Transformation of Japan's Corporation Tax: 1988 to 2000

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Contents
I. INTRODUCTION
II. DECLINE IN REVENUE
III. BUSINESS RESTRUCTURING
A. Background
B. Pure holding companies
C. Financial institutions
D. Share exchanges and share transfers
E. Qualified reorganizations
F. Consolidated returns
G. Analysis
IV. DIVERSIFICATION OF ENTITIES
A. Identification of corporate taxpayers
B. Non-profit organizations
C. Investment funds
D. Securitization
E. Analysis
V. CONCLUSION

I. INTRODUCTION

Japan's corporation tax is in the process of structural transformation. Three trends are evident: a sharp decline in corporation tax revenue, the massive restructuring of business organizations, and the diversification of entities subject to tax.

This article considers the changes underlying the reform of the corporation tax since 1988. The article discusses three developments in particular. First, due to the economic recession and reduction in tax rates, the revenue from the corporation tax dropped sharply during the 1990s. Second, Japanese corporations have restructured their business organizations in order to concentrate on profitable operations and close down unprofitable segments. The tax rules have been changed to facilitate such corporate reorganizations. Third, reforms in the financial sector have produced new legal entities that are subject to corporation tax. As a result, the definition of "corporate taxpayer" has expanded. This article concludes that these three developments are interrelated and are likely to have an impact on the future.

The year 1988 is a good starting point because the major tax reform in 1988 set the current framework for the corporation taxation.[1] Before discussing the changes that have occurred since 1988, it is useful to identify at least three aspects of the corporation tax that have remained unchanged. The first relates to the tax base. As in many other industrialized countries, Japan's corporation tax is designed as a tax on the return of equity holders (Corporation Tax Law, Art. 22).

The second concerns integration. Japan's system has only a modest degree of integration of the tax on corporations and shareholders.[2] Individual shareholders are entitled to a tax credit of 5% to 10% of the dividend distribution; this credit can reduce the individual income tax on the dividend and the tax on income falling in other schedules (Income Tax Law, Art. 92). Individual shareholders may opt out of this system and elect a 35% tax which is withheld from the dividend (Special Tax Measures Law, Art. 8-5). For individuals, net securities gains are taxable at a special 20% rate (Special Tax Measures Law, Art. 37-10).

The third concerns corporate shareholders. Intercorporate dividends may be excluded entirely from taxable income if the shareholding is 25% or more (Corporation Tax Law, Art. 23). If the shareholding is under 25%, 80% of intercorporate dividends are excluded from taxable income. Capital gains from the alienation of shares are fully taxable at the normal rate.

II. DECLINE IN REVENUE

Since the end of World War II, the corporation tax has been a major revenue-raiser in Japan. It contributed approximately 30% to total national tax revenues for most of the period.[3] Since 1990, however, the corporation tax revenue has dropped sharply both in absolute and relative terms (see Table 1).[4]

In absolute figures, the corporation tax produced JPY 18,384 billion in fiscal year 1990. In 1999, the figure dropped to JPY 9,799 billion. Among all the national taxes, the relative share of the corporation tax was 29.3% in fiscal year 1990 and down to 19.6% in 2000. Currently, the corporation tax has the same relative share as VAT (19.5%), which is a much younger tax introduced in 1988.

Two reasons explain the drop in the corporation tax revenue.[5] The first is the burst of Japan's economic bubble.

1. Kaneko, Hiroshi, *Sozeiho* (Tax Law) (Tokyo: Kobundo, 7th revised ed., 2000), at 72.
2. Id. at 188 and 240.
3. Hayashi, Takehisa and Katsuhito Imai, *Public Finance in Japan: Historical Statistics* (Tokyo: Univ. of Tokyo Press, 4th ed., 1994), at 70 (in Japanese).
4. 576 *Zaisei Kinyu Tokei Geppo* (2000), at 19 (monthly journal showing basic statistics). Data are available at <www.mof.go.jp/english/tax/tax.htm> (visited 26 December 2000).
5. See Masui, Yoshihiro, "Designing Consolidated Returns in Japan: Some Policy Issues (1)", 91 *Zeiken* 88 (2000) (in Japanese).

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Table 1: Relative yield of the corporation tax (in billion yen)

Year	Income tax	Corporation tax	VAT
1980	10,800	8,923	–
1985	15,435	12,021	–
1990	25,996	18,384	4,623
1995	19,515	13,735	5,790
1999	15,067	9,799	10,376

During the 1990s, Japan's GDP grew only slowly;[6] thus, the corporation tax revenue did not increase.[7] The second reason is the reduction in tax rates. Prior to the major tax reform in 1988, the basic rate of corporation tax was 42% at the national level. The 1988 reform reduced the rate to 37.5%. In November 1996, the Tax Commission suggested broadening the base and further reducing the rate.[8] In 1998, the rate of corporation tax became 34.5% and, in 1999, it was reduced to 30%. At present, the tax rate amounts to 40.84% if the national and local levels are combined. Rate reduction has come to a halt at the national level. The policy discussions in 2000-01 instead centre on the reform of the local enterprise tax.

If the reason for the decline in revenue were solely the economic recession, the corporation tax revenue will increase again when Japan's economy recovers. Given the massive rate reduction during the 1990s, however, it is difficult to predict that the corporation tax will again become the champion of revenue-raisers in Japan. In this regard, it is important to note that the rate reduction was in response to the claims of business circles that the high effective tax rate hampered the competitiveness of Japanese companies. The policy discussions were coloured by a comparison with the tax rates in other industrialized countries. In an open economic environment, the Japanese government had no other choice but to set the rate in the same range as other countries. According to the current OECD consensus, an across-the-board rate reduction, coupled with expansion of the tax base, does not constitute "harmful" tax competition.[9] Nonetheless, it is hard to deny that there is an element of "competition" among countries to lower the corporation tax rate.

III. BUSINESS RESTRUCTURING

A. Background

The economic recession during the 1990s put strong pressure on the management of Japanese companies. The following reasons explain why Japanese enterprises have restructured their businesses in recent years:[10]

– reduction of expected rate of return;
– reduction of unrealized gains in real property and shares;
– stronger pressure from the capital markets; and
– difficult employment conditions for baby boomers.

For these reasons, corporate management is concerned more about the rate of return than about market share.[11] The key words are downsizing and outsourcing. The number of mergers and acquisitions has increased, especially in the financial sector. Typically, a foreign acquirer retains control of the Japanese target company and sells off unprofitable branches and factories.

In the late 1990s, the Japanese government took several measures to provide a flexible environment for corporate restructuring.

B. Pure holding companies

Art. 9 of the Anti-Monopoly Act[12] was amended in 1997 to permit the establishment of "pure" holding companies. Prior to the amendment, a holding structure was prohibited if the sole purpose of the holding company was to own the shares of controlled subsidiaries. The amendment removed this restriction and focused only on excessive concentration of economic power. The change reflected a policy judgement that businesses should be able to use a "pure" holding structure.

On the tax side, the corporation tax in Japan did not – and still does not – have provisions for consolidated returns.[13] A holding company is therefore not able to offset the losses of its subsidiaries against its own profits. The prevailing view in business circles was that this result was a serious obstacle for companies to move into a holding structure. Many commentators began to argue that Japan should introduce its own consolidated tax return system.

C. Financial institutions

In 1998, as a measure accompanying the reform of the financial system, commercial banks were allowed to move into a holding structure (Law No. 121). To facilitate such restructuring, shareholders were, under certain conditions, entitled to a tax deferral on the gains on shares (Special Taxation Measures Law, Arts. 37-14 and 67-10). This and other tax responses had a limited scope and applied only to the financial sector. These changes were significant, however, because they foreshadowed the rise of non-recognition treatment for corporate reorganizations in general.

D. Share exchanges and share transfers

A new scheme was introduced in the Commercial Code in 1999 for the purpose of establishing a parent-subsidiary relationship with a 100% shareholding. Previously, three methods were possible to form a 100% subsidiary, but each had serious shortcomings.[14]

6. See <www.epa.go.jp/e-e/menu.html> (visited 26 December 2000).
7. See <www.nta.go.jp/category/outline/english/tab/tab15.htm> (visited 26 December 2000).
8. Report of the Subcommittee of Corporate Taxation, 1996, Chapter 1, 1.3.
9. OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998), Para. 41.
10. Economic Planning Agency, *Economic Survey of Japan, Fiscal year 1999* (1999), at 124.
11. Id. at 132.
12. The English text of the Anti-Monopoly Act is reproduced at: <www.jftc.admix.go.jp/e-page/acts/amact.txt> (visited 26 December 2000).
13. Masui, Yoshihiro, "The Corporate Tax Unit", 25 *Japan Tax Law Review* (1997), at 62 (in Japanese).
14. Harada, Koji, et al., *Kabushiki Kohkan Jika Hyoka* (Share Exchange and Mark-to-market Valuation) (Tokyo: Shoji Homu Kenkyukai, 1999), at 21.

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Under the first method, the parent company (P) contributes business assets to a newly formed 100% subsidiary (S). This method is time-consuming because the Commercial Code requires an inspection by a court-appointed inspector. In addition, the procedure is cumbersome because the Civil Code makes it mandatory to notify the debtors individually when loans are contributed to S.

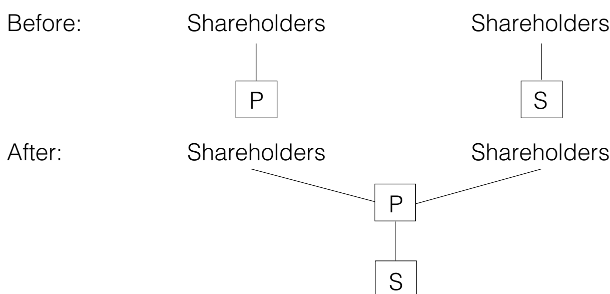
Under the second method, P purchases S shares from the shareholders of S. This method works only if all the S shareholders agree to sell their shares to P. Moreover, P must prepare a large amount of cash.

Under the third method, P issues new P shares to the shareholders of S, who then contribute S shares to P. Again, this method fails if some S shareholders prefer holding S shares and reject the P shares. In addition, under the Commercial Code, there is a ceiling that restricts P's ability to issue new shares.

In view of these difficulties, two schemes were introduced: share exchanges and share transfers.[15]

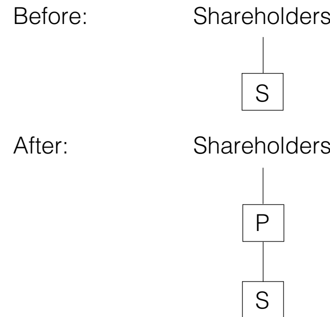
The share exchange scheme, illustrated by Diagram 1, makes it possible for existing corporations to move into a 100% shareholding relationship (Commercial Code, Arts. 352 to 363). The shares owned by the shareholders of S are transferred to P, and P in turn issues its shares to the shareholders of S. As a consequence, P holds a 100% of the shares of S, and the former shareholders of S become the shareholders of P. To reach this result, P and S are required to enter into a written agreement. The agreement must be approved at the shareholders' meetings of both P and S with a two-thirds majority vote by those in attendance, provided that more than half of the shareholders are in attendance. Opposing shareholders of S may request S to buy back the shares that they own. P may increase its stated capital to a certain amount that is fixed by various factors, including S's net assets, the amount of cash paid to the S shareholders, and the book value of the P shares transferred to the S shareholders. P may transfer its treasury shares to the S shareholders instead of issuing new shares.

Diagram 1: Share exchange scheme



Under the share transfer scheme, illustrated by Diagram 2, it is possible to create a new parent company that wholly owns the shares of a subsidiary (Commercial Code, Arts. 364 to 372). A new parent company (P) is created. The shares of S are transferred to P, and P in turn issues its shares to the shareholders of S. The end result is that P holds a 100% share of S, and the former S shareholders become P shareholders. Voting and accounting requirements are similar to those in a share exchange.

Diagram 2: Share transfer scheme



Both schemes removed the barriers to creating a wholly-owned subsidiary structure. A court-appointed inspector is no longer involved, and individual notification to each debtor is not necessary. All that is required is a two-thirds majority vote at the shareholders' meeting.

For tax purposes, share-for-share exchanges are in general a realization event. Therefore, the shareholders of S would be taxable on the gain on their shares at the time of reorganization, unless there were special provisions. The 1999 tax reform introduced a non-recognition treatment at the shareholder level for both gains and losses on the shares in share exchanges and share transfers which meet certain conditions (Special Tax Measures Law, Arts. 37-13-2 and 67-9). The conditions include, among others, that:
- the requirements of the Commercial Code are met;
- P's acquisition cost of the transferred shares of S does not exceed the book value in the accounts of the transferring shareholders immediately before the exchange or transfer (carry-over basis); and
- more than 95% of the value of the transfer from P to S shareholders consists of P shares. In other words, the boot (other consideration such as cash) does not exceed 5%.

At the corporate level, the issuance of new shares does not trigger taxation, but the transfer of treasury shares is a realization event. Therefore, a non-recognition provision was introduced to defer taxation (Special Taxation Measures Law, Art. 67-9-2).

After consummating a share transfer transaction, a corporate group may wish to have a brother-sister relationship, rather than a parent-subsidiary relationship (see Diagram 3). For example, a newly created holding company (HC) owns all the shares of company A as a result of a share transfer. A has its own subsidiary, company B. HC wants to hold the shares of B directly. To achieve this goal, HC purchases the B shares from A with cash. A would be taxable on the gains on the B shares, unless there were special provisions. The new provision ensures that taxation is deferred until HC sells the B shares at a later date (Special Taxation Measures Law, Art. 67-9-3).

15. Ishizuka, Yoichi, "Japan Amends Rules for Tax-Free Reorganizations", *Tax Notes International*, 13 December 1999, at 2211.

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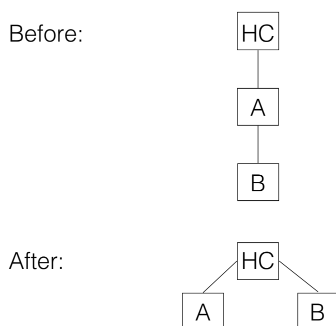
Diagram 3: Brother-sister relationship



The introduction of the share exchange and share transfer schemes makes way for a variety of planning possibilities. For example, it is now easier to create a holding company. A 100% share ownership means that the parent company need not be concerned with the interests of the minority shareholders of a subsidiary. As a result, business decisions become more flexible. In addition, a holding structure may serve as a step to a merger or acquisition. An acquirer can use the share exchange method to obtain the business of a target company. Once the acquirer owns all the shares, it can freely choose different alternatives: hold on to the structure, liquidate the target, or exchange the shares of the target with the shares of other attractive businesses.

The new provision in the Commercial Code became effective on 1 October 1999 and applies only to joint-stock companies. It does not affect companies organized as a limited company, i.e. a company with limited liability, which is another popular form of business entity in Japan.

E. Qualified reorganizations

The demerger provisions were introduced in the Commercial Code in May 2000 (Arts. 373 to 374-31) and apply to joint-stock companies. At the same time, the Limited Company Law was amended to have a similar rule for limited companies (Arts. 63-2 to 63-9). The new provisions will become effective within one calendar year from the day on which the law was promulgated.

Previously, the Commercial Code contained no explicit provisions concerning demergers, while the tax laws provided deferral rules in certain cases where assets were dropped down to subsidiaries from their controlling parent company.[16] The drop-down method was not attractive in practice because a court-appointed inspector is required to evaluate the assets that are contributed and because debtors must be notified on an individual basis. The new demerger provisions are intended to remove both impediments. Incidentally, Japanese practitioners do not use the "spin-off" method[17] for effecting a demerger. In other words, a parent company (P) does not distribute the shares of a subsidiary to the shareholders of P. The legislation in 2000 left untouched the question to what extent spin-offs and other techniques are feasible under the existing Commercial Code.

Since May 2000, when the Commercial Code incorporated the demerger provisions, the tax treatment of demergers became an urgent issue for policymakers. The Government Tax Committee established a Subcommittee on Corporate Taxation, which examined the proper tax rules for corporate reorganizations, including demergers. Members of the Subcommittee visited Germany, France and the United States to study the relevant tax rules in each country. In July 2000, the Tax Committee submitted a report to the Prime Minister.[18] The report emphasized the following points regarding demergers:

– demergers should be treated consistently with mergers and contributions in kind;
– shareholders should be taxed properly on dividends and on capital gains on shares;
– corporate tax attributes should be properly transferred; and
– tax avoidance must be prevented.

After a heated discussion during the summer, a blueprint document was made public on 3 October 2000.[19] The document made clear that the taxation of demergers should not be discussed in isolation. Different legal schemes that have similar economic effects should be treated in the same manner.

On 13 December 2000, the Government Tax Commission submitted a report to the Prime Minister.[20] On the same day, the Liberal Democratic Party made public the general outline of tax reform for fiscal year 2001.[21] Both documents point in the same direction regarding corporate reorganizations. The essence of the relevant parts is summarized below.

The concept of "qualified reorganization" is introduced. In the case of a "qualified reorganization," the taxation of gains and losses on the transferred assets will be deferred.

A "qualified reorganization" consists of a "qualified demerger", "qualified merger", "qualified contribution in kind" and "qualified post-organization contribution in kind". A "qualified demerger" is one of the following:

(a) a demerger between a parent company and a wholly-owned subsidiary;
(b) a demerger between a parent company (P) and a subsidiary (S) where P owns more than 50% but less than 100% of the shares of S and where the following conditions are met: (i) the principal assets and liabilities of an independent business unit are transferred to the receiving corporation, (ii) more than 80% of the

16. Fujieda, Atsushi, National Report on Japan on Subject II: National and international tax consequences of demergers, in *Cahiers de droit fiscal international*, Vol. 79b (1994), at 205 (48th Congress of the International Fiscal Association, Toronto, 1994).
17. Rädler, Albert J., General Report on Subject II: National and international tax consequences of demergers, in *Cahiers de droit fiscal international*, supra note 16, at 553, 565.
18. A short summary in English is available at <www.mof.go.jp/english/tosin/tax/tax001.htm> (visited 27 December 2000).
19. Tax Committee, Basic Directions of the Tax System with regard to Corporate Reorganizations, including Corporate Demergers and Consolidations (2000).
20. See <www.mof.go.jp/english/tax/tax2001.htm> (visited 27 December 2000).
21. See <www.jimin.or.jp/jimin/saishin2000/seisaku-032.html> (visited 27 December 2000).

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employees of the business unit continue to work at the receiving corporation, and (iii) the receiving corporation continues to operate the same line of business;

(c) a demerger for the purpose of a joint venture. The parties should continuously hold the shares acquired in exchange for the transferred assets, and all the conditions in (b)(i), (ii) and (iii) must be met. In addition, either of the following must be satisfied: the sizes of the business units are not considerably different, or the managing directors or the directors of higher standing participate in the management.

"Qualified merger" and "qualified contribution in kind" are defined according to the same criteria as "qualified demerger".

A "post-organization contribution in kind" is "qualified" if the following requirements are satisfied:

– the contribution in kind is scheduled at the time a subsidiary (S) is organized and is actually made within six months after S's organization;
– the parent company (P) owns all the shares of S continuously until the time of contribution; and
– P is not expected to own less than 100% of the shares of S.

Taxation of the gains and losses on the assets that are transferred in the process of a "qualified reorganization" is deferred. Non-recognition treatment is available for "qualified demergers", "qualified mergers" and "qualified contributions in kind". With respect to "qualified post-organization contributions in kind", the gains and losses on contributed assets are initially recognized on the basis of their fair market value but, at the same time, are washed out by the adjustment in book value of the shares of subsidiaries. Regarding non-qualified reorganizations, assets are deemed to change hands at fair market value and are taxed accordingly.

A reserve revenue amount, which is comparable to an earnings and profits account, is carried over in "qualified mergers" and in some "qualified demergers," but not in "qualified contributions in kind", "qualified post-organization contributions in kind" and other "qualified demergers".

At the shareholder level, taxation of the gains and losses on shares is deferred in the case of "qualified mergers" and some "qualified demergers" on the condition that such shareholders receive only shares of the receiving corporation. The amount in excess of the amount of capital, etc. is deemed to be a dividend.

Tax attributes are carried over to the receiving corporation under certain restrictions. For example, a net operating loss carry-forward basically survives after a reorganization, but can be used only if numerous conditions are met.

A comprehensive anti-avoidance provision is introduced in the area of corporate reorganization.

The reform does not affect the treatment of share exchanges and share transfers.

Based on the above summary, the 2001 tax reform bill is expected to be submitted to the Diet in January 2001. In the original plan, the new provisions will apply to corporate reorganizations after 1 April 2001. At the time of writing, the precise content of the bill is not available to the public. In addition, it will take some months before the ministerial orders and circulars are made public. It is certain, however, that this bill will be the first major step in the history of Japan's corporation tax toward developing full-fledged reorganization rules.

F. Consolidated returns

The next step envisaged in the area of corporate tax reform is the introduction of consolidated returns.

As explained in III.B., large businesses in Japan have been strongly in favour of introducing a consolidated tax return system. In the early 1990s, the Japan Tax Association prepared a comparative study of consolidated returns.[22] The Japan Federation of Economic Organizations (abbreviated in Japanese as "*Keidanren*") has consistently claimed the need for introducing some form of consolidation schemes, although the details of the proposals varied from time to time.[23]

Currently, the Government Tax Committee is taking time to consider the appropriate design of a consolidated return system for Japan. The Liberal Democratic Party aims to introduce such a system for fiscal year 2002.

G. Analysis

The mergers and acquisitions tax scene in Japan is changing. Traditionally, there has not been much choice in planning the legal form of a corporate reorganization. Hostile takeovers were rare, and employees stayed at one corporation. Reflecting the stable business environment, the tax rules did not have a well-developed rule for reorganizations, except for mergers and certain types of contributions in kind.

The tax reform consists of three steps. The first, in 1999, was the non-recognition treatment for share exchanges and share transfers. The second is the "qualified reorganization" rule scheduled to be enacted in 2001, and the third is the introduction of a consolidated tax return system, which is likely to be after 2002. The shape of Japan's corporation tax will be different after all the steps have been taken.

IV. DIVERSIFICATION OF ENTITIES

A. Identification of corporate taxpayers

A basic structural decision in the design of a corporation tax is the determination of what entities or organizations should be subject to the tax.[24] One notable feature of

22. Nihon Sozei Kenkyu Kyokai (Japan Tax Association) and Kyuya Inoue (eds.), Renketsu Nozei Seido No Kenkyu (Study on Consolidated Tax Return) (1992).
23. Position papers in English are available at <www.keidanren.or.jp> (visited 27 December 2000).
24. Ault, Hugh J., *Comparative Income Taxation: A Structural Analysis* (The Hague: Kluwer Law International, 1997), at 289.

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Japan's Corporation Tax Law in this regard is the broad definition of "corporate taxpayer". For example, the unlimited partnership company (*Gomei Kaisha* in Japanese) and the limited partnership company (*Goshi Kaisha*) are subject to a corporate-level tax, while their counterparts in France and Germany are treated as pass-through entities.[25] On the other hand, the mainstream companies in Japan have traditionally tended not to use pass-through entities, such as partnerships and trusts, as vehicles to conduct a business.

The issue of identifying corporate taxpayers did not come to the front stage of policy discussion while people used old familiar forms of business organization. In recent years, however, new types of entities have been created, and their tax treatment has become a serious issue.

B. Non-profit organizations

A new law was enacted in 1998 for the purpose of promoting "specified non-profit activities" (Law No. 7 in 1998).[26] Previously, the number of public interest corporations was limited. The new law facilitates the incorporation of non-profit organizations by liberalizing the requirements and procedures.[27]

On the tax side, the issue arose how to treat the new juridical entity created by the new law. The new law basically labelled the entity as a "public interest corporation" for corporation tax purposes, but did not apply a reduced tax rate that was otherwise granted for "public interest corporations" (Law No. 7, Art. 48, Clause 1). Moreover, the new entity was denied a favourable status for purposes of the deduction for charitable contributions when other corporations made charitable contributions to the entity. In effect, the entity was treated in the same manner as a "person without legal personality", meaning that the tax treatment did not change substantially before and after incorporation. This strict attitude reflected fear of abuse since the new law did not require a thorough examination at the time new entities are incorporated.

In the tax reform package for fiscal year 2001, the new juridical entity is expected to be given a favourable status for purposes of the charitable contribution deduction. To guarantee the authenticity of the activities, several requirements will be imposed, including the disclosure of information, the prohibition on certain transactions, and the maintenance of sound governance. This measure will be applicable for both individual and corporate donors.

C. Investment funds

In the past, the structure of investment funds in Japan, at least for funds that invested in securities and were widely offered to the public, was straightforward: only the trust form was available.[28] In 1998, however, in the process of reforming the financial system, a corporate-type investment fund was permitted.[29]

The 1998 tax reform introduced a special tax provision for corporate-type investment funds (Special Tax Measures Law, Art. 67-15). Without a special rule, a corporation per se is subject to a corporate-level tax under the normal rules. A corporation tax on the fund creates serious impediments to the promotion of funds to investors. Most significantly, corporate-type funds are subject to tax at the fund level, whereas traditional trust-type funds do not incur such taxation. In order to mitigate the adverse effect arising from this disparity, distributions from corporate-type funds to investors were allowed to be deducted in computing corporate income at the fund level. This solution does not exactly put corporate-type funds on an equal footing with trust-type funds because the former are still corporate taxpayers while the latter are not.

In May 2000, the law governing investment funds underwent another overhaul. This time, the funds are allowed to invest in securities as well as in other assets, including real estate. The reform affects both trust-type and corporate-type funds. On the tax side, the Corporation Tax Law was amended to expand the definition of corporate taxpayer (Corporation Tax Law, Arts. 82-2 to 82-17). A "specified trust" is now subject to corporation tax at the same rate as an ordinary corporation. At the same time, dividend distributions to the investors continue to be deductible (Special Tax Measures Law, Art. 68-3-4).

D. Securitization

A new law was enacted in 1998 to assist the securitization of assets that were held by corporations. When a corporation has multiple assets, the capital market may not grade the corporation in fair reflection of the real value of a particular asset. Therefore, the corporation forms a "special purpose vehicle" (SPV) to which the corporation transfers the asset. The SPV issues bonds and preferred shares that enjoy an enhanced grading. The originator-corporation downsizes its operation and receives immediate cash.

The SPV may take different legal forms. In particular, an SPV in the corporate form is generally called a "special purpose corporation" (SPC). Since an SPC is a corporation, the issue arises whether there should be a corporate-level tax on SPCs. The 1998 tax reform treated the SPC as a corporate taxpayer, but allowed a dividend-paid deduction (Special Tax Measures Law, Art. 67-14).

The regulatory scheme for SPVs was changed in May 2000. Under the new framework, a "special purpose trust" is included in the definition of corporate taxpayer and is thus subject to an entity-level tax (Corporation Tax Law, Arts. 82-2 to 82-17). Profit distributions are deductible in

25. Masui, Yoshihiro, "Taxation of Partnerships in Japan", 54 *Bulletin for International Fiscal Documentation* 4 (2000), at 150, 151.
26. Kawabata, Yasuyuki, National Report on Japan on Subject I: Taxation of non-profit organizations, *Cahiers de droit fiscal international*, Vol. 84a (1999), at 539 (53rd Congress of the International Fiscal Association, Eilat, 1999).
27. See <www.epa.go.jp/98/a/19981027jpmenu/npomenu.html> (visited 28 December 2000).
28. Kawakami, Eiki, National Report on Japan on Subject II: The taxation of investment funds, *Cahiers de droit fiscal international*, Vol. 82b (1997), at 561 (51st Congress of the International Fiscal Association, New Delhi, 1997).
29. Yamate and Ori, Chapter on Japan, in *Investment Funds: International Guide to the Taxation and Regulation of Mutual Investment Funds and Their Investors* (Amsterdam: IBFD Publications, loose-leaf).

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computing taxable income (Special Tax Measures Law, Art. 68-3-3).

E. Analysis

More entities are subject to the corporation tax in Japan. The phenomenon itself is not new. The scope of corporate taxpayers was already broad in Japan. The changes in the late-1990s, however, are significant because of the diversity of entities that come under scrutiny to determine whether they should be subject to tax and, if so, in what manner.

In particular, vehicles in the form of a trust are included in the definition of corporate taxpayer, as illustrated by "specified trusts" and "special purpose trusts". This development can be explained by the consideration that different investment forms should be treated in a similar manner: if a corporate-type fund is subject to tax, a trust-type fund should also be subject to the same tax. Nonetheless, the logic does not end here. When we start disregarding the different legal forms, what demarcates the entities that are subject to corporation tax? These issues will be examined in the Annual Meeting of the Japanese Society for Tax Law in October 2001.

V. CONCLUSION

Since 1988, Japan's corporation tax has undergone structural transformation. The three trends examined in this article – a sharp decline in corporate tax revenue, the massive restructuring in business organizations and the diversification of entities subject to tax – affect the basic mechanism of the corporation tax system.

The three trends are interrelated. Facing the pressure from globalization, the corporation tax rate has been continuously reduced. On the side of business organizations, the tax rules have been modified to accommodate restructuring to face global competition. On the side of financial intermediation, different vehicles have been born and have invited new tax legislation. In essence, the tax reform in this area in the period 1988-2000 can be seen as a response to further globalization.

The transformation is ongoing, and many issues will emerge in the years to come. Most significant are the international aspects of the legislative changes. Needless to say, the topics mentioned in this article are only part of a larger picture. Even within the area of corporation tax, there are other important developments, including the mark-to-market valuation of portfolio securities[30] and the growing discrepancies between the rules for measuring taxable income and the accounting standards used for disclosure purpose.[31] These issues await future inquiry from a broader perspective.[32]

30. Nakazato, Minoru, *Tax Positions of Investors, Dealers and Issuers of Financial Products* (Tokyo: Yuhikaku, 1999), at 60 (in Japanese).

31. Sekiguchi, Satoshi, "Relationship between Taxation and Accounting in Post-War Japan: Shoup Recommendation and Ministry of Finance", in Shibuya, Hiroshi, et al. (eds.), *Marketization and Impact of America: Economy and Society in Japan* (Tokyo: Univ. of Tokyo Press, forthcoming) (in Japanese).

32. For a comparison between Japan and the United States, see Zolt, Eric M., "Prospects for Fundamental Tax Reform: United States vs. Japan", *Tax Notes*, 10 May 1999, at 903; translated into Japanese in *Jurist* (1999), No. 1156 at 145 and No. 1159 at 151.

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