

Tax Reform After COVID-19: Will Income and Wealth Inequality in Japan Be Reduced?

March 23, 2021 Foreign Press Center Japan Briefing

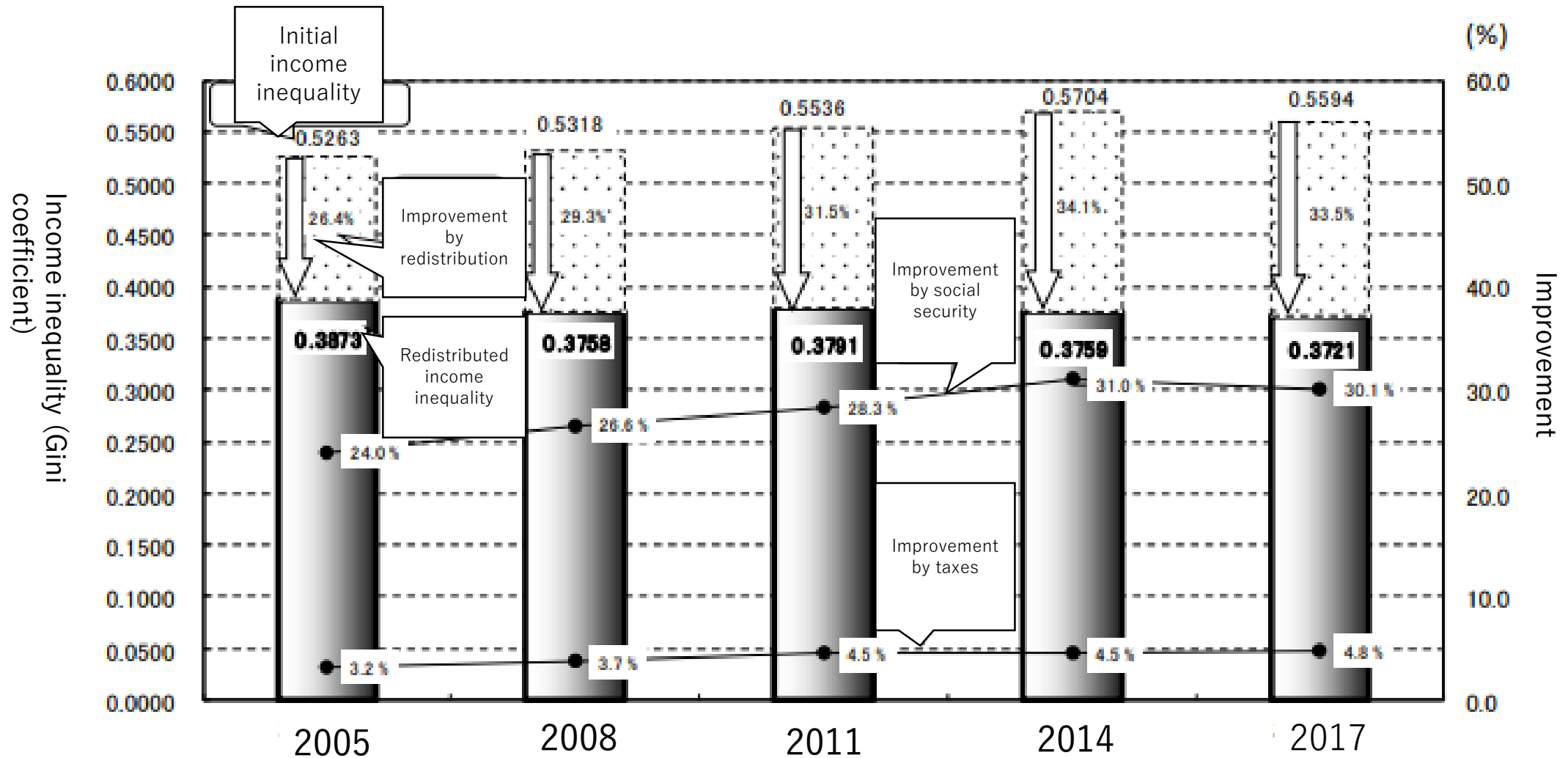
Dr. Shigeki Morinobu, Research Director,
The Tokyo Foundation for Policy Research

Provisional translation by Foreign Press Center Japan

Outline of Today's Briefing

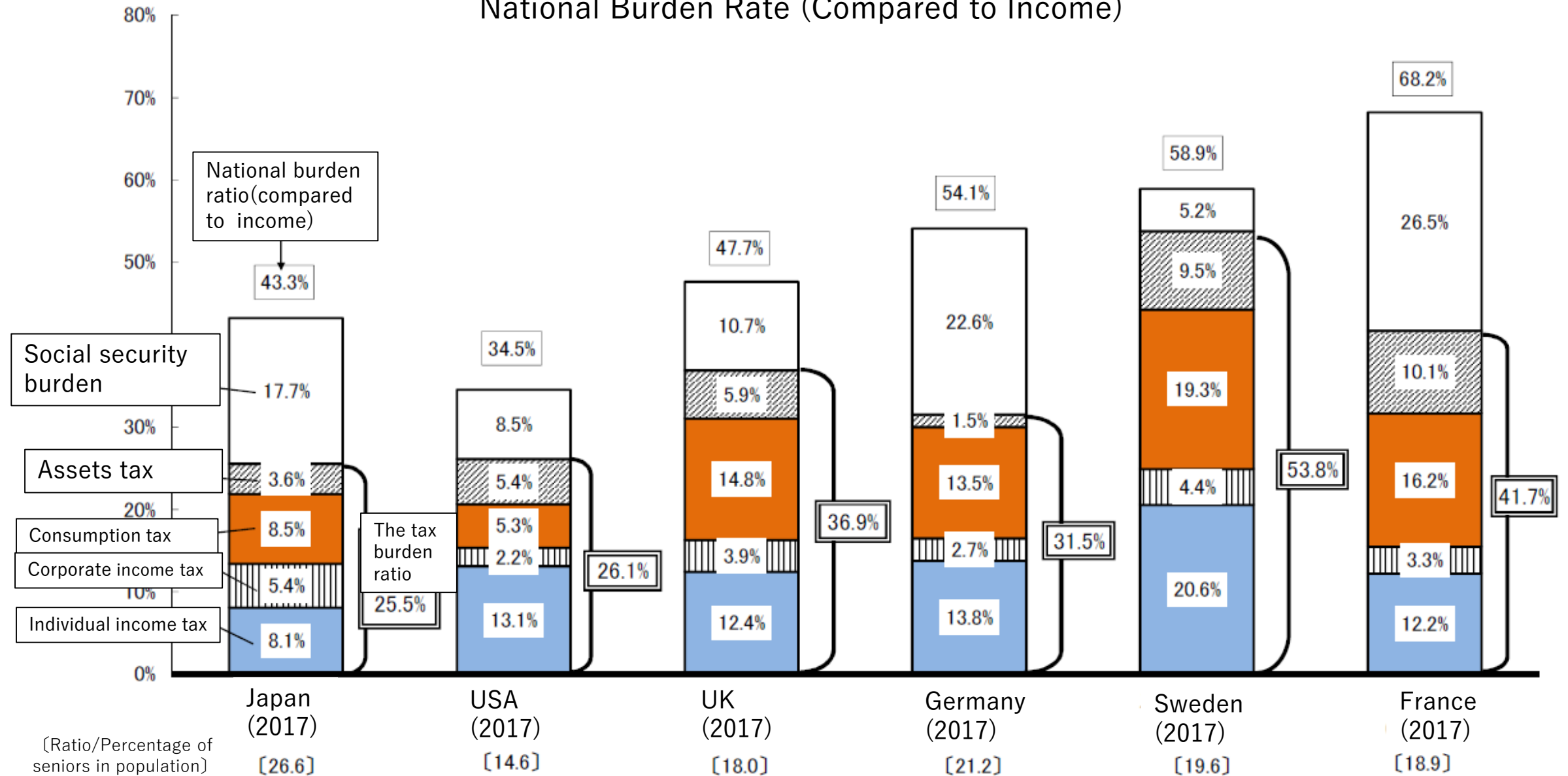
- Growing inequality is a global issue. In Japan, the aging population and development of AI will lead to even worse inequality. The government's Tax Commission and the ruling party's proposal for tax reform both call for greater income redistribution, but no serious policies to correct inequality have been implemented.
- The reason for this is that according to official statistics, over the past few years inequality has been shrinking at an initial income base and after redistribution (until now, inequality on an initial income basis was expanding due to aging population), and inequality is less than other developed countries.
- Despite this, there are those in Japan saying inequality is expanding. A further issue is that through factors such as educational environment, inequality can become entrenched over generations. Stratified society. "Jokyu kokumin" (upper-class citizen).
- Reasons for this are the relative poverty rate rising and significant intergenerational inequality.
- Calculating income and wealth distribution based on the Family Income and Expenditure Survey shows there has been no trickling down during Abenomics, and there has been a growing divide in income and wealth among the middle class.
- Redistribution in Japan tends to be carried out through social security programs more than tax system. In particular, redistribution is performed by collecting social insurance contributions from the working-age population and paying them out to older generations through pensions, etc. in a social insurance system (pay-as-you-go system). This places a burden on all workers regardless of their income, and then pays out to both high-income and low-income seniors, preventing appropriate redistribution from high-income to low-income. Future policy will have to correct this issue.
- The income tax system needs to be improved by reconsidering employment income tax, pension tax, and financial (capital) income tax (which disproportionately benefit seniors).
- Japan could also enhance the unique inheritance tax system it has developed.
- Inequality cannot be corrected through the tax system alone, and both taxes and social security need to be reformed together. It is necessary to increase the consumption tax rate and use that to finance a tax credit system with benefits (earned income tax credit) to support mid- to low-income workers, including freelance workers.
- To that end, a digital real-time information system must be implemented.

3 Change in Gini Coefficient by Income Redistribution



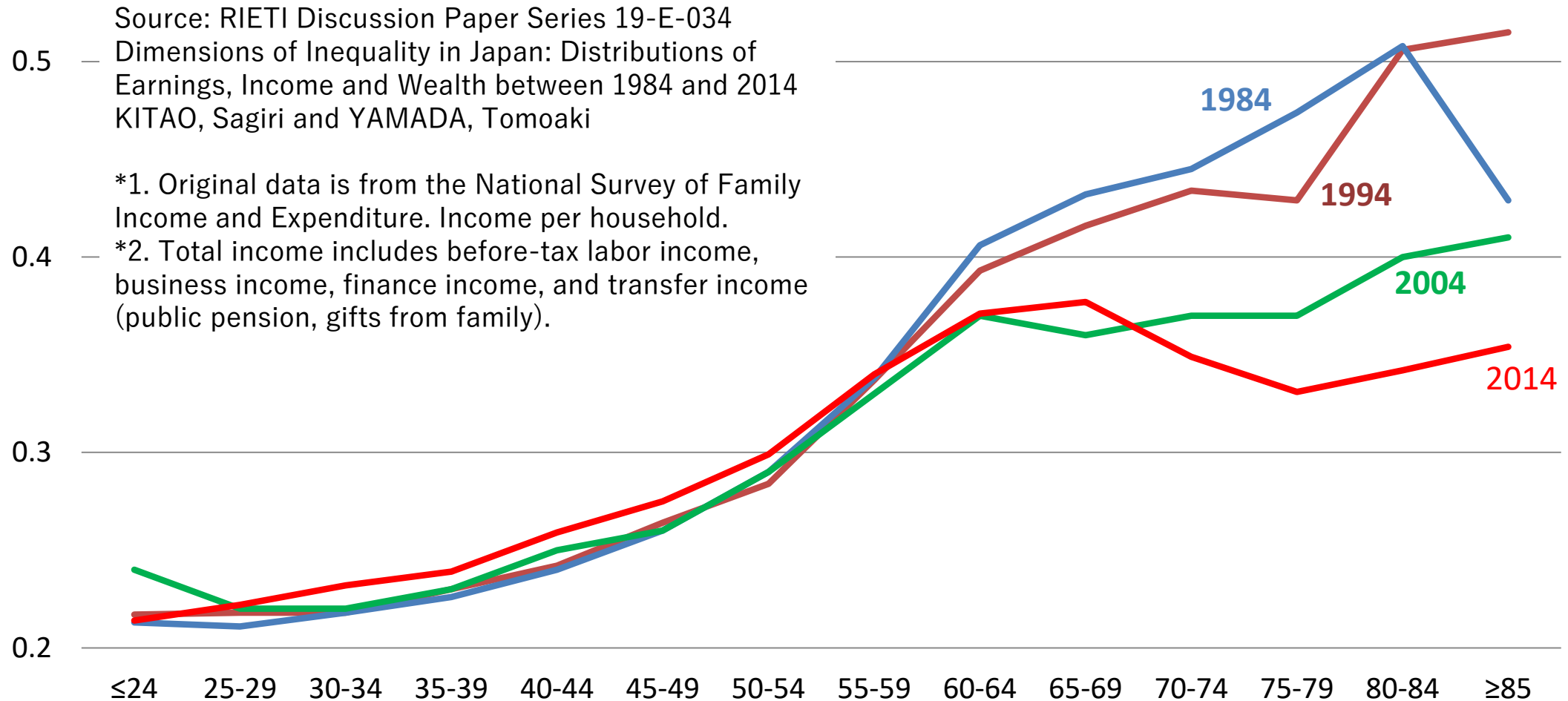
Source: Ministry of Health, Labour and Welfare Comprehensive Survey of Living Conditions

International Comparison of Breakdown of National Burden Rate (Compared to Income)



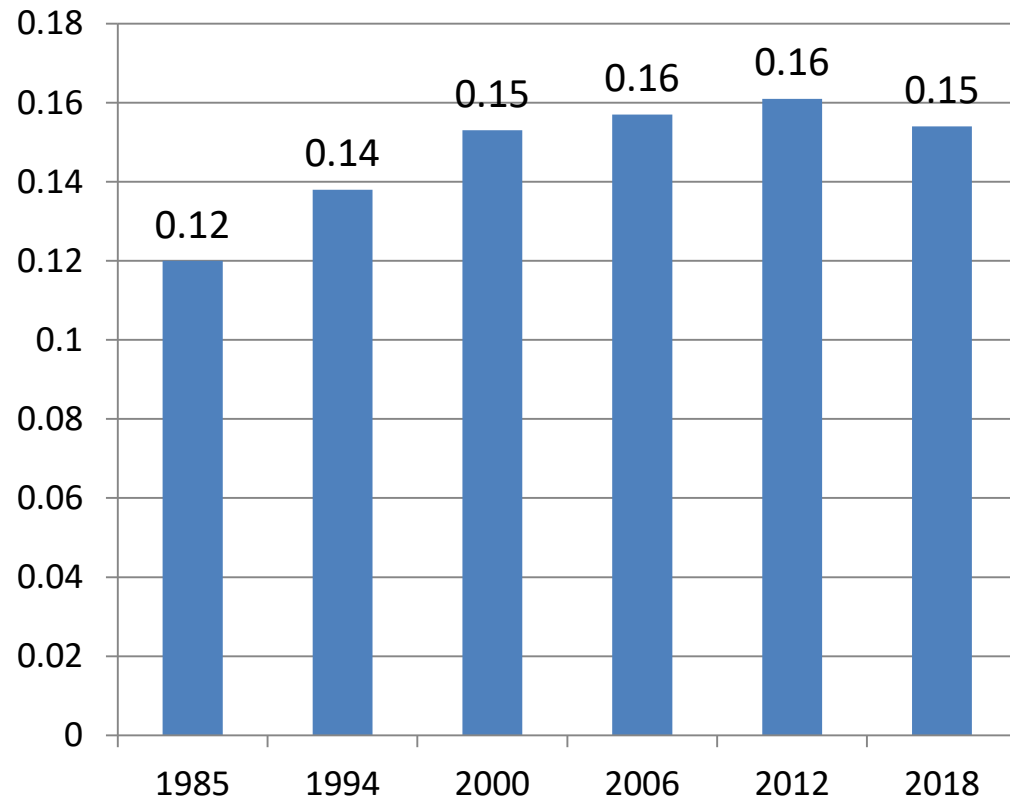
Note : 1. Japan is results from 2017, other countries are from OECD Revenue Statistics 1965-2018 and National Accounts.
 2. The tax burden ratio is a total of national and local taxes. Income tax includes tax on asset income.

Trends in Inequality by Age Group (Gini Coefficient of Total Income)



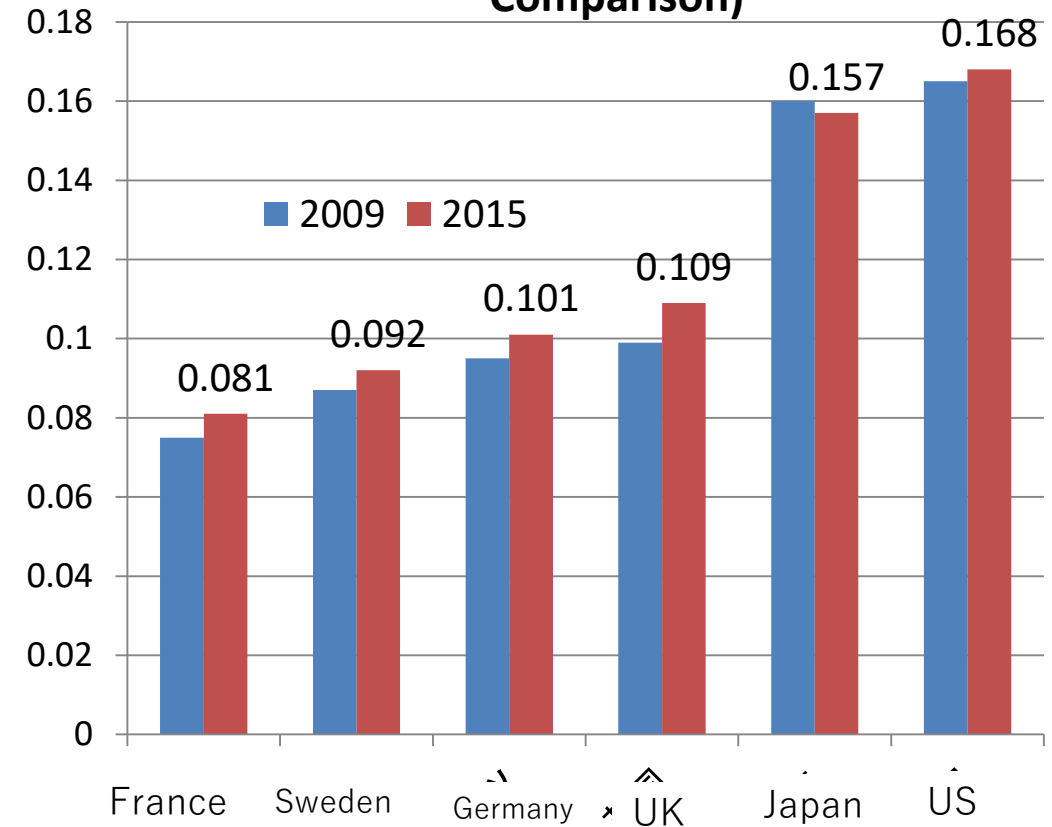
Relative Poverty Rate

Relative Poverty Rate (Japan)



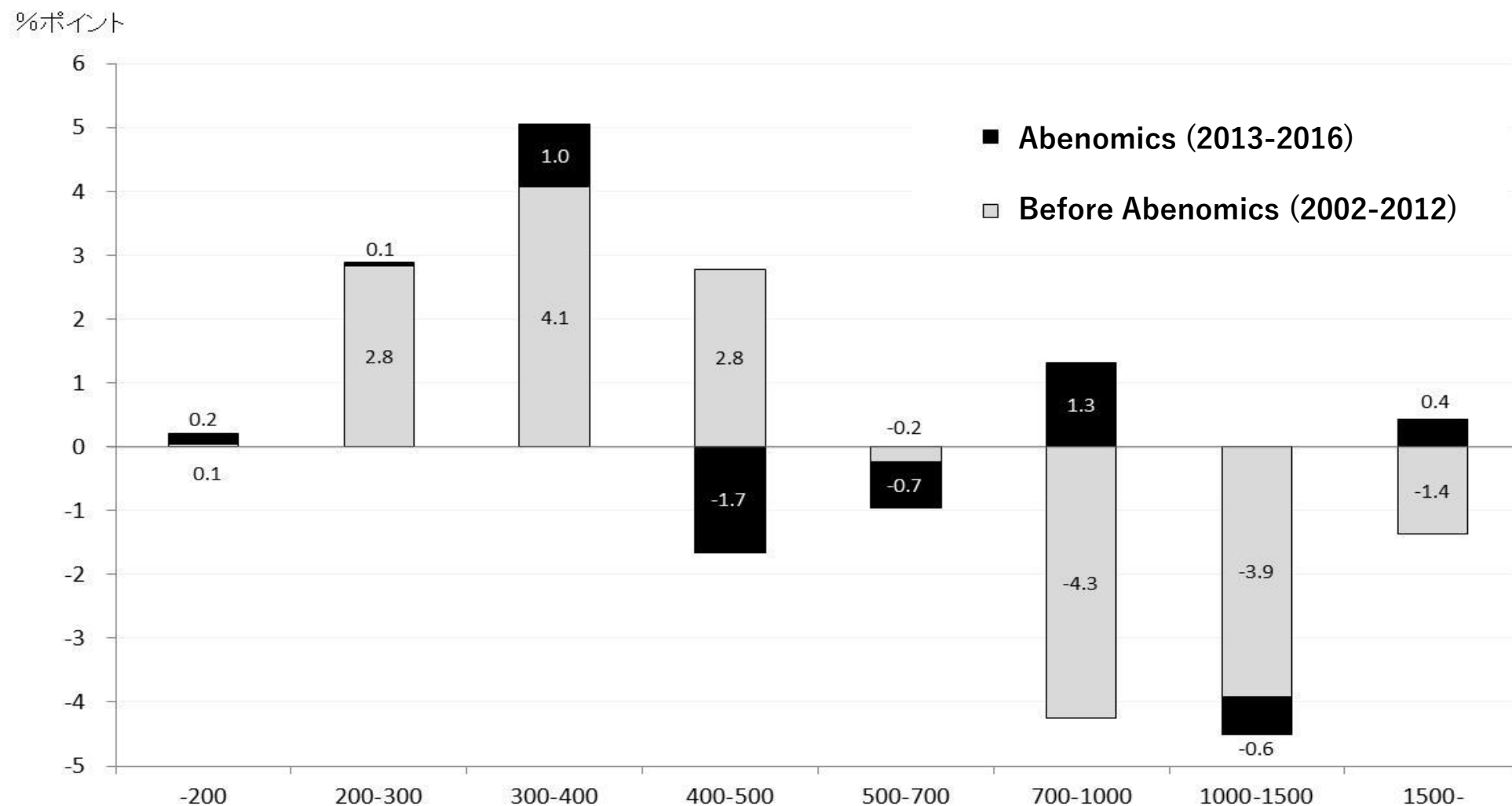
Source: Comprehensive Survey of Living Conditions (2019)

Relative Poverty Rate (International Comparison)



Source: OECD distribution database

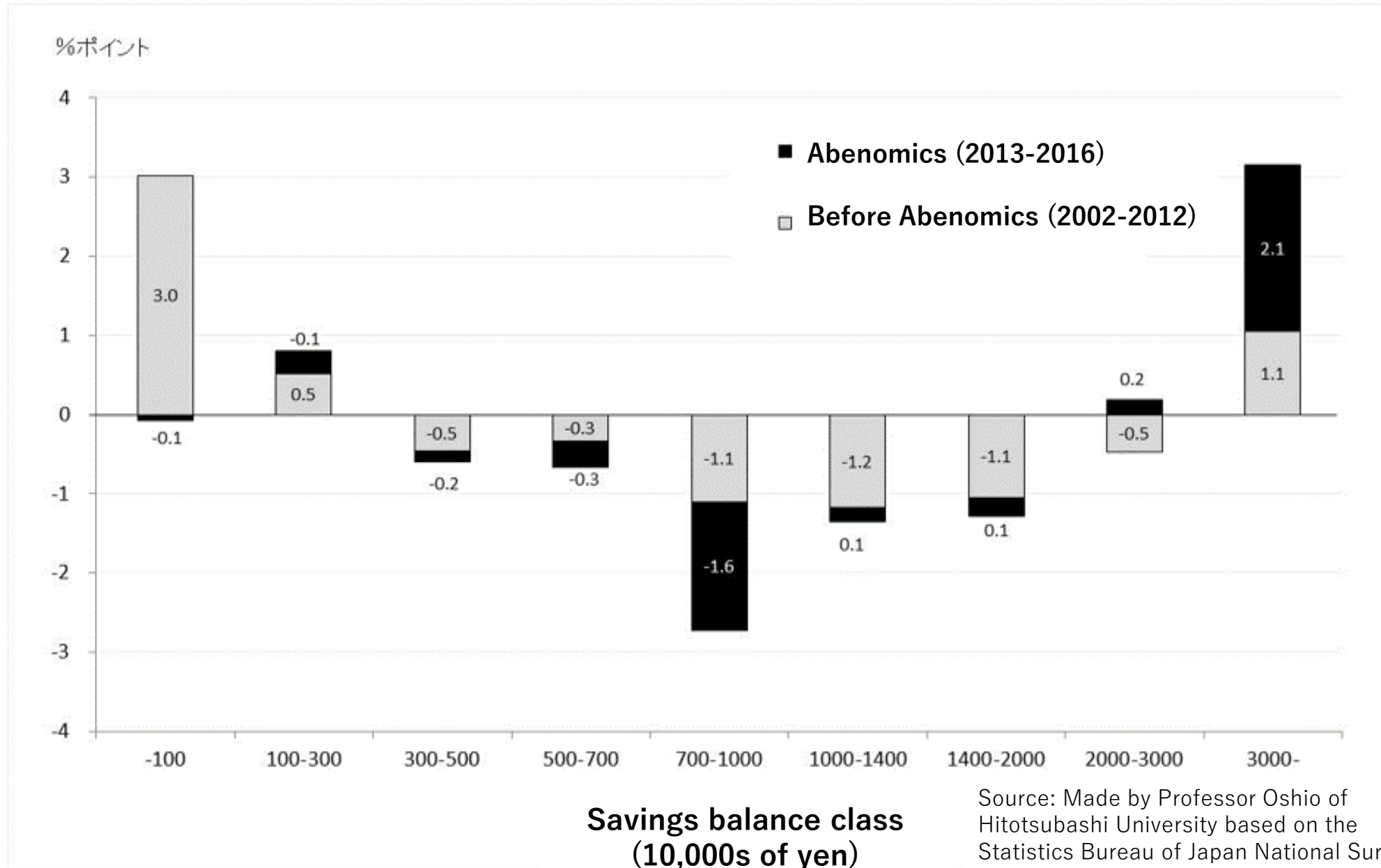
Change in Income Distribution



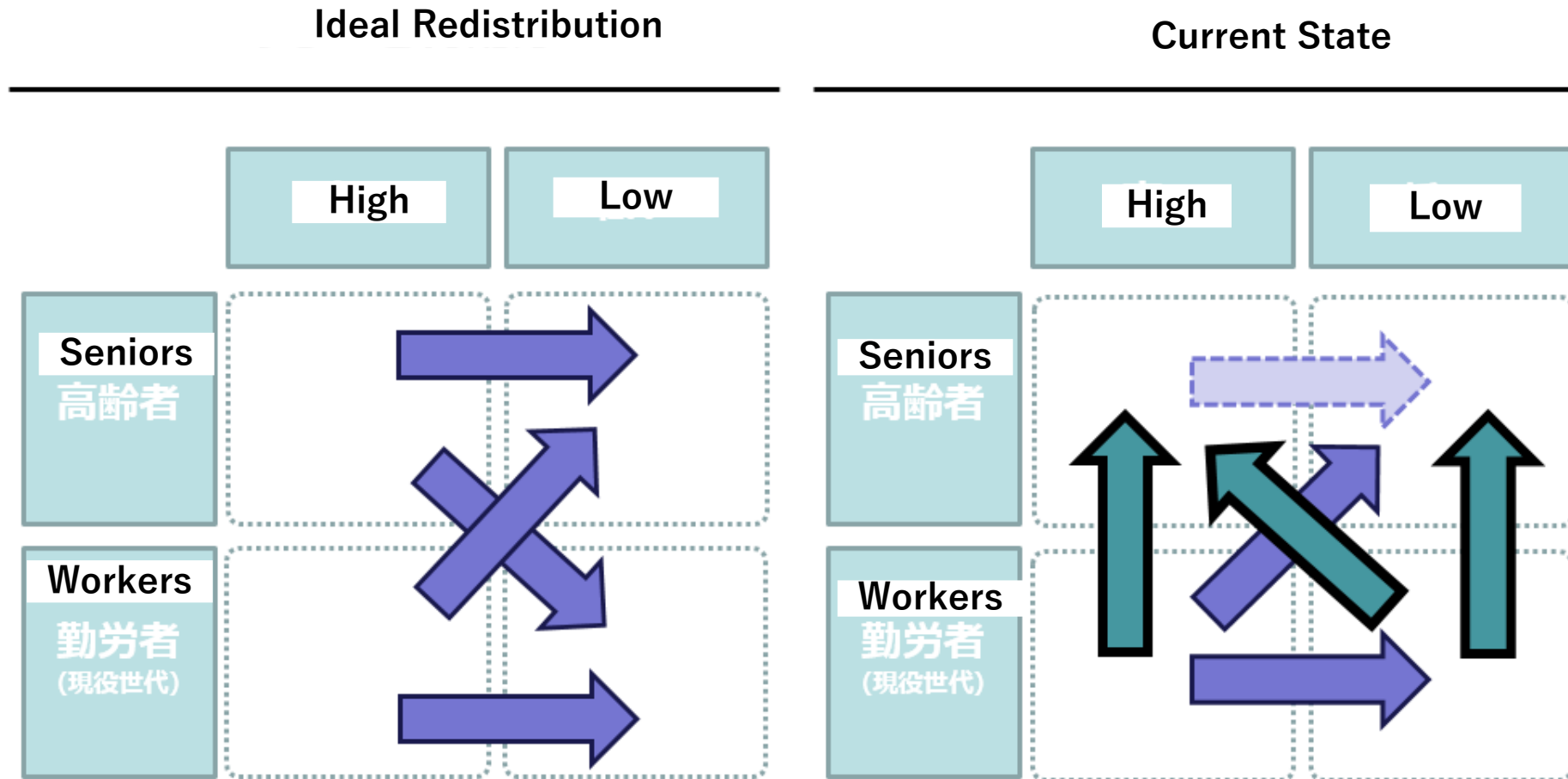
Annual earnings class
(10,000s of yen)

Source: Made by Professor Oshio of
Hitotsubashi University based on the
Statistics Bureau of Japan National Survey of
Family Income and Expenditure

Change in Savings Distribution



Ideal Redistribution Is Not Happening



Concrete Revisions

1) Finance (Capital) Income Tax System

Currently, finance (capital) income is taxed separately at a flat rate of 20% (15% national, 5% local). With a “Buffett curve” placing a peak at 100 million yen of declared income, income redistribution is being weakened. A flat increase of tax rate 5 to 10% would be a tax rate greater than that applicable to their labor income for mid- to low- earners, so some measure is necessary. For example, expanding NISAs and allowing more non-taxed finance income for mid- to low-income earners, or higher taxes for those with finance income over a certain level.

2) Pension Tax System

Japan’s pension tax system is more lenient than other countries (contributions not taxed, income credit exemption for payouts), creating an imbalance in fairness between generations.

- Pension recipients with labor income receive tax exemption for public pension and for employment income (double deductibles for expense)
- Exemption applies not only to public pension, but also to three levels of company pensions (employee pension funds, etc.)

3) Lower the Maximum Employment Income Exemption

Employment income exemptions are an estimated exemption for salary income earner costs, but are higher than other countries with a 1.95 million yen exemption on annual earnings of 8.5 million yen. (The US is 1.4 million yen, France 850,000 yen).

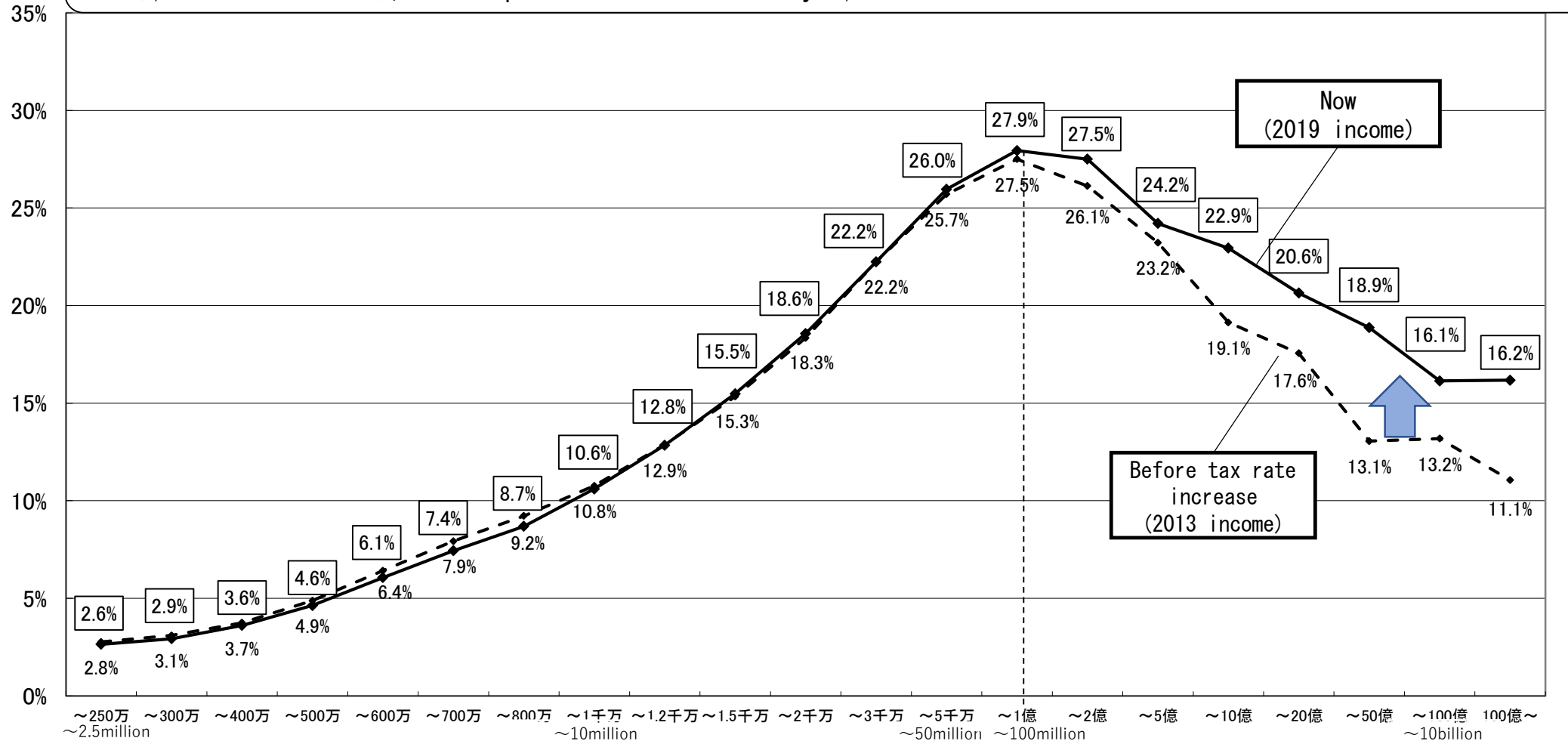
4) Increased inheritance tax. Wealth taxes have many issues, such as asset evaluation

5) Respond to the expanding freelance gig economy. The freelance tax system is harsh compared to salaried workers.

Use the My Number (individual number) system, number bank accounts as well, and develop a fair tax system.

Income Tax Burden Ratio of Taxpayers Filing Returns

- With high-income earners having a high rate of capital gain from stocks, etc. and finance income being taxed separately, high-income earners have a low tax burden from income tax.
- With the 2013 reforms, the reduced tax rate of 10% (income tax 7%, resident tax 3%) for capital gain, etc. from listed stocks, etc. was eliminated as of December 31, 2013, and a tax rate of 20% (income tax 15%, resident tax 5%) was implemented from January 1, 2014.

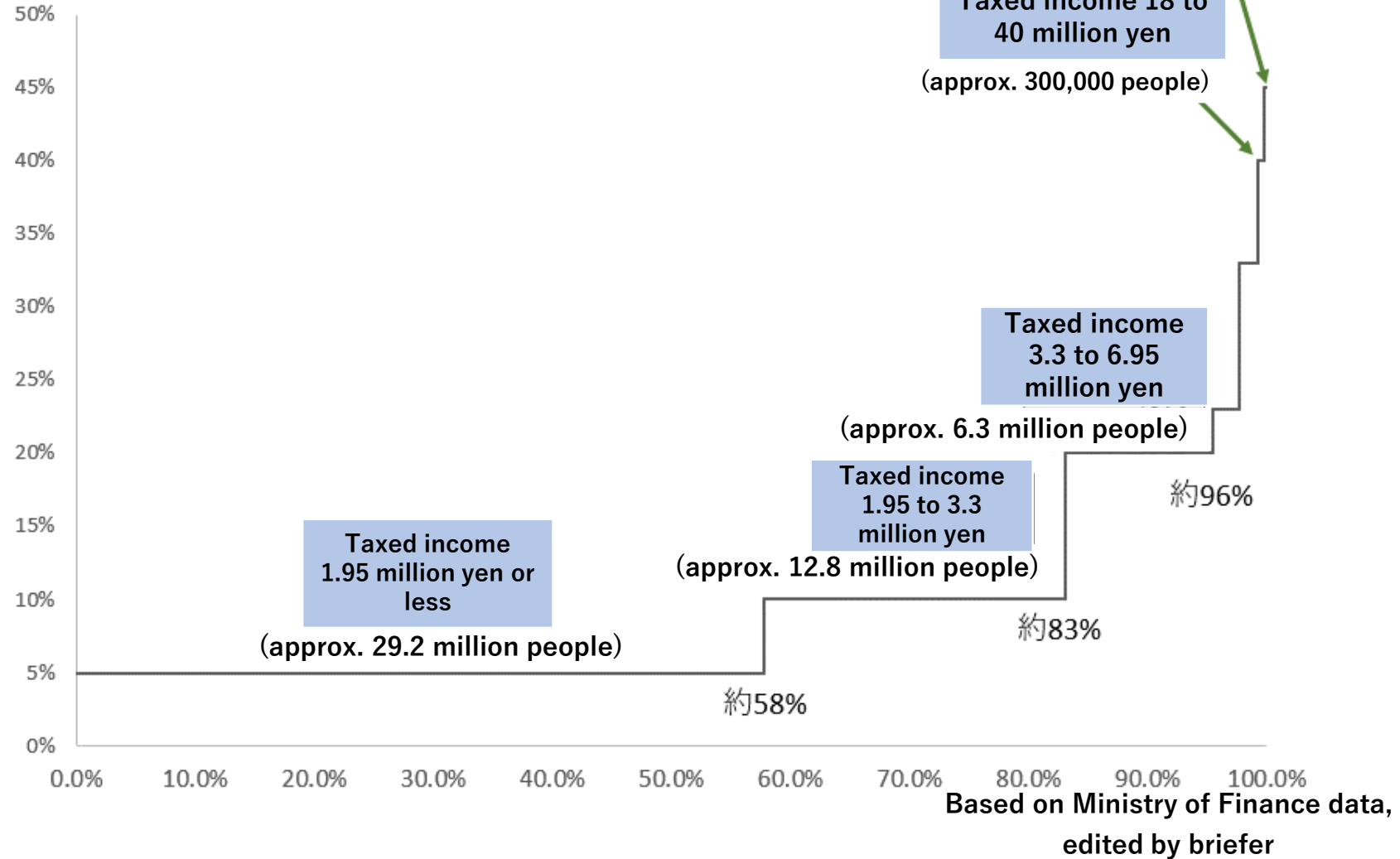


Note. Based on data from National Tax Agency sample survey of declared income (reality of declared income tax based on tax statistics)

*Does not include those with an income but no declared tax amount (for example, those who claimed refunds). Also does not include interest on separate withholding tax, dividend earners which a declaration was decided unnecessary for, and equity transfer income carried out in withholding tax collection accounts for which a declaration was decided unnecessary.

Taxpayer Ratio by Income Tax/Applicable Tax Rate

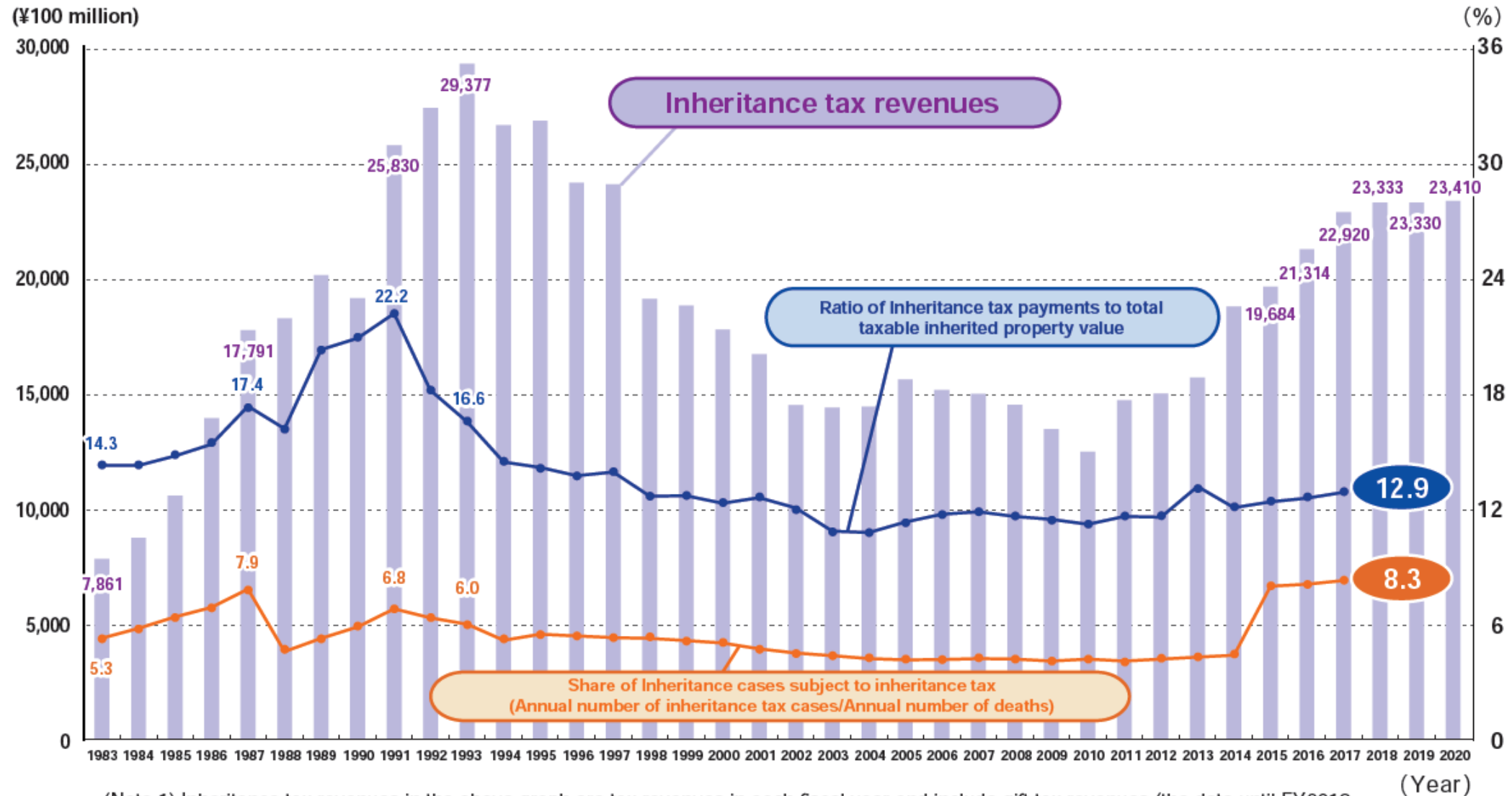
Marginal tax rate



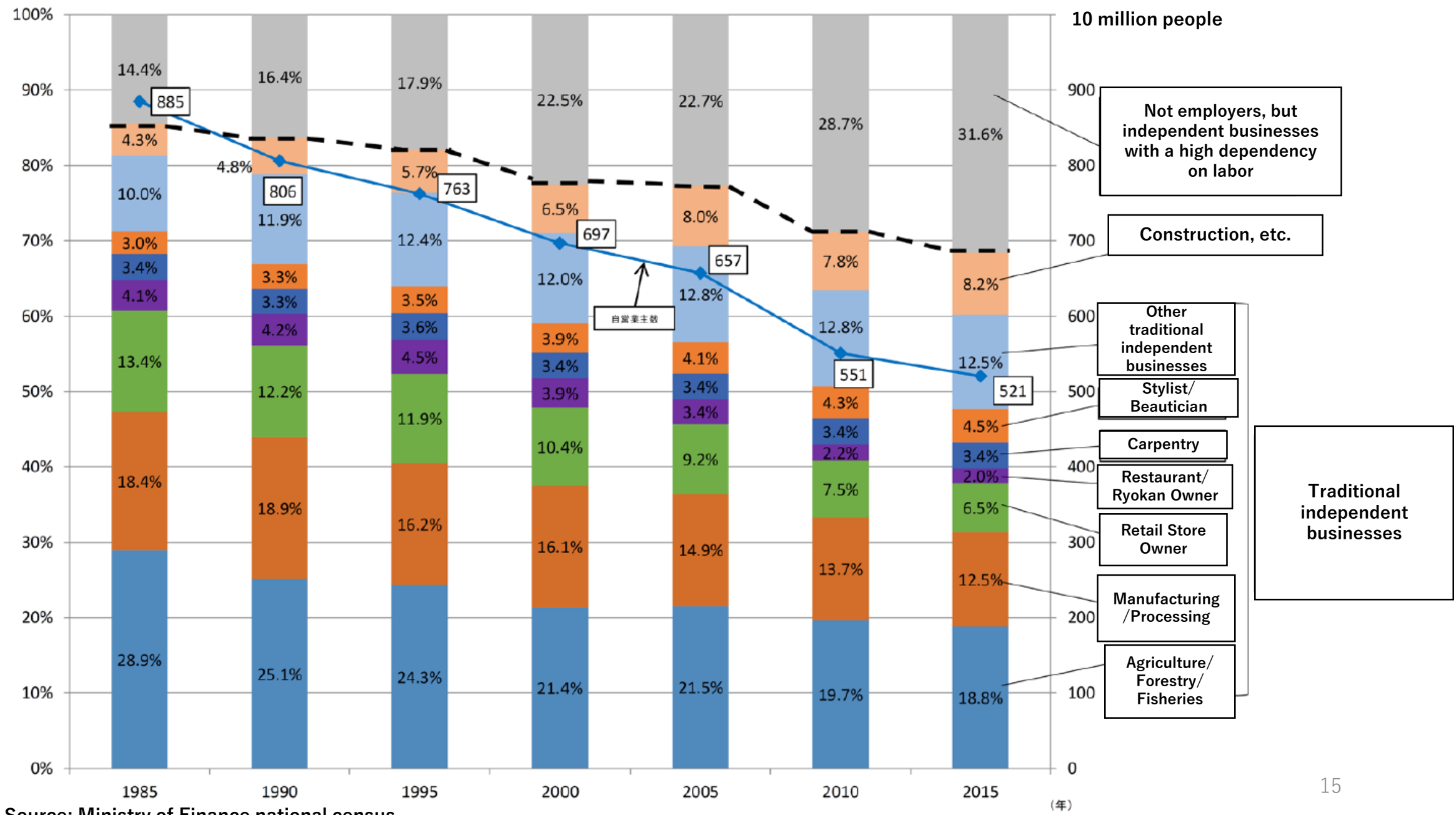
Inheritance Tax

- Inheritance tax in Japan is different from other developed countries, evolving uniquely based on the concept not only of correcting wealth inequality, but of paying at the time of death for the socialization of nursing care costs, etc. due to an aging population
- Was expanded significantly in 2015, with inheritance tax applying to eight deaths out of a hundred. While verifying this is appropriate, further expansion should be considered.

Changes in Share of Inheritance Cases subject to Inheritance Tax, Ratio of Tax Payments to Total Taxable Inherited Property Value and Inheritance Tax Revenues



Diversification of Work Styles and Life Courses



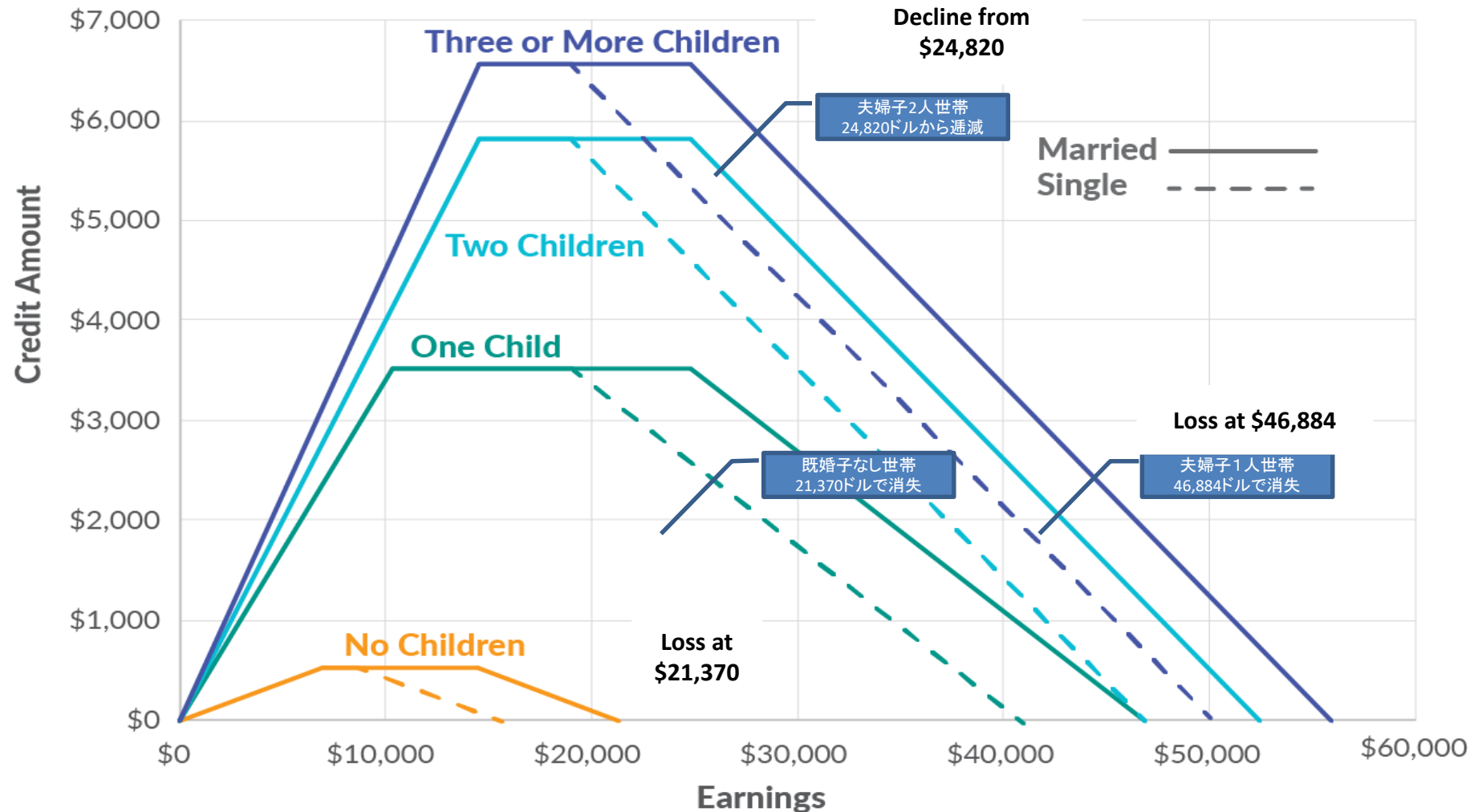
Discrepancy Between Employment Income and Business Income

- Taxation of employment income is based on the combination of withholding tax, annual adjustment, and employment tax exemptions, and many employment income earners do not have to file tax returns to the tax office once the annual adjustment is performed.
- Business income does not have estimated exemptions for costs or a withholding tax system, so there is a responsibility to file a tax return at the tax office and a system for estimated tax prepayment. However, there is a withholding tax system implemented for payments to Certified Public Tax Accountants, lawyers, judicial scriveners, etc.
- Freelancers and gig workers are formally self-employed and considered to be receiving business income, but are called “quasi self-employment” (de facto employee) and in the same way as employment income earners. The tax system should be revised to achieve a balance in the burden on both groups.

Tax Credit System with Benefits in the US

The Phase-In and Phaseout of the EITC

Credit Amount by Marital Status and Number of Children



Source: Amir El-Sibaie, "2019 Tax Brackets," Tax Foundation, Nov. 28, 2018.