Special Reports

International Taxation in Japan: A Historical Overview

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Given the weight of the Japanese economy in a global market, it is increasingly important to have an understanding of Japanese tax rules. Indeed, good information is now available in English to learn the current status of Japanese law.[1] However, one can fully appreciate the present system only when one knows its historical background.

The purpose of this article is to provide a historical overview of the Japanese corporate tax rules on inbound and outbound transactions. The particular Japanese experience may be of more general interest because it shows a pattern of legal evolution similar to many other jurisdictions.[2]

The Japanese corporate income tax is a hundred years old.[3] The first half of the tax's history was relatively quiet on the international front. It was after WWII that many issues emerged. The core of the present international tax rules was framed in the early 1960s, when the Japanese economy turned itself into an open system. Since the oil shock in the early 1970s, various countermeasures have been introduced. The current Japanese tax rules face the challenge of globalization, accelerated by the advent of information technology. The evolution of international tax rules in Japan demonstrates a pattern of how tax law changes as a traditional rural economy adapts itself to a modern global environment.

This article proceeds in a chronological order. It focuses on major legislative changes in the following stages:

- early years (1899-1940);
- the war period (1940-1945);
- postwar reforms (1945-1962);
- establishment of the core system (1962-1973); and
- additions of countermeasures (1973-present).

I. Introduction of Corporate Income Tax in 1899

It was in 1899 that Japan first introduced an income tax on corporate taxpayers. The Income Tax Law of 1899 classified three types of income. The first type was corporate income, which was

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[1]Hugh J. Ault, *Comparative Income Taxation, A Structural Analysis* (1997). For a selected list, *see* http://www.j.u-tokyo.ac.jp/~masui (last visited November 29, 2000).

[2]Minoru Nakazato, *The Impact of International Tax Law on Japan's Economic Growth*, in A Final Draft Report from FAIR to the World Bank on "Taxation and Economic Growth" (Asian Miracle Project) 147 (1993).

[3]Hiroshi Kaneko, *Sozeiho*, 49 (7th ed., 1999).

taxable at a flat rate of 2.5 percent (article 3).

In the initial stages, tax provisions were fairly simple regarding inbound and outbound transactions. When a corporation had a residence in Japan, it was taxable on all its net income (article 1). The residence of a corporation was determined according to the articles of incorporation under the Commercial Code. A corporation having a head office in Japan was taxable on its worldwide income (article 5, item 6). When the corporation was not a resident, it was taxable to the extent it derived income from its "asset or business" within Japan (article 2). No further rule existed to clarify how to determine if an asset was within Japan, or how to attribute revenue and expenses to the business within Japan (article 4, item 1).

In its early years, the corporate income tax was not a big revenue raiser. In 1910, 11 years after its introduction, the corporate income tax financed only 2.2 percent of the total national tax revenue. Major revenue raisers at the time were the land tax (24.0 percent), liquor tax (27.1 percent), and customs duties (12.3 percent).[4]

II. Corporation Tax Law of 1940

In 1940, a major tax reform placed a revenue priority on income taxation. The 1940 reform was a response to the revenue need to finance the war on the Asian continent. The Income Tax Law was significantly amended, and the Corporation Tax Law was separated from the Income Tax Law. Under the new Corporation Tax Law (Law No. 25 of 1940), corporate taxpayers were taxable on their net income at the rate of 18 percent; they were also taxable on their capital at the rate of 0.15 percent (article 16).

Under the Corporation Tax Law, the provisions on inbound and outbound transactions remained almost the same as under the previous law (article 2). The residence of a corporation was determined by looking at the location of its head office in the articles of incorporation. The 1940 law itself did not use the term "domestic corporation" or "foreign corporation." However, it had the idea of classifying corporations into domestic and foreign, taxing them differently. A domestic corporation was taxable on its worldwide income. A foreign corporation was taxable on income derived from its "asset or business" within Japan at the rate of 28 percent (article 16, item 1), which was 10 percentage points higher than for domestic corporations.

The Shoup recommendation did not touch upon the international aspects of the corporate income tax.

In addition to the corporation tax, the 1940 Income Tax Law imposed a withholding tax on interest and dividends paid to corporations (article 3)

When WWII ended in 1945, the revenue share of the corporation tax was 11.2 percent among all national taxes. Individual income tax had a 37.0 percent share.[5] Income taxes, both individual and corporate, became the largest revenue raiser for Japan.

III. Tax Reform After WWII

A. Impact of Shoup Recommendation

After the war, the Constitution of Japan was promulgated November 3, 1946, and came into effect May 3, 1947. The new constitution drastically changed the political, economic, and social environment in which taxes were levied. Lands were distributed to tenants, corporate monopolies (zaibatsu) were dissolved, labor unions gained power, and family law underwent an overhaul.

The tax system also experienced a number of major changes. In 1949, a tax mission visited Japan. The mission was led by Dr. Carl S. Shoup of Columbia University. The mission's aim was to make a comprehensive recommendation on the Japanese tax system.[6] Dr. Shoup believed that income taxation should play a central role in the Japanese tax system. The essence of his advice was to broaden the income tax base and to reduce the highest marginal tax rate. Corporations were seen as an aggregate of individuals; therefore a corporate income tax was to be integrated with an individual income tax. The mission recommended a dividend-received credit for individual shareholders. Most of the recommendations became law in 1950.

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[4]Takehisa Hayashi and Katsuhito Imai, ed., *Public Finance in Japan, Historical Statistics* (4th ed. 1994), at 70.

[5]Hayashi and Imai, *supra* note 4, at 70.

[6]Report on Japanese Taxation by the Shoup Mission (1949, reproduced by Japan Federation of Certified Public Tax Accountant's Associations in 1979). For a retrospective overview, Carl S. Shoup, "The Tax Mission to Japan," 1949-50, in Malcolm Gillis, ed., *Tax Reform in Developing Countries*, 177-232 (1989) and the Japanese Society for Tax Law ed., "The Significance and Problems of the Shoup Recommendations: examination after 50 years," *Japan Tax Law Review* Vol. 28 (2000).

The Shoup recommendation did not touch upon the international aspects of the corporate income tax. Japan was then still under the occupation of the Allied Forces. Thus, it was possible to formulate a tax policy under the assumption of a closed economy. Accordingly, the distinction between domestic and foreign corporations remained intact as under previous law.

B. Introduction of Foreign Tax Credit

In 1951, a peace treaty was signed in San Francisco, and Japan became independent again. As a result, international trade gained momentum.

In 1953, the foreign tax credit system was introduced into the Corporation Tax Law.[7] Before 1953, foreign taxes were only deductible expenses. Compared with the old rule, the new foreign tax credit was a favorable measure for most corporations engaged in international transactions. After 1953 resident corporations were able to elect either the foreign tax credit or the deduction. The foreign tax credit was subject to a per-country limitation, so that the upper limit for the credit was calculated on a country-by-country basis, rather than an overall basis.

In 1954, Japan entered into a tax treaty with the United States. In the same year, foreign corporations were exempted from taxation on certain items of income when they were subject to the Income Tax Law (Corporation Tax Law article 5-4). The exempt items were:

- interest on governmental and corporate bonds;
- interest on bank deposits;
- distributions from jointly administered investment trusts;
- distributions from silent partnership arrangements;
- royalties from industrial property rights and technological rights; and
- interest on loans associated with domestic business.

C. Modification of Shoup Tax System

In the late 1950s, Japan experienced spectacular economic growth. In this process, the Shoup tax system was gradually modified. A growing number of special measures were introduced to stimulate capital accumulation and economic development. These special tax measures eroded the corporate tax base. Some incentive measures were specifically aimed at stimulating exports.

The tax reform in 1962-63 was the most significant period in the historical development of Japan's international tax rules.

In 1955 Japan joined the GATT regime and consequently faced the charge of granting undesirable export subsidies. The government had to resort to "export drives" several times to mitigate the turbulence in trade balance. It was only after 1964 that export incentives were shut down.[8]

Despite the tax-base erosion, Japan's rapid economic growth increased the revenue proportion of the corporate income tax. Among total national taxes, the corporate tax had a revenue share of 18.7 percent in 1950, 24.9 percent in 1955, and 36.6 percent in 1960.[9]

Regarding inbound and outbound transactions, the corporate tax rule remained essentially undeveloped from what it had been in 1940. A number of tax issues emerged. The old rules were unable to catch up with the increase in sophisticated international transactions.

IV. Establishment of Core System: Tax Reform in 1962-63

A. 1962 Reform: Setting the Framework

It was against this background that the corporate tax reform was undertaken in 1962. The 1962 tax reform provided the legislative foundation for the corporate taxation of inbound and outbound transactions. Its basic rules are still alive today.

The 1962 reform had three features. First, the source rule became specific and workable. The 1962 Corporation Tax Law did not change the definition of "foreign corporation." However, it explicitly introduced the concept of "source." The foreign corporation was to be taxable on its Japanese-source income (article 1(1), item 2). In drafting the law, the Japanese policymakers utilized insights gained from comparative legal studies and from their experience in treaty negotiations.

Second, regarding business profits of a foreign corporation, taxation was only possible if the

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[7] Hiroshi Kaneko, "Basic Structure of the Foreign Tax Credit System of Japan," 40 *Bulletin for International Fiscal Documentation* 148 (1986).

[8] Hideaki Sato, "Japanese Tax Preferential Treatment on Exports," 3 *General Tax Studies* 79 (1995).

[9] Hayashi and Imai, *supra* note 4, at 70.

corporation had a permanent establishment in Japan (article 1(4)). A foreign corporation had a PE when it had a branch, local office, business office, factory, or other fixed place of business in Japan. This rule was introduced in the domestic law itself, rather than only in a treaty. Nevertheless, the Japanese domestic law defined the concept of a PE along the lines commonly adopted in tax treaties.

Third, the foreign tax credit was expanded significantly (article 10-3), as follows:

- In addition to a per-country limitation, an overall limitation was provided at the election of a taxpayer; the overall limitation was welcomed by corporations that operated in more than two foreign countries;
- an indirect foreign tax credit was introduced, so a parent corporation could credit taxes paid by its foreign subsidiaries when it received dividends; and
- the scope of the credit was broadened to cover those taxes paid to local governments in a foreign jurisdiction.

Notwithstanding the 1962 reform, the definition of a domestic corporation remained formalistic. As explained earlier, the test for becoming a domestic corporation was to have a head office in Japan. The head office was designated in a corporation's articles of incorporation and registered under the Commercial Code. The head office did not necessarily coincide with the place where business was actually conducted. Since then, tax policymakers have been consistently opposed to adding a "place of effective management" test in determining the residence of a corporation.[10]

B. 1963 Reform: Expanding Foreign Tax Credit

In 1963, the foreign tax credit system was further expanded: (1) carryover rules were introduced for excess credits and excess foreign taxes; and (2) the credit was now subject only to an overall limitation, and the old per-country limitation was discarded.

C. Significance of 1962-63 Reform

The tax reform in 1962-63 was the most significant period in the historical development of Japan's international tax rules. For inbound transactions, this reform clarified that without a PE in Japan, a foreign corporation's business profits were not taxable in Japan. For outbound transactions, foreign taxes were creditable under a rather generous limitation.

One leading commentator characterizes the 1962 reform as an 'Americanization' of Japanese domestic tax laws.

One leading commentator characterizes the 1962 reform as an "Americanization" of the Japanese domestic tax law.[11] According to another commentator, who traced the roots of Japan's source rule, "Japanese international tax law . . . can be said to be a mixture of European and American systems."[12]

The years 1962-63 were considered to be the period when Japan was rapidly moving toward an open economy environment. In 1963 Japan became an article 11 country under the GATT, so it was no longer possible to restrict imports due to trade imbalances. In 1964 Japan became an article 8 country of the IMF and a member of the OECD. Around the same time, Japan concluded nearly 30 tax treaties in line with the OECD model tax treaty. Currently, it has 44 treaties.

During the 1960s, the volume of Japan's international trade skyrocketed. In 1961, Japanese exports were worth US $4,149 million, while imports were worth US $4,707 million. In 1971, exports were worth US $23,566 million, and imports US $15,779 million. Until the oil shock hit the Japanese economy in 1973, the annual increase ratio of exports was more than 20 percent, on average.[13]

V. Antiavoidance Legislation Since 1970s

A. Economic Downturn

Japan's miraculous economic growth ended in 1973. After 1974 the Japanese gross national product grew in real terms no more than 6 percent annually even at its best year.[14] And the fiscal deficit accumulated.[15]

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[10]The Tax Committee Report of 1963, Section 3.7, and the Report by the Small Committee on Corporate Taxation of 1996, Chapter 2, 16 (1). For an analysis, *see* Konosuke Kimura, *Kokusai Zeiho* 340 (2000).

[11]Yoshiakira Komatsu, *Lectures on International Tax Law*, 7 (1998).

[12]Tadatsune Mizuno, "The Basic Concepts of International Taxation and Their Application to Japanese Law," 22 *University of British Columbia Law Review* 159, 182 (1988).

[13]Shigetsugu Okumura et al. ed., *Data World Economy*, 111 (1990).

[14]Okumura et. al, *supra* note 13, 101. For fiscal years 1997 and 1998, the GNP growth rate was negative. It turned positive in 1999. *See* http://www.epa.go.jp/html/monthly.html (visited on November 29, 2000).

[15]*See* http://www.mof.go.jp/english/budget/brief/2000/brief01.htm (visited on November 29, 2000).

The period after 1973 is characterized by the successive introduction of antiavoidance legislation,[16] most notably the following:

- anti-tax-haven legislation in 1978;
- transfer pricing legislation in 1986;
- tightening the foreign tax credit in 1988; and
- thin capitalization legislation in 1992.

B. Anti-Tax-Haven Legislation

In 1978, a countermeasure was introduced against the subsidiary operations in tax havens (Special Tax Measure Law articles 40-4 and 66-6).[17] The minister of finance specifically listed the names of tax havens. The countermeasure applied to both individual and corporate shareholders.

Under the new rule, undistributed profits of certain foreign subsidiaries in tax havens were taxable at the level of the parent corporation. These foreign subsidiaries were called "foreign related corporations," and they included such foreign corporations that more than 50 percent of their issued stock was directly or indirectly owned by the domestic corporation.

In subsequent years, the following amendments have been introduced to tighten the rule.

First, under the original rule, a tax haven subsidiary (S) was able to distribute its profits as a dividend to a related corporation (R) in a non-tax-haven country, which would reduce the amount of accumulated profits that should have been taxable at the domestic parent corporation level. If R was a resident in a jurisdiction that granted participation exemption, R was able to receive the dividend without paying taxes. This technique was frequently used to avoid the countermeasure. In 1985, these dividends were made a nondeductible item in the computation of accumulated profits of the tax haven subsidiary.

Second, in 1988, parent companies became obliged to file the accounting documents of tax haven subsidiaries, even if these subsidiaries were exempt.

Third, before the 1992 amendment, the minister of finance released a list of designated tax haven jurisdictions. The countermeasure had been applicable only when a subsidiary had a head office in one of the designated tax havens. Beginning in 1992, a subsidiary was subject to this countermeasure when its head office was located in a country where the office's income tax burden was less than 25 percent of its income.

The period after 1973 is characterized by the successive introduction of antiavoidance legislation.

Finally, the 1992 amendment also expanded the scope of shareholders subject to this rule. Before the amendment, a 10 percent shareholding was necessary for this countermeasure to apply. After the legislative change, the holding requirement was reduced to 5 percent. Accordingly, when a domestic parent company owned 5 percent or more of the issued stock of a foreign subsidiary in a tax haven jurisdiction, the countermeasure applied.

The anti-tax-haven provision aimed at preventing abusive operations, rather than eliminating deferral altogether.[18] Exceptions to this countermeasure were allowed under certain conditions. One condition was that the tax haven subsidiary must be engaged in an active business with substantial "management and control" (Special Tax Measure Law article 66-6(3)).

Two cases have been reported in connection with this "management and control" test. In one case, Tokyo District Court Decision of September 19, 1990, Shomu Geppo 37(4)757, failed to find sufficient management and control at the local subsidiary level. The decision was upheld by Tokyo High Court Decision of May 27, 1991, Gyosei Jiken Saiban Reishu 42(5)727. Another case, Kumamoto District Court Decision of July 27, 2000, still not published, also found there was no local management and control, thus disqualifying the corporation for the exception.

The law specifically denied the above exception if the tax haven subsidiary was a certain holding company (article 66-6(3), first parenthetical). Accordingly, the countermeasure applied to the holding company located in tax haven jurisdictions. In Shizuoka District Court Decision of November 9, 1995, Shomu Geppo 42(12)3042, the court held that the local subsidiary was indeed a holding company in the given business year and that the exception did not apply.

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[16]For the situation in the late 1980s, *see* Kaneko and Gomi, "Outlook for Japan," in Herbert Stein ed., *Tax Policy in the Twenty-First Century* 148 (1988).

[17]Brian Arnold, *The Taxation of Controlled Foreign Corporations: An International Comparison* 266-294 (1986).

[18]Yoshihiro Masui, "Comment: A Japanese View," 52 *SMU Law Review* 541 (1999).

C. Transfer Pricing Legislation

In 1986, a transfer pricing provision was introduced in the Special Tax Measures Law (article 66-4).[19] Even before its introduction, a number of transfer pricing cases existed involving a Japanese automobile corporation with foreign sales subsidiaries.[20] In one case, a correlative downward adjustment was disputed. In Tokyo High Court Decision of March 28, 1996, Shomu Geppo 42(12) 3057, the court held that the local government must give the taxpayer a refund for fiscal years before 1986.

The transfer pricing legislation followed a general pattern among OECD countries — it conformed to the arm's-length principle and to article 9 of the OECD model tax treaty, in particular. In essence, the provision deemed the transaction price of a corporation to reflect an arm's-length price in the computation of corporate income for tax purposes.

A transfer pricing adjustment was to be made when a corporation entered into a transaction with a "foreign related party," which was defined as a corporation more than 50 percent of whose issued stocks were directly or indirectly owned by another corporation or the same person. Also, a foreign party was deemed to be "related" when it met certain conditions, such as management influence and dependency on business terms.

The "arm's-length price" was determined according to one of the following three basic methods: the comparable uncontrolled price method (CUP), the resale-price method (RP), and the cost-plus method (CP). When these methods were not available, it was possible to employ other methods.

In 1991, the following revisions were made to strengthen the enforcement of the transfer pricing rule:

- the entire amount of donations made to a foreign-related party was made nondeductible;
- the statute of limitations for making a transfer pricing adjustment was extended from 3 to 6 years;
- for the collection of corporate income taxes, the statute of limitations was suspended for one year for transfer pricing adjustments;
- in the field audit process, tax officials were granted the power to investigate the books of unrelated corporations whose businesses were comparable to the case in question; and
- domestic corporations were required to submit an information return specifying the operating profits and expenses of foreign-related corporations in the previous accounting year.

Transfer pricing provisions were introduced in 1986.

D. Limitation on Foreign Tax Credits

The limitation on foreign tax credits has been tightened over the years. This development was in response to some cases that made an aggressive use of the rather generous overall limitation.

In particular, the 1988 reform made the following revisions (Corporation Tax Law article 69).

First, the corporate taxpayer must reduce 50 percent of the amount of exempt foreign-source income when computing foreign-source income. This measure aimed at preventing high foreign taxes to be charged against exempt foreign-source income. The corporate taxpayer was obliged to reduce 66.67 percent, instead of 50 percent, beginning in 1992.

Second, when corporate taxpayers earned more than 90 percent of their income from foreign sources, a ceiling was introduced. The creditable amount of foreign taxes was accordingly limited to no more than 90 percent of the corresponding amount that was otherwise available.

Third, the scope of creditable foreign taxes was restricted. When the corporate taxpayer was taxed at a rate of more than 50 percent in foreign jurisdictions, the amount in excess of 50 percent was excluded from the creditable taxes. In a similar vein, if the withholding tax rate imposed on interest exceeded 15 percent, the excess portion was made not creditable.

Fourth, cross-crediting was restricted with regard to an indirect tax credit. Suppose that a foreign subsidiary had incurred the corporation tax in a foreign country, and had withheld taxes when paying dividends. In total, an effective tax rate may become higher than the Japanese tax rate. The amount of creditable foreign tax at the parent corporation level

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[19] The original provision in 1986 was numbered as article 66-5.

[20] For its legislative history, *see* IBFD, *The Tax Treatment of Transfer Pricing: Japan* 16 (written by Toshio Miyatake, 1994). For issues in secondary adjustments, *see* Hiroshi Kaneko, "Legal Aspects of the Transfer Pricing System," *Bulletin for International Fiscal Documentation* 49(10) 490 (1995). *See also*, Joseph H. Guttentag and Toshio Miyatake, "Transfer Pricing: U.S. and Japense Views," *Tax Notes Int'l*, Feb. 7, 1994, p. 375.

in these cases was made not to exceed 50 percent of the total amount of dividends received, plus a gross-up for foreign taxes.

Finally, the carryover period for excess credits and excess foreign taxes was reduced from five to three years.

On the other hand, in 1992, the indirect tax credit was extended to second-tier subsidiaries by an amendment to the Special Tax Measures Law. This rule is now incorporated in the Corporation Tax Law (article 69(6)).

E. Thin Capitalization Legislation

In 1992, certain interest payments were not deductible when thin capitalization was involved (Special Tax Measure Law article 66-5).[21] This measure was aimed at countering the base erosion of a thinly capitalized domestic subsidiary of foreign shareholders. Under the new rule, interest payments were partly excluded from a corporation's deductible expenses when the debt of the corporation exceeded three times the amount of its equity capital, and when the loan from the lender exceeded three times the equity capital owned by the lender.

The interest was nondeductible when the debt in question was financed from a "foreign leading shareholder," which was defined as a nonresident or a foreign corporation that could control the corporation in question by owning more than 50 percent of its capital or by maintaining a special relationship with the corporation.

F. More Countermeasures

During the 1990s, more countermeasures were added for both inbound and outbound transactions.

A withholding scheme was introduced in 1990 when a nonresident or foreign corporation sold Japanese real estate (Income Tax Law article 213(1), item (2)). When a foreign corporation sold a patch of land located in Japan, its capital gains were Japanese-source income. The foreign corporation was required to file a tax return and pay the tax due. However, the foreign corporation frequently remitted money abroad and then disappeared before it filed a return. To prevent these sort of practices, 10 percent of the consideration was withheld, if the consideration exceeded ¥100 million. The foreign corporation could credit the withheld amount when it later filed a return.

Despite the ups and downs, the trend toward further globalization has remained strong.

In 1992, another withholding regime was enacted for foreign entertainers (Special Tax Measures Law article 42).[22] Its purpose was to counter the use of an interposed corporation that received the remuneration instead of the entertainers. The withholding rate was reduced from 20 to 15 percent in 1995.

In 1996, a certificate was made necessary for a domestic corporation to claim treaty benefits for dividends.[23] When a domestic corporation wanted to apply a treaty provision that reduced a withholding rate on dividends, the corporation was required to supply a residence certificate that had been issued by a treaty partner.

In 1997, certain "foreign investment and interest income" was specifically included in the Japanese-source income of a foreign corporation (Corporation Tax Law Enforcement Order, article 176(5)). Before the amendment, the scope of Japanese-source income was limited. Suppose a foreign corporation (F) had a PE within Japan. F made a loan to a foreign borrower (B) through the Japanese PE. When F received interest from B, the interest was in principal treated as having a Japanese source. However, under the old rule, an exception was granted. That is to say, F was able to treat the interest as having a foreign source, if it proved the interest was subject to corporate taxes in a foreign jurisdiction. Under the new rule, the interest was treated as having a Japanese source. The rationale for the new rule was that it was F's resident country, not Japan, that should have avoided double taxation. The 1997 amendment was a Japanese response to the triangular situation in international taxation.

Beginning in April 1998, cross-border capital flows were drastically liberalized.[24] Information on money transfers was no longer available to the Japanese

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[21]Yonetaro Ori, Japan, in IFA, *International Aspects of Thin Capitalization*, Cahiers de droit fiscal international, Vol. LXXXIb, 523 (1996); Tadatsune Mizano, "Thin Capitalization Rules: A View From Japan," *Tax Notes Int'l*, Apr. 28, 1997, p. 1407.

[22]Toshio Miyatake, Taxation of non-resident entertainers in Japan, in IFA, *Taxation of non-resident entertainers* 100 (1995).

[23]Enforcement Regulations of the Law Concerning the Special Rules, etc. of the Income Tax Law, Corporation Tax Law and Local Tax Law Incidental to the Enforcement of Tax Treaties, article 2(3).

[24]Yoshihiro Masui, "Taxation of Cross Border Interest Flows: Japanese Responses," in Moris Lehner ed., *Festschrift for Klaus Vogel* __ (forthcoming).

tax authorities after the deregulation in the area of foreign exchange. Therefore, the 1997 Law No. 110 made it obligatory for a person who transmitted money abroad to submit necessary information to tax directors via financial institutions. At the same time, an identification mechanism was introduced to apply the portfolio interest exemption to nonresident holders of bonds (Special Tax Measures Law article 6).

VI. Facing the Global Environment

This article traced the historical development of the Japanese corporate tax rules regarding inbound and outbound transactions. In this article, the period after 1973 was categorized as a single stage. A deeper observation reveals there was a change in the economic climate within this period. Japan recovered from the oil shock more quickly than other OECD member countries.

During the 1980s, the Japanese economy boasted its strength. The Tax Reform of 1988, which introduced VAT at the domestic front, was politically possible partly because the economy was in good shape. The 10-year period after 1990 is often called the "lost decade" for Japan, because Japan suffered severely from the burst of the bubble economy. In the meantime, the corporate tax rate had been reduced from 42 percent in 1988 to 30 percent in 1999 at the national level.

Despite the ups and downs, the trend toward further globalization has remained strong. The legislative measures enacted on the international front since 1973 can be seen as a response to the global environment in which capital moves across borders more easily.

Annex: Timetable

1899: Introduction of the Corporate Income Tax

1940: Separation of Corporation Tax Law from Income Tax Law

1949: Shoup Recommendation

1951: Peace Treaty

1953: Introduction of Foreign Tax Credit

1954: First Tax Treaty (with the United States)

1955: GATT Membership

1962: Establishment of Source Rule, Permanent Establishment for Business Profits, and Expansion of the Foreign Tax Credit

1964: OECD Membership

1978: Introduction of Anti-Tax-Haven Legislation

1986: Introduction of Transfer Pricing Legislation

1988: Limitation on Foreign Tax Credit

1992: Introduction of Thin Capitalization Legislation. ✦

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