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THE DEVELOPMENT OF THE INCOME TAX IN JAPAN

The history of the income tax in Japan may be divided into the following four periods:

1. From 1887 (in which year the income tax law was first enacted) to 1899, the period covering the Sino-Japanese War of 1894-5.

2. From 1899 (in which year the new income tax was enacted) to 1913, the period covering the Russo-Japanese War of 1904-5.

3. From 1913 (in which year the emergency special tax law resulting from the Russo-Japanese War was abolished) to 1920, the period covering the World War.

4. From 1920 (in which year the income tax now in force was enacted) to the present.

The purpose of my article is to trace the development of the Japanese income tax from the viewpoint of finance.

CHAPTER I. THE FIRST PERIOD (1887-1899) CREATION OF INCOME TAX

1. Influence of Rudolff's draft of the revenue tax. Our income tax was established by the income tax law promulgated in March, 1887. The immediate cause of the establishment of the income tax was the necessity of alleviating the tax on products in Hokkaido. Japan at that time had undergone a rapid national development, and she faced the necessity of expanding her naval forces—a fact which caused an ever-increasing government expenditure. Until that time Japan had depended on her two traditional taxes, namely, the land tax and the tax on *sake*, to meet her government expenditure; and the income tax was adopted as the first

step towards the creation of a modern tax system by borrowing elements in the Western tax system. As I have been studying comparative finance, I am naturally interested in how we came to adopt elements in the Western tax system.

The first income tax bill was presented to the Cabinet council in January, 1887. Its provisions were somewhat modified by the Council of State, and it was promulgated on March 19 by Imperial Ordinance No. 5.

Professor Isamu Abe refers to Count Masayoshi Matsu-kata's "Principles of the Income Tax Law", and asserts that the income tax law draft prepared by the count in December, 1884, formed the basis of the first income tax law in Japan. I must say that by the help of Mr. Takatate of the Library of the Department of Finance, I have found materials showing there is a still older basis. The fact is that the revenue tax law draft presented to Hirobumi Ito, member of the Council of State, in a letter dated November 29, 1874, formed the basis of the income tax law. In that letter, a German financial adviser, named Rudolff, presented a draft prepared by himself, and asked Hirobumi Ito to entrust to him the work of preparing a draft of the instructions necessary for the promulgation of the revenue tax law in 1875. In the same letter, Rudolff stated that, following instructions by Hirobumi Ito, he exempted income from the land on which the land tax was imposed and on the income from *sake* breweries, but that he included in the list of tax objects all miscellaneous income. Ten years later, Miyoji Ito, secretary, after having consulted the views of Rudolff and another German financial expert named Roesler, presented a letter to Hirobumi Ito expressing his views on the current problems of this particular form of taxation. At the same time, Miyoji Ito presented to Hirobumi Ito a number of translations of tax law drafts and German tax laws. At any rate, the revenue tax law was made on the advice of these two German experts and the substance of that draft greatly resembled that of the German income tax law. It is certain that this draft influenced at least indirectly the income tax law of 1887.

This is what I mean when I say that we borrowed elements in the Western tax system in the establishment of our first income tax law.

2. The features of the first income tax law of 1887. I wish to bring out the features of this income tax law by comparing its provisions with those of Rudolff's draft of the revenue tax. The two agree in their general structure but differ in many minor points. Article 1 of the income tax law fixes the exemption point at 300 yen as compared with 400 yen in the revenue tax. But this exemption point was raised to 400 yen in 1913. The revenue tax law draft had detailed provisions regarding the domicile of taxpayers and the location of tax objects, but these were not realized in the income tax law, either because our relations with foreign countries were very simple or because we had to respect the sentiments of foreign powers. At any rate, the spirit of the revenue tax law draft, as expressed by Rudolff, came to be regarded as important from 1899 when the new income tax law was enacted.

The method of calculating incomes as provided in Article 2 of the first income tax law, namely, the three-year actual average principle, was the same as that provided in the revenue tax law draft. This principle of actual average was temporarily replaced by the principle of estimation in 1899 but was restored in 1926.

Whereas the rates of the first income tax law were percentages of total progressive rates (and the system of percentages of progressive rates continued down to 1913), the revenue tax law draft adopted monetary amounts of total progressive rates. The former system is undoubtedly superior to the latter, but it has the disadvantage of having a smaller number of progressive scales than the latter. Consideration for the domestic circumstances of taxpayers as provided by the revenue tax law draft was not materialized in the first income tax law; it was adopted only in 1920.

The income tax law and the revenue tax law draft have their respective features as regards the time of payment

(Article 5), obligation of declaration to the revenue office (Article 6), the county district income investigation commission (Article 7), the prefectural standing commission (Article 20), and reduction and revision (Article 23). However, there is no denying the existence of close relations between the two sets of provisions.

CHAPTER II. THE SECOND PERIOD (1899-1912) ESTABLISHMENT OF INCOME TAX

1. Fundamental revision of the income tax law. The enactment of the income tax of 1887 was a great attempt at importing foreign systems and institutions. It was to be regarded as an idea rather than a working tax system. In order to make this idea workable, both the withdrawing of too progressive elements and the introduction of new elements were necessary. The law-makers who revised the first income tax went back to the stoppage-at-source system in the taxation of corporate income and interest on bonds and debentures, but they took progressive steps to solve the questions of international taxation, and to expand the scales of rates for Class Three incomes (Individual incomes). The Sino-Japanese War had imposed upon the Government the necessity of securing a vast source of revenue to make up the huge fiscal deficits of the post-bellum period. Accordingly, the Government presented a bill for revising the income tax law at the 12th session of the Imperial Diet when it was opened in May, 1898. At the committee meeting on June 2, Mr. Reijiro Wakatsuki, government delegate, explained the bill substantially as follows:

"The Department of Finance has long contemplated the necessity of revising the income tax law, enacted in 1887 and now in force, because it has become out of harmony with the existing circumstances. Its defects are very pronounced when the law is applied to foreigners. When the revised treaties take effect and foreigners are taxed under the operation of these treaties, the income tax law must be

revised by all means . . . Since corporations and individual taxpayers are different, the tax should be imposed on both corporations and the individual citizens who receive dividends from them.

"Such a system of income taxation is adopted in England and Germany. Our proposed law taxes only corporations and does not tax individual taxpayers on their corporate dividends because of a sentimental reason. But justice demands that both corporations and individuals receiving dividends should be taxed. But we do not wish to go too far in our present attempt at tax revision. Although we do not believe that the taxation of both corporations and individual recipients of corporate dividends is double taxation, we decided to tax only corporations. At any rate, we have no desire to exact an excessively heavy toll from corporations.

3. The new income tax of 1899. The bill for revising the income tax law presented to the 12th session of the Imperial Diet in May, 1898, was killed as the Diet was dissolved in June. In November of the same year, another bill for revising the income tax law was presented to the 13th session and was adopted by the House of Representatives after having somewhat modified by that body. The House of Peers was in favor of the bill in its original form and after re-modifying it to that effect sent it back to the House of Representatives. The latter House approved the revision of the former House, and the bill became law as modified by the Upper House on February 10, 1899.

The bill presented to the 12th session of the Imperial Diet retained something of the earlier law inasmuch as it adopted the three-year average system in its Article 5. But it included a progressive feature in that it had a system of five-class progressive rates which represented a compromise between the classified income tax and the general income tax. Mr. Reijiro Wakatsuki, government delegate, explained Articles 3 and 4 substantially as follows in the Diet :

"Generally speaking, all incomes should be taxed. But in actual practice, there are some exceptions. Some incomes

are exempted from the tax. Such incomes are included in Article 3. Salaries paid to soldiers during war, temporary incomes and incomes of persons who pay the tax through their corporations—such incomes are exempted under this provision. I shall now explain Article 4. Some incomes are certain and can be secured without much labour, while others can only be obtained by hard toil. Some incomes are uncertain. Different incomes are classified into five categories under this provision and different rates are imposed on them in order to ensure fairness. Corporate incomes (class one) have been entirely set apart from others because it is difficult to tax them according to their kinds. Class Two income is the result of former labour and can be secured without any labor in the present. Class Two income is a very certain income. Class Three income can be secured only when both capital (or the labour of yesterday) and labour are combined. Class Four income is secured only through labour. Class Five income is such income as pensions or annuities and its rate is somewhat higher than that of the Class Four income but lighter than the rates for the first three classes.

The bill failed to pass the Diet because of the dissolution of the House but the idea contained therein, namely, that corporate income (Class One income) and interest on bonds and debentures (Class Two income) should be detached from other incomes (Class Three income) was re-asserted in the bill presented to the following session (13th) of the Diet. This idea forms the basic structure of the income tax law now in force. The House of Representatives modified the bill by merging the Class Two income with the Class Three income, but the House of Peers went back to the original. When the bill as adopted by the House of Peers was sent back to the House of Representatives, the latter House accepted the bill as presented by the Government. In explaining the restoration of the bill to its original form by the House of Peers, Mr. Reijiro Wakatsuki stated that the House of Peers was right in accepting the principle that, so long

as the tax is levied on corporate income at its source, it should also be levied on interest on bonds and debentures where it is paid.

This principle of detaching Class Two income from the Class Three income has now been in force in Japan for many years. Even after the stoppage-at-source system came to be abandoned in part in 1920, when 60 per cent of dividend was added to individual income for the purpose of lump-sum taxation, the Class Two income maintained the spirit which was given articulate expression in 1899. At any rate, the fundamental idea of the five-class income tax proposed at the 12th session of the Diet (different income are classified into five categories and different rates are imposed on them) came to be adopted and was put into actual practice, though as a three-class income tax, when it was adopted in the following year.

The principal features of revision made by the 13th session of the Diet in 1899 are as follows:

(i) The sphere of the obligation of taxpayers was clarified as to their domicile, residence and location of their tax objects.

(ii) The income tax was divided into the following three classes:

a. Class One income. This is corporate income. Individuals are not taxed for their dividends from corporations.

b. Class Two income. This is interest on bonds and debentures and is taxed when and where it is paid out.

c. Class Three income. This is individual income that does not belong to Class Two income.

(iii) The method of calculation was modified. The Class One income is computed by deducting losses from profits and is fixed by taking into consideration the valuation of corporate property and its depreciation. Class Two income is computed by taking the total amount. Class Three income is computed by deducting from the total income all necessary expenditures and by taking annual estimates.

(Note: an Imperial Ordinance issued in 1899 defines

necessary expenditures as seeds, silk-worm eggs, fertilizers, at their purchase price, the cost of food for cattle, cost of raw materials, repairing expenses, wages of employees and other expenditures which are necessary for deriving income.)

(iv) Tax rates were decided. The law adopted proportional rates for Class One and Class Two incomes and progressive rates for Class Three income, for which a greater number of scales was established.

(v) The right of investigation and decision regarding income was transferred from the heads of prefectures and counties to the head of the tax affairs supervision bureau.

3. The emergency special taxes. In order to meet the expenditure of the Russo-Japanese of 1904-5, the tax burden was greatly increased and the income tax law was revised twice. The first tax increase was made in 1904 by law No. 3. Holding that the income tax is levied on persons of property, the amount of the tax on Class One and Class Three incomes was increased by 70 per cent of the original tax amount. The Class Two income was exempted from this increase because of the Government's wish to maintain the market value of the war-time government bonds at as high a level as possible.

The second increase of the income tax rates was made in 1905. The Government formulated a plan to increase the rates by 80. As the first increase was 70 per cent, the total increase was thus to be 150 per cent. Class One incomes were classified into A and B. The former was defined as the incomes of joint-stock companies or partnerships each of which is composed of 21 or more shareholders or 21 or more shareholders and company officials. The rates of such incomes were increased by 80 per cent. Incomes coming under B were defined as those of other corporations and were grouped into eight classes and their rates were increased by 10 to 640 per cent progressively. Class Three incomes were grouped into 10 classes and their rates were increased by 30 to 200 per cent progressively. The Government wished

to raise a sum of 5,862,240 yen by this second increase of the income tax rates. But as the Diet modified the rates of Class One incomes grouped under B, the amount to be raised was reduced to 5,286,462 yen. It is noteworthy that the second increase in the income tax rates made the structural revision of dividing Class One incomes into A and B. This division was necessary in order to cope with attempts at tax evasion through the formation of various corporations by individual business men. Thus, corporations having 21 or more shareholders or 21 or more shareholders and company officials combined were to pay proportional taxes as hitherto; while smaller corporations were to pay progressive taxes according to their respective individual incomes, as such corporations have to some extent an individual aspect.

At first the special treatment given to government bonds by the legislators was of a negative character. Both in the first and second increases of the income tax, no steps were taken to increase the rates on Class Two incomes. But positive steps to favour government bonds were taken in 1905, and again in 1909, when they were expressly exempted from income taxation. Thus, the law enacted in February, 1905, exempted from income tax interest on all government bonds issued after 1904 for military purposes. The second step in the same direction was taken in March, 1909, when interest on all government bonds, without regard to kind, were exempted by law from the income tax.

The emergency special tax was to be abolished at the close of the Russo-Japanese War, but this did not come to pass because the disposition of post-bellum affairs required a large amount of government expenditure. Although the tax system was revised twice, in 1908 and again in 1910, the method of levying income tax was left without the desired improvements. By 1913 the emergency special tax law existed only as regards the income tax, in which year it was totally abolished and the income tax law was revised.

CHAPTER III. THE THIRD PERIOD (1913-1920) REVISIONS OF INCOME TAX

1. The revision of the income tax in 1913. As has been seen, the income tax law was thoroughly revised in 1899 but no further improvement was made because of the emergency special tax law, and it was in this condition for many years even after the close of the Russo-Japanese War. There was the necessity of making fundamental revision instead of temporary revisions previously made and of maintaining harmony between corporate income and individual income. A bill for revising the income tax law was presented to the 30th session of the Imperial Diet in 1913 side by side with a bill for abolishing the emergency special tax law. The bill was presented to the Diet by Finance Minister Korekiyo Takahashi. It was modified by the House of Representatives and the revised bill was accepted by the House of Peers, becoming law in the same year.

The features of the income tax revision of 1913 may be summarized as follows:

(i) The structure and rates of the income tax were revised. The income coming under A in the Class One income group was exchanged with the incomes grouped under B in the same class of income. First the system of total progressive rates was replaced by the system of excess progressive rates, and the new system was applied to the incomes grouped as A in Class One incomes, as well as to Class Three incomes. Secondly, individual incomes of small amounts were made entitled to deductions of fixed amount and a system of indirect progression was adopted. The number of scales of progression was increased for all individual incomes. These two revisions of the income tax rates represent much progress in our tax system.

(ii) The exemption point which had remained at 300 yen was raised to 400 yen.

(iii) Adjustment was made in the method of calculating individual incomes although its underlying principle of esti-

mation, as determined in 1899, remained.

(iv) A fixed amount of deduction was adopted for earned income; it being the first instance of such deduction for earned income in this country.

(v) Income accruing from important industries during some fixed period of time was exempted.

(vi) The obligation of making a declaration to the revenue office was extended to third persons.

2. The revision of the income tax law in 1918. The World War broke out in 1914, and Japan was dragged into it at an early stage. Our financial world was greatly upset by such events as the unprecedented soaring of prices, a great wartime prosperity and a big expansion of government expenditure. The need was felt for adjusting the income tax law to the real circumstances of the financial world. At the same time the War Department made plans to perfect military forces, while the Navy Department contemplated expanding the naval forces. The Government presented a bill for revising the income tax law in March, 1918. This bill was explained by Finance Minister Shoda substantially as follows:

"The principal aim of the bill is to raise the rates of income tax for both corporate and individual incomes by 20 per cent. The rate on the interest on debentures is to be raised by one per cent. The exemption point for class three incomes has been raised from 400 yen to 500 yen. We have given some consideration to deduction from incomes under 1,000 yen. Another feature in the bill is that we have established another scale above the highest ordinary scales for both corporate and individual incomes. The Government have accepted minor revisions made in the bill by the House of Representatives."

The House of Peers sanctioned the revisions made in the bill by the House of Representatives and the bill became law.

The revision of the income tax law made in 1918 was only partial. Its important features are twofold, as follows:

(i) The tax rates were raised. On the income of joint-

stock companies a proportional income tax of 7.5 per cent was levied. Rates were differentiated for interest on government bonds and interest on debentures. For individual income, a new scale of 200,000 yen was newly created and excess progressive rates ranging from 3 to 30 per cent were levied. The amount of deductions for small incomes was increased.

(ii) The exemption point for class three incomes was raised to 500 yen.

CHAPTER IV. THE FOURTH PERIOD (1920-x) THE PRESENT MODERN INCOME TAX

1. The lump-sum taxation against the stoppage-at-source taxation. We shall not here take up the income tax law of 1887, which was simply copy of the Western system. The income tax system of 1899, which may be considered as the basis of the present income tax law, was a sort of classified income tax. The original draft of the income tax presented to the 12th session of the Diet was a five-class progressive income tax; it was a compromise between the stoppage-at-source income tax and the lump-sum income tax. But this tax draft was not enacted into law because of the fact that the Diet was dissolved. The government income tax bill presented to the 13th session of the Diet was a three-class income tax. It was made a two-class income tax through revision by the House of Representatives; but it was changed back to three-class income tax by the restoration of the original bill by the House of Peers. Corporate income (Class One income) and interest on capital (Second Class income) were to be taxed at their sources before being paid to individuals, while Class Three incomes were to be taxed in a lump-sum at the place where taxpayers receive them. This constituted the main feature of the tax law as explained by Mr. Wakatsuki, and it became a serious issue in the academic world of Japan. Dr. Gotaro Ogawa, Professor of the Kyoto Imperial University was most vehement in criticizing that

very point as being legislation objectionable from the viewpoint of social policy. On two occasions, namely, in 1915 and 1920, Dr. Ogawa in his lecture on The Social Policy Society of Japan criticized the 1899 income tax law substantially as follows:

"The income tax is the central tax among taxes on gains. The land tax is levied on real estate; the business tax is levied on business transacted. This being so, capital which is not used for business must be also taxed. Movable property in most cases takes the form of negotiable securities of which the principal ones are government bonds, debentures and shares. Let us see how that our income tax deals with these securities. Let us first take bonds and debentures. Income from these is classified as Class Two income on which a two per cent tax is levied. The same rate of tax is levied however large the amount of income from bonds and debentures. Suppose a taxpayer receives an income of 10,000 yen from such bonds and debentures, he will have to pay only a tax of two per cent of his income. The owners of land are taxed twice: they have to pay the income tax as well as the land tax. Business men also are taxed twice: they have to pay the income tax as well as the business tax. But the owners of bonds and debentures will be taxed only once, and the rate of the tax is only two per cent. Moreover, no tax is levied on the government bonds. This policy, which has been enforced since the time of the Katsura Cabinet, is open to serious criticism.

"I shall now take up the tax on dividends from shares. Observe that no tax is levied on the corporate dividend. It is merely levied on the income of joint-stock companies. Our lawmakers have explained this by saying that it is too troublesome to tax the dividend after it has been paid out, and that this is why it is taxed while it is in the hands of joint-stock companies. Now joint-stock companies in our country regard income tax as a sort of business expense and they do not deduct the tax from the amount of dividend, and companies with a sound financial basis attempt to main-

tain a definite rate of dividend. They make no attempt to shift the burden of income tax to the shareholders even when the rate of the tax has been increased. Thus, our shareholders do not have the feeling that they are shouldering the tax burden as far as the dividend they secure is concerned. We may truly say that the dividend on shares is exempted from income tax. Even supposing that the taxation of corporate income is a convenient method of taxing dividends, the fact remains that the tax is proportional and no progressive tax is levied on such income.

With the advance of society, the amount of bonds, debentures and shares will be increased and they will represent the wealth of the property class. But the tax on these at present is very light. Their taxation is not harmonious with social policy."

Again, in his work "Our Public Finance from the Viewpoint of Social Policy", Dr. Ogawa argues:

"It is well that the income tax in force adopts progressive taxation, but income tax rates are very heavy of individual income and light for the income of partnerships and joint partnership. As to the income of joint-stock companies, no progressive tax is levied thereon, it being subject to a proportional tax only. We may say that the greater the capital the lighter is the tax imposed. Individual income is taxed properly but the income tax fails to reach the greater part of the national income inasmuch as income derived from interest on bonds and debentures, and from dividends and bonuses is not taxed in reality. Of course one may say that the gains from these negotiable securities is indirectly taxed as corporate income or as Class Two income. But the former is usually deducted as a business expense and therefore does not affect dividends, and for this reason one may say that the dividends paid to individuals are free from all taxes. As to the latter, it must be remembered that government bonds are exempted from income tax. Supposing, however, for argument's sake, that all these are taxed once, cannot we say that such a tax is a tax on profits rather

than on income?

"On the other hand, landowners and business men shoulder the income tax in addition to this tax on products. Shareholders and owners of bonds and debentures should similarly bear the burden of the income tax in addition to that of the tax on products. But our tax system exempts them. . . . If we tax joint-stock companies lightly and exempt negotiable securities or tax them lightly, the rich will become richer and discontent over the unjust system of tax distribution will become keener."

Thus, there was a movement in favor of the imposition of a lump-sum income tax on corporate income (Class One income) and on interest on capital (Class Two income), thereby replacing the stoppage-at-source system. At this very juncture there was a trend in other countries to adopt a lump-sum tax, or a surtax on income, in addition to the classified income tax or the usual income tax hitherto adopted, and this trend assisted very materially our movement in favour of the lump-sum form of income tax.

2. The new income tax bill presented during the 42nd session of the Diet. The World War ushered in an unexpected prosperity so far as the economic world of Japan was concerned, but gave rise to an undesirable phenomenon in the distribution of wealth. In 1919 or thereabout there was considerable social discontent which centred around a political movement for universal franchise. At this juncture, that is to say, during the 42nd session of the Diet, Premier Takashi Hara introduced a new income tax bill.

The revision made by this bill on the income tax law of Japan was epoch-making inasmuch as the traditional stoppage-at-source system of taxation, continued from 1899, was replaced by a lump-sum system of taxation. However, part of the traditional system was retained inasmuch as the stoppage-at-source system was continued as regards Class Two income. On this point a debate was held between Finance Minister Takahashi and Dr. Gotaro Ogawa, who interpellated the Finance Minister as follows:

"I wish to ask questions about the substance of the income tax law now before the House. The law has abolished the stoppage-at-source system as regards Class One income, or corporate income. I believe this is progress in our tax system, and I heartily support it. But I should like to hear the Government's reason for abolishing this system."

To this Finance Minister Takahashi replied substantially as follows :

"The Government abolished the stoppage-at-source system because it is unjust for individual taxpayers. Under this system persons whose income is 100 yen will have to pay the same rate of tax as persons whose income is several million yen. Thus, there will be injustice of taxation. The Government abolished the stoppage-at-source system because it believes that the lump-sum personal taxation of income is in conformity with justice."

The bill was modified, in its minor details, by the House of Representatives. One of the modifications was a deduction of 20 per cent of the income individuals receive from corporations. In the House of Peers, Finance Minister Takahashi explained that this modification was made by the House of Representatives because of its fear that the taxation of individuals for their corporate income might prove a hard blow to the investors in shares and thereby jeopardize the development of industry.

This bill failed to become law because the House of Representatives was dissolved on February 26, before the House of Peers could complete its consideration of the bill. The bill is important for the reason that, whereas the only object of revisions of the income tax law previously attempted was to secure revenue for the Government, this bill had some social-political purpose in view.

3. The new income tax law of 1920. Four steps were necessary before the enactment of the new income tax law of 1920. The first step was the Government income tax bill presented to the 42nd session of the Diet; the second step was the Government income tax bill presented to the 43rd

session ; the third step was the revision made in the second bill by the House of Representatives ; the fourth step was the new income tax law of 1920. I have already explained the first one, so I shall proceed to explain the others by comparing them with one another.

The income tax bill presented by the Government at the 43rd session of the Diet was practically the same as that which was modified by the House of Representatives in the previous session. It was explained by the Finance Minister Takahashi as follows :

" The income tax now in force is levied to on corporations for their income, but it is not levied on the individual who receive dividends from them. This is likely to create an unbalanced tax burden between the earners of big incomes and those of small incomes. For this reason, the proposed revision of the income tax law aims at taxing individuals for their income from dividends together with their other income all of which form Class Three income. A deduction of 20 per cent is provided for income from dividends, because it may justly be supposed that some expense is incurred in earning that income. But if only individuals receiving dividends are taxed and no tax is levied on corporations themselves, the latter may reserve the greater part of their earnings in order to evade the tax. For this reason, the proposed bill provides for the taxation of the reserve funds of corporations. Furthermore, when the dividend of corporations exceeds eight per cent of their circulating capital, excess income tax is levied on the surplus amount.

" Under the present income tax law, a deduction of 10 per cent is made on earned income, but the proposed bill provides for a deduction of 20 per cent for incomes below 6,000 yen per year, and a deduction of 10 per cent for incomes below 12,000 yen. But no deduction is made for incomes above 12,000 yen, because the Government does not believe in the necessity of any deduction for such big incomes.

"The proposed bill also provides for a deduction of some fixed amount for incomes below 3,000 yen of those who have to support children, disabled, defective or aged persons, because such responsibilities will undoubtedly affect a taxpayer's ability to shoulder the tax burden. The amount of deduction varies with different amounts of income.

"The exemption point is to be raised from 500 yen to 600 yen.

"We have adopted a system of excess progressive rates from a minimum rate of one per cent to a maximum rate of 40 per cent, the latter being applicable to incomes exceeding 5,000,000 yen, whereas the law now in force provides for a minimum rate of three per cent and a maximum rate of 30 per cent for incomes exceeding 200,000 yen.

"The proposed revision provides for the taxation of interest on bank deposits as Class Two income instead of as Class Three income, as such income is regarded under the present law. We have made this revision because in actual practice the taxation of this particular form of income is not properly performed. We propose to tax interest on bank deposits as Class Two income, as and when it is paid. Thus, we made this change for technical reasons.

"The proposed revision separates income from forests from all other incomes for the purpose of effecting taxation at different rates for each class of income."

The Government income tax revision bill was subjected to a modification by the House of Representatives on the lump-sum taxation of corporate dividends. The bill was again modified by the House of Peers on the same point, so that much of its social-political significance was discarded.

When the bill was referred to the House of Representatives from the House of Peers, after modifications therein had been made by the latter House, Mr. Fujiya Suzuki, of the Kenseikai, opposed the adoption of the bill on the ground that the decision of the Lower House, once made, should be respected. On the other hand, Mr. Chuzo Mitsuchi supported the bill as revised by the Upper House, and it was finally

passed by a large majority. After regretting that the bill was sent back to the Lower House from the House of Peers, Mr. Mitsuchi gave his reason for supporting the revised bill in effect as follows :

"I am in favour of accepting this bill as modified by the House of Peers, because the revision does not injure the spirit of the tax law ; the amount of revenue is not changed and therefore the Government's financial policy is not affected. By way of paying respects to the spirit of co-operation between the two Houses, I wish to support the bill as modified by the House of Peers. But I must say a few words as to the criticism made by Mr. Fujiya Suzuki to the effect that the modification made by the House of Peers has overturned the principle of lump-sum taxation. I cannot agree with him on this point. I do not believe this principle has been overturned. If the tax is levied only at the source and no lump-sum tax is levied, then one may say that this principle has been overturned. But as a matter of fact, the bill as revised by the House of Peers provides for the stoppage-at-source taxation as well as the lump-sum taxation."

On the other hand, Mr. Kiroku Oguchi, of the Kakushin Club, who submitted an interpellation, expressed the view that the principle of the lump-sum taxation was overturned by the modification of the bill by the House of Peers, but he supported the bill on the ground that the adoption of the bill was necessary from the point of view of the Government's necessity of securing revenue.

The following are the features of new income tax law of 1920 :

(i) A lump-sum tax is levied on individuals for 60 per cent of their corporate dividends and bonuses.

(ii) The corporate income tax is divided into the following five kinds : the reserve income tax for income which is held in reserve by a corporation instead of paying it out as dividend ; the dividend income tax for corporate income which is paid out as dividend ; the settlement income tax for income which will become a surplus when settled ; the

excess income tax for income which exceeds 10 per cent of the circulating capital.

(iii) The structure of Class Two income was retained and interest on bank deposits for fixed periods was added to it, while the rates on interest on bonds and debentures were raised.

(iv) Various improvements were made in regard to Class Three income. The principle of lump-sum taxation was more thoroughly applied, and not only dividends and bonuses received from corporations but also bonuses received from the Government and other public organizations, as well as income received in territories outside the jurisdiction of the income tax law,—all these are taxed in lump-sums. The exemption point was raised to 800 yen and tax rates were revised. The method of taxing income from forests was changed. The assesment of, and the deductions from, earned income were improved. A special deduction was provided for the first time in Japan for members of one's family one is supporting.

4. The revision of the income tax law in 1926. The income tax law was revised several times on minor points during the period between 1920 and 1926. In 1922 interest on money in trust was included as a taxable form of income. In 1923 all bank deposits, instead of only bank deposits for fixed periods as had been the case hitherto, were included, and the income tax investigation commission was authorized to regard as dividend reserves exceeding some fixed points and to ignore certain actions of corporations. A maximum deduction of 200 yen was also provided for life insurance premia payable by taxpayers or members of their family or their heirs. All these were partial revisions. Major revisions were made in 1926, along the line of corporate income.

The bill for effecting these revisions was introduced during the 50th session of the Diet together with other bills for the adjustment of the tax system, and the substance of the bill was explained in effect as follows by Finance Minister Yuko Hamaguchi.

"The proposed bill will abolish the progressive taxation of the reserve income of corporations. By abolishing the distinction between the reserve income and the dividend income, we wish to levy a proportional tax of five per cent on the total amount of corporate incomes. Under the present income tax law, a proportional tax of five per cent is levied on the dividend income while a progressive tax of from five to twenty per cent is levied on the reserve income. As a result of this distinction between the two forms of income, corporations tend to have reserves that are as small as possible in order to incur the least tax burden, and this, in turn, tends to weaken the financial basis of corporations and jeopardize industrial development in general. The income tax now in force is intended to prevent undue reservation of income by corporations, but as it is applied indiscriminately to all corporations, it results, in actual cases, in an undue taxation of corporations with good intentions; and does not suit the actual circumstances. The bill before the House proposes to abolish the progressive taxation of the reserve income, to do away with the existing distinction between the dividend and reserve incomes, and to levy a proportional tax of five per cent on the total corporate income. The Government are quite mindful of the possibility of tax evasion by holding companies carrying unduly large reserves, but they are desirous of revising the law in order to assure justice in taxation.

"We have decided to deduct from Class One income the amount of the income tax paid during the business year, in order to prevent double taxation between Class One income and Class Two income.

"We intend to raise the exemption point of Class Three income from 800 yen to 1,200 yen.

"The tax on income from forests is calculated by multiplying the amount of the tax on one-fifth of the income by five.

"A deduction of 100 yen each is to be made for each member supported by taxpayers whose incomes are below 3,000 yen per year."

A heated debate was carried on regarding the bill which, however, was passed by the two Houses of the Diet in its original form and became law in March, 1926. Since that time minor revisions have been made but the above measure remains as the income tax law in force at present.

The main features of the revision of the income tax law in 1926 may be summarized as follows:

(i) The structure and rates of Class One income were changed. The progressive taxation on corporate reserve income was abolished and laws regarding holding companies were revised in order to prevent their evasion of the income tax. The distinction between the dividend and reserve incomes was abolished, and a proportional tax of five per cent was provided for the ordinary incomes of corporations. The amount of Class One income tax paid during the business year is deducted from Class One income, in order to prevent double taxation between these two forms of income. The rates for settlement income and the income of foreign corporations were modified.

(ii) The revisions of the tax on Class Three income. The exemption point and deductions for family members dependent on taxpayers for support and for earned income were revised. The method of calculating corporate income was changed from "the estimated total income from which necessary expenses have been deducted" to "the total income of previous year from which necessary expenses have been deducted". The method of calculating income from forests was also changed.

CHAPTER V. OUTLINE OF THE DEVELOPMENT OF OUR INCOME TAX

1. Four stages of income tax. As has been explained, the income tax law in Japan was developed by passing through four stages. The first stage may be described as a period of imitation. During that period our country imported foreign systems for experimental purposes. A categorical

study of the provisions of the laws reveals that they were deeply affected by foreign systems through foreign financial advisers to our Government. It was during the second period that the income tax suitable to our national circumstances came into existence. The spirit of the income tax of this period continued to exist to a large extent down to 1920, and to some extent it even exists to this very day. During the second period the Russo-Japanese War necessitated the increase of revenue and temporary revisions of the income tax law. It was during the third period that thorough-going revisions were made. During this period the World War occurred, and income tax came to occupy a very important place in our tax system. The necessity of embodying social-political considerations the income tax was felt during this period. Fundamental revisions in the structure of the income tax law were made during the fourth period. Thus, our income tax was developed from its crude form of 1887 to the complex modern form it now assumes. The future development of our income tax law will, of course, depend on future conditions, but its general outline can be forecast by its past history.

2. Taxes, monopoly revenue and income tax revenue. An interesting fact is revealed by comparing the following national taxes with the revenue from monopolies: the land tax, the income tax, the tax on *sake* and customs duties. The following table shows figures for the more than 40 years between 1889 and 1935. (1,000 yen)

*Budget

Year	Important tax revenue				Mono- poly revenue	Total	Percentage of the in- come tax to both taxes and mono- poly revenue
	land tax	income tax	tax on <i>sake</i>	customs duties			
1889	42,161	1,052	16,439	4,728	—	71,294	1.47
1890	40,084	1,092	13,912	4,392	—	66,114	1.65
1891	37,457	1,110	14,686	4,539	—	64,423	1.72
1892	37,925	1,132	15,812	4,991	—	67,167	1.68
1893	38,808	1,283	16,637	5,125	—	70,004	1.83

1894	39,291	1,353	16,130	5,755	—	71,286	1.90
1895	38,692	1,497	17,748	6,785	—	74,697	2.00
1896	37,640	1,810	19,476	6,728	—	76,387	2.37
1897	37,964	2,095	31,105	8,020	—	94,912	2.21
1898	38,440	2,351	32,959	9,092	—	97,629	2.41
1899	44,861	4,837	48,918	15,936	—	126,034	3.84
1900	46,717	6,368	50,293	17,009	7,244	141,170	4.51
1901	46,666	6,836	58,017	13,630	10,866	150,441	4.54
1902	46,505	7,460	63,738	15,501	12,367	163,452	4.56
1903	46,873	8,247	52,821	17,378	14,898	161,061	5.12
1904	60,939	14,369	58,286	23,159	27,462	221,824	6.48
1905	80,473	23,278	59,099	36,757	33,602	284,877	8.17
1906	84,637	26,348	71,100	41,853	32,574	316,043	8.34
1907	84,973	27,291	78,406	50,027	35,607	351,591	7.76
1908	85,418	32,144	83,590	40,067	61,419	384,055	8.37
1909	85,693	32,800	91,480	36,423	58,449	381,856	8.59
1910	76,291	31,722	86,701	39,949	62,089	379,375	8.36
1911	74,936	34,755	86,032	48,518	63,336	392,407	8.86
1912	75,365	38,933	93,861	68,496	66,015	426,985	9.12
1913	74,635	35,591	93,223	73,722	69,297	438,777	8.11
1914	74,925	37,157	95,781	44,228	54,587	398,296	9.33
1915	73,602	37,567	84,649	32,165	68,803	381,548	9.85
1916	73,274	51,284	89,837	35,918	67,127	415,800	12.33
1917	73,478	94,649	106,738	45,186	77,592	508,196	18.62
1918	73,527	122,817	120,635	68,937	89,515	608,808	20.17
1919	73,754	193,148	137,626	81,135	74,467	746,853	25.86
1920	73,944	190,344	163,896	69,371	124,124	820,381	23.20
1921	74,130	200,938	176,085	100,941	124,289	910,141	22.08
1922	74,325	229,132	222,585	108,044	129,670	1,026,074	22.33
1923	73,134	163,846	221,497	89,309	130,157	917,360	17.86
1924	71,969	209,992	221,577	119,638	148,231	1,035,469	20.28
1925	74,614	234,971	212,638	111,160	153,029	1,047,837	22.42
1926	68,728	209,577	216,583	150,612	167,403	1,054,402	19.58
1927	67,576	215,070	242,037	140,600	173,257	1,071,931	20.06
1928	67,821	206,741	235,749	150,944	177,201	1,093,111	18.91
1929	67,484	199,851	242,562	136,096	177,803	1,071,308	18.65
1930	68,035	200,616	218,854	105,379	198,339	1,033,380	19.41
1931	63,915	144,501	188,798	114,274	190,461	925,965	15.61
1932	58,348	136,131	177,395	105,375	177,906	873,743	15.58

1933	58,137	159,706	208,865	113,962	179,266	927,833	17.21
1934*	58,265	165,076	218,571	114,273	188,155	963,418	17.13
1935*	57,922	195,888	212,562	129,955	195,711	1,024,452	19.12

The tax revenue of the first period was largely made up of the tax on land and *sake*, and income tax was less than customs duties, its amount being between 1.47 per cent and 2.41 per cent. During the second period, revenue from government monopolies was added, but it was more than the amount of the income tax revenue, the land tax and the tax on *sake* still being predominant. But the income tax revenue increased from 3.84 per cent to 9.12 per cent during this period.

The conditions at the beginning of the third period were substantially the same as those in the second period, but with the outbreak of the World War, the revenue from the income tax greatly increased and in 1919 it constituted 25.86 per cent. In that year the income tax revenue was at the head of the list of revenues, the tax on *sake* being second, customs duties being third, followed by the revenue from monopolies and the land tax. In the early part of the fourth period, the income tax revenue still kept its place of predominance, but with the post-bellum depression the income tax revenue took a downward trend, while Government income from the land tax, the tax on *sake*, customs duties and revenue from monopolies maintained their high positions as during the World War. As the result of this, the order of the various revenues was as follows: first, the tax on *sake*, second, monopoly revenues, third, the income tax, fourth, customs duties, fifth the land tax. The percentage of the income tax to the total tax revenue and revenue from monopolies during the fourth period was 23.2 per cent. Since then the percentage has further declined, and it was little more than 19 per cent in 1935. However, the income tax has been steadily developed during the past 47 years and has remained the centre of Japan's direct taxes.

CHAPTER VI. CONCLUSION

1. Chronological record of the adoption of the income tax by different countries. The following table gives a chronological record of the adoption of a national income tax by different countries. (The record is given both in the Western and the Japanese calendars. I have adopted the results of the investigation made by Popitz after having made some necessary revisions therein.)

1. Great Britain in 1798 (the tenth year of the Kwanei era).
2. Switzerland in 1840 (the eleventh year of the Tempō era).
3. The United States in 1862 (the second year of the Bunkyo era).
4. Italy in 1864 (the first year of the Genji era).
5. Serbia in 1884 (the seventeenth year of the Meiji era).
6. South Australia in 1884 (the seventeenth year of the Meiji era).
7. **Japan in 1887** (the twentieth year of the Meiji era).
8. New Zealand in 1891 (the twenty-fourth year of the Meiji era).
9. Holland in 1893 (the twenty-sixth year of the Meiji era).
10. Tasmania in 1894 (the twenty-seventh year of the Meiji era).
11. Austria in 1896 (the twenty-ninth year of the Meiji era).
12. Spain in 1900 (the thirty-third year of the Meiji era).
13. Hungary in 1909 (the forty-second year of the Meiji era).
14. France in 1914 (the third year of the Taisho era).
15. Czechoslovakia in 1914 (the third year of the Taisho era).
16. Russia in 1916 (the fifth year of the Taisho era).
17. Greece in 1919 (the eighth year of the Taisho era).
18. Luxemburg in 1919 (the eighth year of the Taisho era).
19. Belgium in 1919 (the eighth year of the Taisho era).
20. Germany in 1920 (the ninth year of the Taisho era).
21. Bulgaria in 1920 (the ninth year of the Taisho era).
22. Poland in 1920 (the ninth year of the Taisho era).
23. Brazil in 1922 (the eleventh year of the Taisho era).
24. Rumania in 1922 (the eleventh year of the Taisho era).

There are several points to be observed in the foregoing chronological list. In the first place, as to the adoption of the income tax by Great Britain, some believe that its origin is tracable to the triple assessment of 1798, while others consider it is to be traced to the new income tax act of 1799. I have followed the former view in compiling the above list. As to the adoption of the national income tax

by the United States, Popitz traces its origin to the first income tax act of July, 1862. In my view, however, the full-fledged income tax should be traced to the new income tax act of 1913 which took effect after the amendment of the Federal Constitution.

Our Japanese income tax which was adopted in 1887 (or the twentieth year of the Meiji era) is seventh in the order of the adoption of the income tax among nations.

2. Circumstances attendant on the adoption of the income tax by different countries. As in the case of all social systems, the time of the adoption of the national income tax by different countries was naturally affected by various circumstances and the contents of the tax were also similarly affected. This will be seen in the case of such countries as the United States, Great Britain, France, Germany, Russia, and Italy.

Let us first take the case of the United States. The state income tax had existed since the formation of the United States through the amalgamation of the different states, but it was in July, 1862, that the first Federal income tax came into existence. It then had only a feeble existence and indeed was often abolished only to be re-adopted, until an amendment was effected in the Federal Constitution whereby the long standing criticism that "the Federal income tax was a violation of the Constitution" was forever swept away. The new income tax act was adopted in October, 1913, and it has come down to this day.

In Germany a tendency to decentralisation was quite strong because of the historical circumstances of its origin and the iron law "direct taxes are to each state and indirect taxes to the Empire" was in force. In consequence, the income tax was developed as a state tax instead of an imperial tax. But after the adoption of a centralised system of government which was based upon the Weimar Constitution, the M. Erzberger reform was effected, and the income tax was transferred from the states to the Empire. It was because of the above-mentioned historical circumstances that

the development of the income tax in Germany was especially delayed.

In France, the income tax was looked at askance because the real taxes based on the principle of external indications had long held sway over the people's minds, and the income tax was regarded as opposed to the declaration of human rights which was the spirit of the French revolution. Thus, more than 200 bills for the adoption of the income tax were killed by the French legislature. It was as late as 1914, the year in which the World War broke out, that France adopted the income tax.

Lastly, let us see the case of Great Britain. The income tax was legislated in 1798 only to be abolished in 1802. It was re-adopted in 1803. Then after a period of making and unmaking, it finally came to remain as a permanent tax in the British tax system. The British income tax of 1803 was a schedule system based on the principle of the stoppage-at-source system, incomes being classified as A, B, C, D, and E. Thus, it was far from the lump-sum income tax. It was in 1910 that Mr. Lloyd George adopted a super-tax on income which was later re-named as a surtax on income. This tax together with the established schedule system gave rise to a lump-sum taxation on income. We should also observe the notable fact that the Italian income tax was enacted with the object of attaching importance to production, and that the Soviet income tax is intended as a means of realising the spirit of social revolution.

Professor E.R.A. Seligman says that the origin of the income tax is closely associated with the development of commerce and industry, with the widespread diffusion of the money economy and the consequent emergence of new forms of wealth which could not be reached by older forms of taxation. These factors do not, to my mind, constitute a sufficient cause. For the establishment of the income tax in a country, its political and social conditions must be satisfied. We have seen that the constitutional provisions of the United States retarded the development of the income

tax in that country, that Germany's political principle of economic distribution delayed the adoption of its income tax, and that the spirit of the French revolution did not allow the adoption of the income tax until just before the outbreak of the World War. We have also seen that even Great Britain, which experienced industrial revolution ahead of all other nations, had been bound by the power of its tradition and had to remain satisfied with the schedule system of income taxation until 1910. All these show that the special circumstances of nations considerably affect their tax systems.

3. The adoption and development of the Japanese income tax. Our income tax was adopted in 1887 and underwent big revisions in 1899 and 1920. Minor revisions made thereon number more than 20. It should be observed that the income tax of all nations was in its infancy when our country adopted it in 1887. At that time the British income tax had just discarded its war-time complexion, had passed a period of transition, and had just entered a period of permanent taxation. The British tax was still based on the principle of the stoppage-at-source system, and its rates were proportional. In the United States there was a period of transition in which the Federal income tax was abolished in 1871 and was revived in 1894. France was in a period of adjustment following the Franco-Prussian War, and no proposal regarding income tax was likely to be realized. Italy adopted the national income tax in 1864. It was drastically revised in 1877, the revised income tax forming the basis of the existing Italian income tax. But the income tax at that time was a crude tax on the revenue from movables. In Russia there was no question of any form of income tax.

Viewed from contemporary finance, the Japanese income tax law of 1887 was a very simple tax. But inasmuch as it was a progressive tax based upon the principle of lump-sum taxation, it was much more advanced than those in Great Britain and Italy. What was the model of the Japanese

income tax law which was so advanced? It was modelled after the German system. In Germany at that time there was no national income tax. There was an income tax having the spirit of lump-sum taxation in the state of Prussia, and this might have affected the Japanese income tax of 1887. At any rate, it is noteworthy that such a progressive income tax existed in Japan at that early date. Our income tax of 1887 was fundamentally revised in 1899, and the classification of three forms of income made at that time remains today as the fundamental feature of our income tax. In 1920 a new income tax having a more thorough-going principle of lump-sum taxation was adopted, and it is still in force.

It is rather surprising that our country, which joined the family of nations comparatively recently, should have adopted the income tax ahead of Western countries and that it should have such modern features. However, this is not limited to the income tax law but may be said of all our social systems. To have a thorough-going insight into this phenomenon, a special inquiry of the students of the history of economy will be necessary, but I have the following theory about the development of our income tax.

At the time of the adoption of our income tax in 1887 our tax system was not an established order, and our finance was a virgin field in which new systems might be tried. We may therefore suppose that the pioneers of our finance, at the suggestion of foreign financial advisers, without hesitation planted in that virgin field what was considered to be a progressive system. On the other hand, the old countries of Europe had tax systems which were too rigidly established for the adoption of new elements in taxation. To adopt new elements, these countries had to destroy the old systems. But Japan had no established tax system which had to be destroyed in order to make progress. The fact that our finance was a virgin field for an advanced tax system was responsible for the adoption and development of an income tax which was disproportionately advanced for our country.

The fact remains, however, that our income tax at that time was advanced only in respect of its legal provisions and that its progressive elements were not in evidence in actual practice. It is doubtful whether our legislators at that time had any articulate knowledge of what "income" was. At the time when the concept of the proportional tax was unintelligible to our financiers, the real meaning of the progressive tax must have been unknown to them. But this must have been more or less true as regards other social systems also.

Some social systems come into being at the demand of society, while others first come into being and society accepts them. The former is shown by the examples of Western nations in regard to their income tax, and the latter is exemplified by our own case. We may therefore say that while a study of British history will be sufficient for investigating the British income tax, in order to understand our own income tax not only is a study of the history of our own finance necessary, but a study of that of Western nations is necessary as well.

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