 65) is remarkably higher than for other age classes. Needless to say, aged people are quite often poor and sick.

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[28] Ministry of Health, Labor, and Welfare - Policy Planning Office, Report on Redistribution of Income p.10 (2005). (Per ¥10,000) (Total number includes households whose age is unknown.) (*Image Reconstructed.*)

Figure 3-4: Gini Coefficient Before and After Redistribution of Income in 2004
(compared by age)[29]
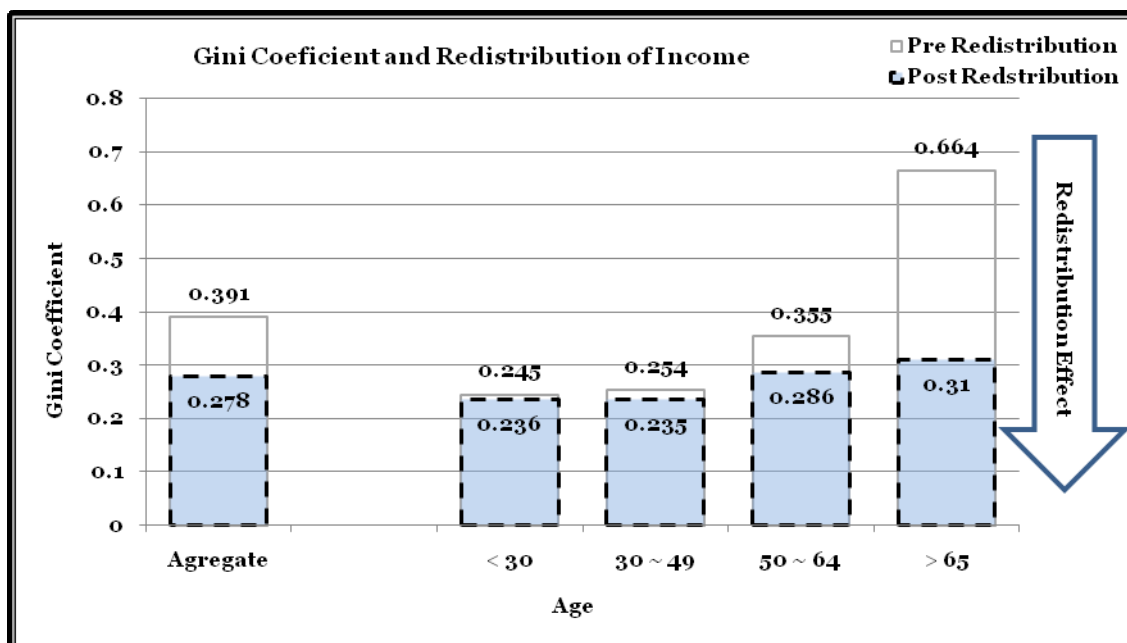
Table 3-4: Gini Coefficient Comparison: Before and After Redistribution of Income
(Per Heads of Household; by Age; 1999, 2004)[30]

	1999			**2004**			Difference of Redistribution Effect **F – C**
	Before Redistribution **(A)**	After Redistribution **(B)**	Redistribution Effect **C = A – B**	Before Redistribution **D**	After Redistribution **E**	Redistribution Effect **F = D – E**	
Total	0.363	0.273	0.09	0.391	0.278	0.113	0.023
≤ 30	0.232	0.222	0.01	0.245	0.236	0.009	–0.001
30 ~ 49	0.253	0.235	0.018	0.254	0.235	0.019	0.001
50 ~ 64	0.341	0.277	0.064	0.355	0.286	0.069	0.005
≥ 65	0.644	0.308	0.336	0.664	0.31	0.354	0.018

[29] Statistics Bureau, Ministry of General Affairs and Communications, 2004 National Survey of Family Income and Expenditure, p.142 (2007). (*Image Reconstructed.*)
[30] Id. (*Image Reconstructed.*)

Figure 3-5 shows the general picture of the effects of redistribution in 2004 for all the households, and for various types of households (households of aged people, households of employees, households of single people, and households of father or mother with children). The burden ratio, benefit ratio and net burden ratio are shown for each income class of each type of household. From these Figures, it is apparent that for all households and for various types of households except the households of singles, redistribution works for low-income classes to a considerable extent.

Figure 3-5: Effects of Redistribution for All Households and for Various Types of Households by Income Class[31]
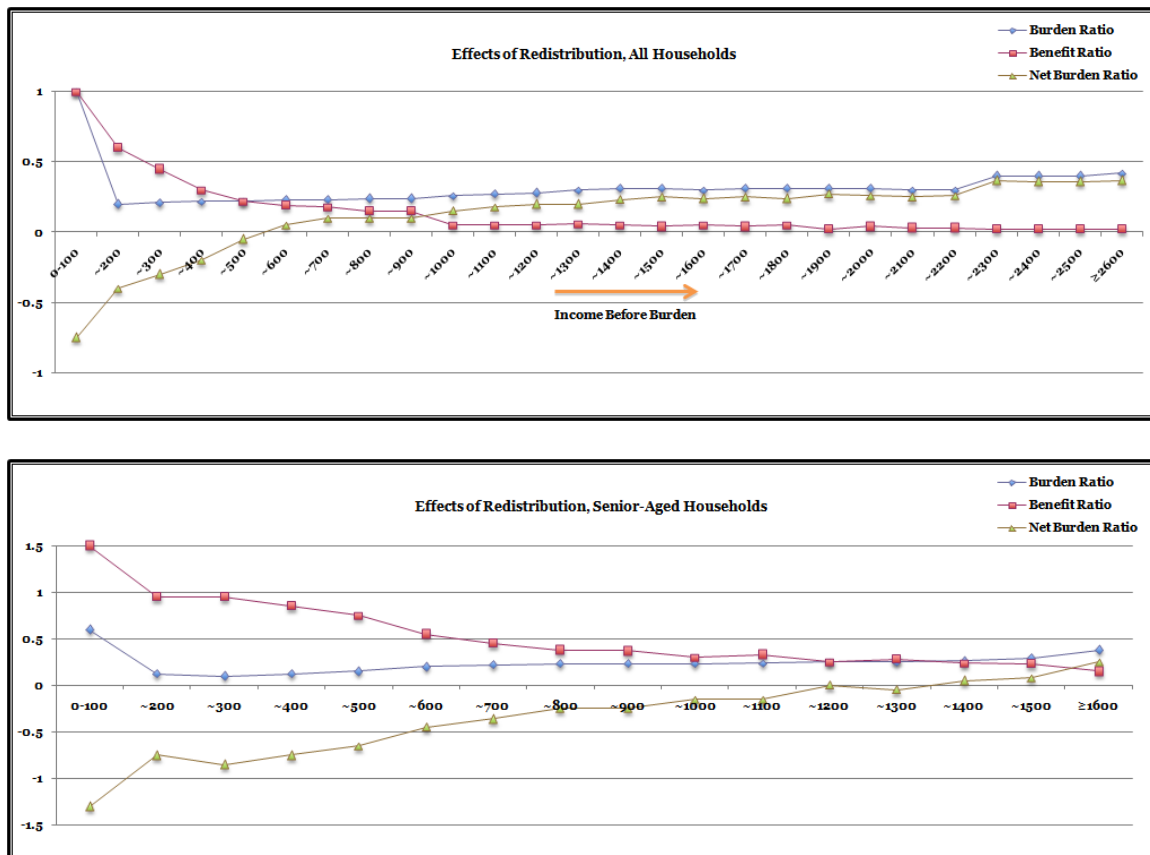
[31] Professor Fumio Ohtake (submitted to Government Tax Policy Committee of Japan in 2007). (*Images Reconstructed.*)

Effects of Redistribution, Employee Households

Effects of Redistribution, Single Households

Effects of Redistribution, Single Parent Households
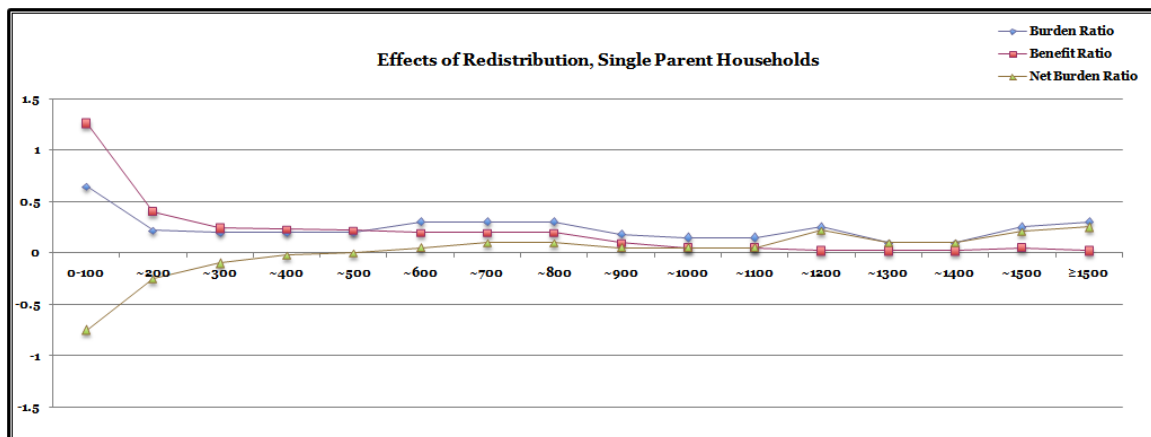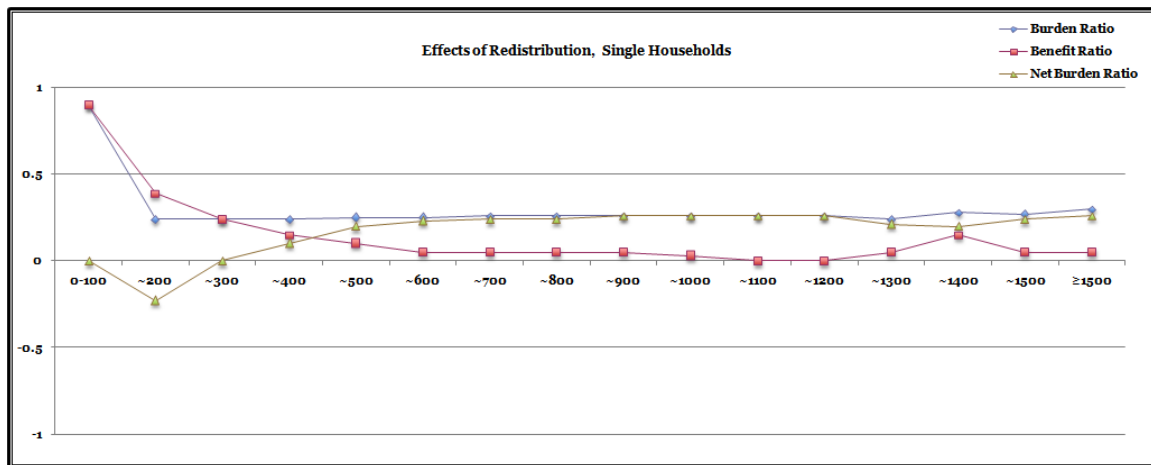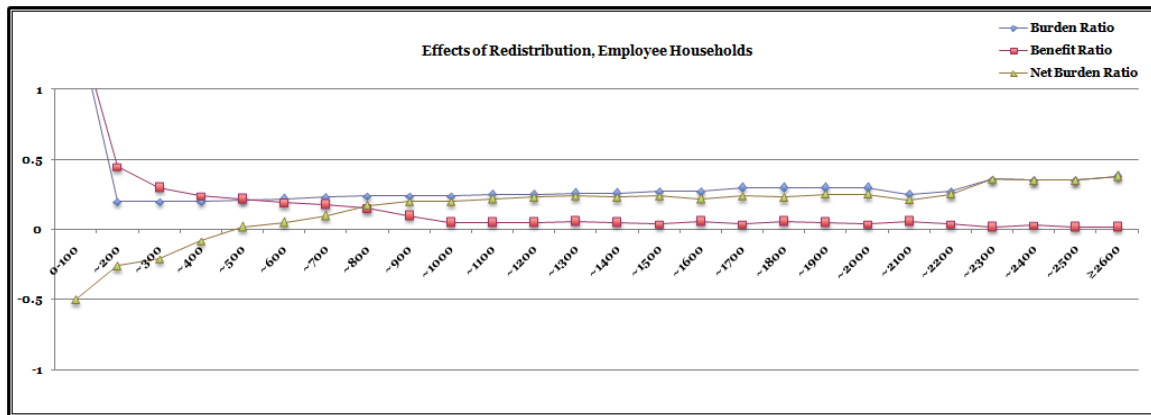
IV. How the Tax System could Mitigate Income Disparities

The role of the income tax in the mitigation of the disparity of income is much smaller than that of the social security system. Nevertheless, the income tax could have and should have an important role in mitigating the disparity as well. In the remaining section, this article examines several important aspects of this role.

1. Redistribution

Turn first to whether the tax system should be used for redistribution. In the history of tax theory, redistribution has been recognized as a legitimate function of the income tax. However, in the latter half of the 20th century, such eminent scholars as Milton Friedman and Friedrich von Hayek have asserted that the tax system should not be used for redistributive purposes, and that redistribution should be done only through the expenditure side of the budget. They strongly opposed progressive taxation. Many tax economists and tax law scholars assert the same arguments.

Whatever the merits of this position, most wealthy countries do use the tax system for redistribution. Were they not to do so, most would find it difficult (if not impossible) to prevent the concentration of wealth in the hands of a small portion of people. That in turn would cause enormous popular dissatisfaction, and would make the society unstable.

2. Scope

Ask next what the scope of the tax base should be. If any income is excluded from the tax base, it will fall outside of the disparity-mitigating function of income tax. Therefore, a comprehensive tax base is indispensable to maintain and strengthen the disparity-mitigating function of income tax.

3. Personal Exemptions

Third, consider the possible range of personal exemptions. The amount indispensable to a minimum standard of living for a taxpayer and his or her household should be exempted from the tax base. I suggest that the amount of the exemption should be about the same as the amount of the public assistance.

Article 25 of the Japanese Constitution provides that "All citizens are secured the right to have a healthy and cultural life of minimum standard of living." Based on this provision, the Public Assistance Act provides detailed and elaborate standards for assistance. Currently, the maximum monthly amount for a two-child household living in Tokyo is 261,130 yen (191,330 yen for living and a maximum of 69,800 yen for housing; the yearly maximum amount is 3,133,560 yen).

The personal exemption under the income tax is also based on Article 25 of the Constitution. Therefore, the standard personal exemption should be about same as the amount of the public assistance. The prevailing explanation is that, since the minimum taxable income amount in Japan is currently 3,250,000 yen for married taxpayers with two dependent children, and the amount is above the level of public assistance, the

present level of personal exemption satisfies the requirement of the Constitution. However, this explanation is not always persuasive. The amount of 3,250,000 yen includes the amount of employment income deduction, which is not a personal exemption, but a deduction in calculating the amount of employment income, which is available only for employees. Since the amount of employment income deduction is disproportionately big (for instance, 1,260,000 yen for the employment income of 3,600,000 yen, 1,860,000 yen for employment income of 6,600,000 yen), I think that a substantial part thereof should be moved to the personal exemption to increase the amount thereof.

One important problem with the Japanese personal exemption is that as in many other countries, it constitutes a deduction from income. Because this system disproportionately benefits high-bracket taxpayers, I think that the system should be replaced by a credit as soon as possible.

Another important question is whether or not a system combining an income tax credit with social welfare benefit payments should be adopted. Although I think it should be adopted in the long run, the system presents two problems. First, to adopt the system, an elaborate means test is indispensable. Japan, however, does not have the taxpayer identification number system at present. It is necessary to adopt the number system as soon as possible. Second, to introduce the system, the unification of the National Tax Administration Agency and the Social Insurance Agency would be necessary. The latter, however, was recently separated from the government and is now an independent public corporation. Not many people have foreseen or supposed the unification of the two agencies in the near future. Since the new coalition government which started in September of 2009 has formerly adopted around the end of December of 2009 the policy to establish the Revenue Agency combining the National Tax Administration Agency and Social Insurance Agency, however, the unification of two agencies will probably be realized sooner or later. When the agencies are unified, it will be feasible to combine income tax credits with social welfare benefit payments.

4. Range[32]

Fourth, consider the range of tax rates. The present rates are:

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[32] Individual Income Tax Act, Sec.89.   +ocal Taxes Act, Sec.35, Sec.314-3. (*Image reconstructed.*) Note: If national and local taxes are combined, the highest rate becomes 50%.

National Income Tax	
Taxable Income	**Rate**
≥ 1,950,000	05%
≥ 3,300,000	10%
≥ 6,950,000	20%
≥ 9,000,000	23%
≥ 18,000,000	33%
< 18,000,000	40%
Local Income Tax	
Prefectural	04%
Local Communities	06%
Total	10%

Although many people oppose the current progressive rates as too high, I think at least this level of progressivity is necessary to achieve the needed redistribution of income.

5. Other Income

Lastly, turn to the possible treatment of income from financial assets. As mentioned above, the Japanese income tax system is now moving to tax this income separately at a 20% flat rate. Once the set-off of capital losses on the sale of publicly listed shares against interest income is adopted, the movement will be complete.

The system presents a difficult problem. Because high-income taxpayers earn a disproportionate fraction of this financial income, the shift reduces the progressivity of the system. Necessarily, it will weaken the disparity-mitigating function of the income tax. For two reasons, I nonetheless support this system as a temporary preferential treatment from the viewpoint of economic policy. First, the system will improve the Japanese business and investment environment. In the process, it will increase the likelihood that foreign investors invest and foreign entities do business in Japan. Second,

it will reduce the movement of Japanese financial assets to foreign countries of lower tax burden. Therefore, I suppose that this system will continue for a rather long time.

6. Two Proposals
(1) Proposal of a dual income tax
In 1991, I proposed to adopt combination of a flat income tax and a progressive net wealth tax as a long-term reform of the income tax. This was a proposal for a dual income tax that is different from the dual income tax later adopted in the Nordic countries. I proposed this system for the following reasons. First, high progressive rates tend to cause tax evasion and avoidance, and to reduce the incentives for private initiatives. Although a flat rate offers less vertical equity, if the rate is not too high it will avoid these problems. Second, a net wealth tax would reintroduce progressivity into the income tax system. As long as the progressive rates remain relatively low, it would do so without substantially harming economic efficiency. Note that in 1991 Japan had not yet escaped the bubble economy. The price of land was still high, and since under my proposal unrealized capital gains would be part of the tax base for a progressive net wealth tax, my proposal, if adopted, would also have had desirable counter-cyclical effects.

Though my proposal was not paid much attention, the land tax eventually adopted reflected the same ideas. As mentioned before, Japan does not yet have a taxpayer identification number system, and without identification numbers it is very difficult to obtain accurate information about wealth. Japan is quietly moving ahead, however, with the introduction of the number system. When the number system is eventually adopted, this proposal may become a feasible reform proposal.

(2) Proposal of an international taxpayer identification number
Since about ten years ago, I have been proposing the adoption of an international taxpayer identification number system. Put 001 at the head of your U.S. number, and it could become your international identification number. Put 081 at the head of the Japanese number (once Japan adopts its own identification number system) and that could be the Japanese international number. When Japanese residents make deposits at American banks, they would be required to show their international number cards. When Japanese and American tax authorities exchange information based on the tax treaty, they would disclose not only names but also these numbers. As a result, cooperating countries would find it much easier to reach the foreign incomes of their residents and corporations. In turn, this would also increase the feasibility of my dual income tax proposal.

If adopted, these two proposals would not just increase horizontal and vertical equity. They would also increase the degree of redistribution. Necessarily, they mitigate the disparity of income as well.

V. Conclusion

As the Japanese economy grew rapidly since the middle of 1960s, the income and wealth of people grew as well. Unfortunately, as general income levels rose, income disparities rose as well. Poverty and misery remained.

Once the bubble economy burst, people started to pay attention to these unfortunate side-effects of the economic growth. Especially under the present recession, income disparities and poverty have only worsened.

To improve the situation, or at least to prevent the situation from deteriorating further, a tremendously large stimulus will be necessary. This, of course, must ultimately be funded out of tax revenues. Augmenting current revenues only through the income tax would be difficult. Perhaps the only alternative is to increase the VAT. That, however, introduces the problem of mitigating the regressive nature of the VAT especially for low-income people. To devise the appropriate mechanism is a crucial mission for the next generation.