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Japan's 2019 Tax Reform and its Impact on the Food Industry

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ABSTRACT

Japan's general indirect tax, known as the Consumption Tax (CT), will undergo a comprehensive reform on October 1, 2019. The tax reform covers four major areas. First, the CT rate will increase from 8% to 10%. Second, the CT system will be converted from the long-lived single-rate system to a multi-rate system. As a result, a reduced CT rate of 8% will be applied to any food. Third, small and medium-sized enterprises will receive a 5% tax refund from the National Treasury on consumers' cashless purchases such as credit card payments. Fourth, within four years, companies will be required to introduce an invoice system for recording the CT amount for each trade. This study examines the impact of this reform on the food industry and, in particular, small and medium-sized grocery stores, which are popular among Japanese consumers. The results show that this tax reform will increase clerical work for tax payment. In particular, those who sell both food and non-food items will be required to apply different rates to different commodities. However, it is unclear whether this tax reform favors or disfavors the food industry. The results suggest that the Japanese government's fiscal expenditure will keep increasing to deal with the aging of the Japanese population. Therefore, in the medium run, the government is expected to increase the general tax rate while reducing the tax rates for specific commodities (targeting both food and non-food). This phenomenon will induce more substantial involvement of business circles in the food industry in political activities to withdraw favorable treatments from the government in the new CT system.

Keywords: Consumption Tax, general indirect tax, invoice system, tax reduction, political dynamics, small and medium-sized enterprises

INTRODUCTION

The Japanese tax system entails a general indirect tax known as the Consumption Tax (CT). Currently, 8% is charged for the sales of all commodities and services. However, a new CT system will be introduced on October 1, 2019.

As a result of this comprehensive reform, the CT system will shift from the long-lived single-rate system to a multi-rate system. As a result, starting on October 1, 2019, the CT rate will be 8 % for any food and 10 % for other products.

The conversion to the multi-rate system is accompanied by technical problems such as how to categorize food. In addition, the clerical work for the tax payment will increase under the multi-rate system.

This study addresses a set of open questions: Why does the government need to reform the CT system? What are the features of the new system? What will be the next step for Japan's tax policy in the near future? How will this reform affect the food industry?

Taxation is the centerpiece of the nation's governance. Thus, both academic and historical perspectives are necessary to understand the background and implications of this tax reform.

The remainder of this paper is organized as follows. Section 2 provides a brief review of the literature on the general indirect tax. Sections 3 to 7 provide an overview of the historical development of Japan's tax policy. Section 8 describes in detail the upcoming CT reform. Section 9 discusses the political dynamics possibly generated by the new CT system. Section 10 provides our concluding remarks.

ADVANTAGES AND DISADAVATAGES OF THE GENERAL INDIREXT TAX

Taxes are generally classified as direct and indirect. While the former is levied on a person's income and assets, the latter is charged when commodities and services are sold and purchased in the market. The income tax, property tax, and inheritance tax are direct taxes. Indirect taxes are further classified into commodity tax and general indirect tax depending on whether the tax is levied on specific commodities and/or services or all types of commodities and services. Cigarette and liquor taxes are examples of commodity taxes. Historically, income taxes represent the majority of tax revenues in the US, while general indirect taxes are the primary form of revenue in European countries.

In Europe, general indirect taxes are value-added taxes, whereby enterprises pay the tax amount levied on their sales after deducting the tax amount levied on their purchases. To determine the correct tax amount, invoices should be written between a seller and a buyer for each sale/purchase.

Classic economics wisdom contends that general indirect taxation has an advantage in reducing distortion to economic activities (and reducing the adverse impact on the will to work). In addition, since fluctuations in consumption are smaller than fluctuations in profits and income, which are subject to the business cycle, the revenue from general indirect taxes is more stable than that from direct taxes.

An unintended consequence of general indirect taxation is that lower socioeconomic strata families also pay taxes on their daily necessities. To mitigate this concern, many European countries introduced multi-rate general indirect taxes, whereby the tax rate decreases according to the need for commodities in daily life.

However, the measurement of necessity and the categorization of commodities and services are problematic. For example, many European countries apply reduced tax rates to food as a daily necessity. However, a common understanding among citizens on how to define food and how much the tax rate should be reduced for food is hard to achieve. In addition, multi-rate systems are thought to distort resource allocation. Thus, experts often contend that, instead of applying reduced tax rates to daily necessities, relief for poorer families should be provided as a welfare payment[1].

TAX REFORM IN THE EARLY POST-WWII PERIOD

Before WWII, the taxation system in Japan was underdeveloped, and the Japanese government did not take a systematic approach to levying taxes. For example, since the tax authorities could not precisely assess each family's income level, the taxable amount was determined according to each family's social position and reputation. Various commodity taxes existed, and double taxation often happened due to the lack of an invoice system. No general indirect tax existed.

During WWII, to finance the increasing military expenditure, the Japanese government introduced various types of taxes on an *ad hoc* basis and without coordination. As a result, the Japanese tax system became increasingly complex and unsystematic.

Japan introduced a comprehensive tax reform in 1950 under the governance of the occupation force. As a result, a US-style progressive income tax was introduced and became the primary source of income for the National Treasury.

In progressive income taxes, the tax amount is calculated based on the “ability principle of taxation.” While this seems adequate from the viewpoint of fairness, two major problems exist in the implementation of progressive income taxes. First, capturing each taxpayer’s income may be challenging because taxpayers have strong incentives to reduce their tax payments by underreporting their income level. Second, since progressive income taxes can be seen as taxation on labor, the will to work is harmed if tax rates are perceived as too high.

The US tax authorities cope with these problems in a unique way. First, the US government imposes a unified personal identification number system to collect information on each taxpayer’s income sources and provides strong power to tax inspectors. Second, the US government sets the income tax rate at a moderate level. This translates in the reduction of the tax burden for wealthy families, which is often criticized from the viewpoint of equality. However, the US culture is shaped around the “American Dream,” whereby the success of a business should be socially praised. This belief makes citizens tolerant of a moderate income tax rate for high-income families.

Unlike the US, until 2014, no unified identification number system existed in Japan. While a new type of personal identification number system was introduced in 2015, its coverage is not comprehensive enough for tax authorities to capture each taxpayer’s income level. In addition, the ability of Japanese tax inspectors is limited[2] (note 2). Thus, US-style taxation cannot be applied to Japan for capturing each family’s income level. However, Japan’s unique employment system helped tax authorities. In the Japanese high growth era, from 1950 to the mid-1970s, the company-oriented life-style was popular among Japanese workers under the so-called “lifetime employment.” In such a situation, the personnel affair division in each company could easily collect personal information on each employee’s family condition (including their income level and family structure). Using such information and deducting tax at the source, the personnel divisions could pay income taxes on behalf of employees. However, tax authorities had (and still have) difficulties in collecting the correct amount of income taxes from independent businesspersons and farmers. It was alleged that independent businesspersons (including self-employed workers in family-run enterprises) and farmers often committed tax fraud by underreporting their incomes. Thus, salaried workers gradually developed a sense of unfairness.

The two-digit economic growth rate in the high-growth era was a lucky event for Japanese tax authorities. A natural increase in tax revenues enriched the National Treasury. Thus, the Japanese government needed not to set the income tax rate at a high level. As a result, the adverse impact on the will to work was not severe as long as the Japanese economy grew fast.

CHALLENGES OF INTRODUCING A GENERAL INDIRECT TAX IN THE 1970S AND 1980S

The Japanese economic situation drastically changed in the mid-1970s. The two oil crises (in 1973 and 1978) weakened Japanese manufacturers’ international competitive position, and the country’s two-digit economic growth became unsustainable. As a result, the Japanese government became unable to collect sufficient tax revenues. In addition, the Japanese citizens’ concern also shifted from material wealth to the stability of daily living[3]. As a result, the government received pressures from citizens to provide more social welfare, thus posing a heavy burden on the National Treasury.

In the late 1970s, the Japanese government became aware of the necessity to reform the tax system to fill the gap between increasing fiscal expenditures for social welfare and decreasing tax revenues. The simplest way to increase tax revenues is to increase the income tax rate. However, such an intervention would depress economic activities by discouraging taxpayers’ will to work and would accentuate salaried workers’ sense of unfairness. In addition, after the oil crises, the traditional company-oriented working style and life-term employment attitude gradually disappeared. The income tax collection was to become more difficult for salaried workers as well. Thus, further reliance on the income tax revenue was not the Japanese government’s best option. Instead, the government began considering the introduction of a general indirect tax.

In January 1979, Masayoshi Ohira, the then-prime minister and the then-president of the Liberal Democratic Party (LDP), announced a plan to introduce a new tax system, called the "General Consumption Tax (GCT)," whereby a 5% *ad valorem* tax would be applied to all commodities and services.

However, citizens directed fierce resentment against this plan for the following two reasons. First, the GCT would contradict the ability principle of taxation because even a needy family would be required to pay tax in purchasing daily necessities. Second, since the general indirect tax was a brand-new phenomenon for Japanese citizens, they showed emotional antipathy against the GCT.

The election of the members of the House of Representatives took place in October 1979. The LDP, led by Ohira, was soundly defeated (while the LDP lost its majority in the House of Representatives, it stayed in power by receiving support from non-affiliated members in the House of Representatives). Citizens' resentment against the GCT was recognized as the biggest reason for the LDP's defeat. After the election, Ohira fell into distressing circumstances. Ohira passed away in June 1980 after suffering a heart attack, before being able to implement his plan for the GCT. The mass media reported that Ohira's death was to be attributed to the stress of political strife.

The next attempt at the introduction of a general direct tax was made by Yasuhiro Nakasone, who served as the prime minister and president of the LDP from November 1982 to November 1987. In 1986, Nakasone proposed to the Diet a bill to introduce a 5% general indirect tax, called the "Sales Tax (ST)." Just as Ohira's GCT, Nakasone's ST plan generated strong resentment in the citizens. As a result, the bill for the ST was not approved.

Noboru Takeshita, who succeeded Nakasone as the prime minister and the LDP president, also tackled the introduction of a general direct tax. Takeshita prepared a bill to implement a 3% general indirect tax, called the "Consumption Tax (CT)" and submitted it to the Diet in July 1988. Takeshita was considered an expert in human relationships inside the Diet. Based on his strong network among principal Diet members of not only the LDP but also opposition parties, Takeshita's CT bill was passed in December 1988. However, the approval in the Diet did not imply consumers' assent. As soon as the CT was implemented, in April 1989, Takeshita met citizens' fierce antipathy. As a result, Takeshita resigned as the prime minister in June 1989[4].

It should be noted that, while the CT is a value-added tax, Japan did not (and still does not) have an invoice system as European countries do. Thus, how to record the prices charged between companies was (and still is) a challenge for clerical work for tax payment.

If companies kept detailed information on their sales and purchases, the calculation of how much they should pay to tax authorities would be straightforward. However, many small and medium-sized enterprises do not perform accurate accounting. Thus, the Japanese government introduced two special measures for small and medium-sized enterprises. One is the tax exemption for enterprises with total sales in a year of less than 10 million yen. According to this provision, companies do not need to pay the CT collected from their customers to the tax authorities. The other measure is the presumptive taxation system for enterprises with total sales in a year of less than 50 million yen. According to this provision, the total amount of CT paid in procurements is estimated by multiplying total sales for a government-determined percentage (which depends on the type of business). These two systems reduce the burden of small and medium-sized enterprises' clerical work for tax payment. However, these measures are often criticized as a considerable portion of the CT amount collected from consumers, which should be paid to the tax authorities if companies carried out accurate accounting in their bookkeeping, remains in the budget of small and medium-sized enterprises.

The mass media keep reporting cases in which companies illegally evade taxes by underreporting their sales[5]. For example, if a consumer pays by cash at a grocery store, the store manager can hide this revenue (if a consumer pays by credit card, the transaction is difficult to hide because the card company holds the record of the purchase). The significance of this problem increases with the increase in the CT rate set by the government.

As discussed in Section 3, Japanese tax authorities generally take a lenient approach to collecting income taxes from self-employed workers in family-run enterprises (most of which are small and medium-sized enterprises). Thus, under the current income tax and CT system, small and medium-sized enterprises are treated twice as leniently. However, this treatment impairs efficiency and transparency in taxation.

CHALLENGES FOR INCREASING TAX RATES IN THE 1990S

The CT made an epoch as a general indirect tax was introduced in Japan for the first time. However, considering that Ohira and Nakasone proposed a 5% tax rate for the GCT and the ST, respectively, the CT's 3% rate may be considered too low. In addition, the aging of the population began accelerating faster than the government's estimation after the 1980s[6], and tax revenues declined after the so-called "burst of the bubble" in the beginning the 1990s. Thus, increasing the CT rate became the next unavoidable task for the Japanese government. However, citizens' ill-feeling against the CT made it not an easy task.

The first to tackle an increase in the CT rate was Morihiro Hosokawa of the Japan New Party (JNP). While the JNP only ranked 5th in terms of size in the Diet, Hosokawa won great popularity among citizens thanks to his stylish appearance. In August 1993, Hosokawa was elected as the prime minister and formed a coalition government comprising eight political parties. His administration scored a 70% approval rating in public opinion polls, the highest in the post-WWII period.

However, the Hosokawa administration lost its popularity only six months after its inauguration. In February 1994, Hosokawa announced a plan for increasing the CT rate to 7%[7]. This surprised not only the citizens but also the leaders of the other coalition parties. Receiving fierce criticism, Hosokawa withdrew this proposal only two days after the announcement, thus losing his credibility. Hosokawa resigned as the prime minister in April 1993.

The second to tackle a CT rate increase was Tomiichi Murayama, who served as the president of the Social Democratic Party (renamed after the former Social Democratic Party of Japan in March 1996) from September 1993 to September 1996. In June 1994, Murayama formed a coalition government with the LDP and became the prime minister. In April 1994, Murayama prepared a bill, the Laws Related to Tax Reform (LRTRs), which proposed an increase in the CT rate from 3% to 5% from April 1997. The bill passed in the Diet in November 1994. Murayama resigned as prime minister in January 1996, and Ryutaro Hashimoto, the president of the LDP, succeeded to power.

The LRTRs stipulated that the CT rate increase should be postponed if economic conditions were unfavorable. Around 1996, it was unclear whether the Japanese economy had finally escaped the deflation that had begun in 1991. Nonetheless, Hashimoto increased the CT rate from 3% to 5% in April 1997, as scheduled.

After the CT rate increase, the Japanese economy suffered a demand fall (an annualized rate of -11.2% from April to June in 1997) in reaction to the "last-minute rise" in demand before the CT rate increase[8]. The Asian Financial Crisis and a sequence of bankruptcies of Japanese financial companies fettered the Japanese economy. As a result, the LDP suffered a substantial defeat in the House of Councilors election, in July 1998. Taking responsibility for the poor results, Hashimoto resigned as the prime minister immediately after the election. Hashimoto later admitted that the timing of the CT rate increase had been inappropriate.

Despite this CT rate increase, Japan's fiscal conditions did not improve because the country had been subject to 20-year-long economic stagnation. In this scenario, the direct tax revenues could not be substantially increased. In addition, fiscal expenditures for social welfare kept rising to meet the needs of the aging population. In particular, a new public insurance system, called "the long term care insurance," which provide care services to aged citizens, was established in 2000, posing a heavy burden on the national treasury (in contrast with its name, the long-term care "insurance" heavily relies on fiscal expenditure from the government).

THE THREE-PARTY AGREEMENT FOR THE CT RATE INCREASE IN 2012

Japan's national debt reached the highest level among major developed countries in the 2000s[9]. It soon became clear that Japan needed a further increase in the CT rate. However, drawing a lesson from the bitter experiences of Hosokawa and Hashimoto, successive prime ministers were reluctant to increase the CT rate.

Yoshihiko Noda of the Democratic Party of Japan (DPJ), who served as the prime minister from September 2011 to December 2012, achieved a breakthrough. In June 2012, under Yoshihiko Noda's leadership, the DPJ reached an agreement on a tax reform plan with the two major then-opposition parties, namely, the LDP and New Komeito, commonly known as "the three-party agreement." The arrangement established that the CT rate should be increased to 8% in April 2014 and 10% in October 2015 and, based on these tax increases, the government should develop its social security programs. In particular, the DPJ strongly advocated a plan for a drastic increase in the government's payment for low-income patients' medical expenditures.

This agreement was to be effective whichever party (or parties) would be in power at these two points in time. The three parties also agreed on the so-called "economic clause," which stated that these CT rate increases should have been postponed if economic conditions were unfavorable (however, the meaning of "unfavorable" is not clearly defined in the three-party agreement).

The DPJ lost power as a result of its defeat in the election for the members of the House of Representatives in December 2012. Shinzo Abe of the LDP formed a coalition government with New Komeito and replaced Noda as the prime minister. As soon as Abe's cabinet began operations, the Japanese economy began booming as a result of Abe's a special package of fiscal and monetary stimulus policies, known as "Abenomics." Thus, it was clear that the economic clause could not be applied. Abe increased the CT rate to 8% in April 2014, as scheduled.

MINISTRY OF FINANCE'S PLAN FOR A TAX REFUND SYSTEM FOR FOOD EXPENDITURES IN 2015

Abe's next challenge was to fulfill the agreement and increase the CT rate to 10% by October 2015. However, a last-minute increase in demand before the CT rate increase in April 2014 led to three consecutive quarters of negative GDP growth. Thus, given that the economic conditions were unfavorable for a further tax increase (as per the "economic clause" in the three-party agreement), in November 2014, Abe announced that he would postpone the second increase by 18 months. Abe prepared new bills for postponing this tax. However, these bills did not include a plan for a drastic increase in the government's payment for low-income patients' medical expenditures, which the DPJ strongly requested as part of the three-party agreement. Claiming that Abe contravened the three-party agreement, the DPJ became critical of the increase in the CT rate to 10% even after the 18-month postponement.

In December 2014, the two ruling parties, the LDP and New Komeito, jointly announced a tax reform plan, titled "Tax System Revision General Rules for 2015 Fiscal Year" (abbreviated as the 2015 Tax Plan, henceforth).

The 2015 Tax Plan recognized the need for a further increase in the tax rate to improve Japan's financial condition. However, the 2015 Tax Plan also mentioned that, in the future, a reduced CT rate should be introduced and applied to daily necessities. The 2015 Tax Plan was unclear about what commodities should be levied at a reduced rate, and when the reduced CT rate should be introduced. When drafting the 2015 Tax Plan, while leaders in New Komeito strongly advocated for the application of a reduced CT rate of 8% for food when the CT rate would be increased to 10 %, Takeshi Noda, who served as the chairperson of the LDP Tax Investigation Committee, was critical toward a reduced CT rate. As a compromise between the two parties, details (the contents and schedule) of the plan for the CT rate reduction were evasively expressed in the 2015 Tax Plan.

Responding to the 2015 Tax Plan, the Ministry of Finance (MOF) has set up a taskforce team for defining the details of the new system for the CT rate reduction. The MOF taskforce team found two problems in the introduction of the CT rate reduction for food. The first problem relates to how "food" should be defined. Because many definitions of "food" exist, which commodities should be eligible for the reduced tax is not straightforward. At first, the taskforce team compared three draft ideas as a basis for discussion regarding which food items should be eligible for a tax reduction: rice only, fresh food only, and all fresh and processed food except for alcohol. After discussion, the taskforce team chose the third option.

The second problem relates to companies' burden for clerical work for tax payment. For example, different CT rates will complicate the tax-report-related clerical work of grocery stores that sell both food and non-food products. In European countries, where various rates are applied according to the types of commodities, companies' tax-report-related clerical work is not too heavy because an invoice system, whereby an invoice is sent/received for each trade between a seller and a buyer, has been developed. However, as mentioned earlier, Japan has not adopted an invoice system yet.

The 2015 Tax Plan stated that Japan should introduce an invoice system four years after the introduction of the multi-rate system in the CT. This implies that, at least for the first two years, the multi-rate system must be operated without an invoice system.

In this context, the MOF taskforce team created a new plan to provide favorable treatment for food expenditures and proposed the introduction of tax refund for consumers' food expenditures instead of tax rate reductions for food. In 2015, the Japanese government introduced a new ID card, called My Number Card[10]. Each citizen is eligible to receive his/her own My Number Card from the government, which should be used for tax payment. Because some consumer groups argue that citizens' privacy would not be protected under the My Number Card system, the government leaves each citizen's freedom regarding whether to hold a My Number Card. Each My Number Card has an IC chip to record the holder's personal information. This IC chip should also be used for tax refunds.

The refunds would be provided after the following two steps are taken. First, when citizens purchased food, they would present their My Number Cards and ask retailers to record the food expenditures in their IC chips. Then, at their final tax declarations, citizens would receive refunds based on the record of food expenditures in the IC chips (in Japan, in principle, all the Japanese citizens are obliged to submit a final tax declaration to tax authorities at the end of Japanese fiscal year). The refund would be calculated by multiplying a citizen's total food expenditure by 1/55[11]. The MOF also plans to set an upper limit for refunds. The reason for setting a limit is that refunds should be provided only for goods that are essential to daily life. For example, high-income families may allocate large amounts of money to buy extravagant foods. By setting an upper limit, the MOF taskforce team aims to prevent such lavish expenditures from benefiting from tax refunds[12]. The MOF taskforce team estimates that retailers would suffer a lower burden under the tax refund system than by applying different CT rates for food and other goods.

When this tax refund plan was announced, in September 2015, some academics stood in favor of this plan[13]. Thus, the MOF taskforce team considered this plan acceptable for the Japanese citizens (and the two ruling parties).

Takeshi Noda supported the MOF taskforce team's plan. However, the leaders of New Komeito strongly opposed the MOF taskforces team's plan. The leaders of New Komeito argued that the CT rate reduction would be better than the tax refund system in the sense that consumers would be aware of the reduced burden of tax payment each time they purchase food.

As the prime minister of the coalition cabinet of the LDP and New Komeito, Abe decided to accept New Komeito's view. In October 2015, Abe divested Takeshi Noda as the chairperson of the LDP Tax Investigation Committee and appointed Yoichi Miyazawa of the LDP as the new chairperson because Miyazawa was (and still is) sympathetic to New Komeito's view on tax reform. Simultaneously, Abe declared that the CT rate increase to 10% and the introduction of the CT rate reduction for food should take place simultaneously on October 1, 2019. As a result, the MOF taskforce team was forced to relinquish its tax refund plan.

ABE'S FINAL DECSION ON THE CT REFORM

Abe rescheduled the CT rate increase again in May 2016 just after the 42nd G7 summit in Japan. Abe argued that G7 countries recognized the potential dangers of the global financial crisis and, to take preventive measures, Japan would postpone the rate increase until October 2019.

Abe dissolved the House of Representatives in September 2017. A general election (the election of the members of the House of Representatives) took place in October 2017. During the campaign, Abe pledged that he would increase the CT rate to 10% in October 2019. Large special procurements for the 2020 Tokyo Olympic Games would keep the economy buoyant in 2019 and 2020, thus making October 2019 a good time to raise the CT rate.

At the same time, Abe declared that two special treatments would be introduced when the CT rate increased to 10%: a reduced tax rate (8%) for food[14] and a 5% tax refund from the national treasury for small and medium-sized retailers on consumers' cashless purchases.

Abe's official explanation for these special treatments was as follows. To protect low-income families, daily necessities such as food should be levied at a lower tax rate. Therefore, unlike previous increases in 1997 and 2014, a multi-rate system should be introduced. Since a multi-rate system is more complex than a single-rate system and can create a heavy burden of clerical work for small and medium-sized enterprises, the government would help businesses by providing a tax refund. Simultaneously, this measure helps increase cashless sales in the private sector, which, in turn, may reduce illegal transactions such as money laundering and tax evasion.

According to the government guidelines, meal expenditures at restaurants would be taxed at 10% because restaurants belong to the service industry. However, take-out orders would be taxed at 8% because they are sold as food. Another example is a supermarket with an eat-in area. A customer buying bread to eat in the supermarket would pay a tax of 10%, while a customer buying bread to bring home would pay a tax of 8%, potentially leaving the *onus* to determine which tax to apply on the sales clerk.

Some academics have criticized Abe's plan for alleged special treatments since, in their opinion, it would distort economic activity, thus hindering income redistribution. In April 2019, a group of Japan's top academics led by Takeo Hoshi of Stanford University prepared an opinion paper on the Commodity Tax reform (referred to as the Hoshi Paper hereafter)[15]. The essence of the Hoshi Paper is summarized by the following four points: (1) the CT rate should be increased to 10% because Japan's aging society requires expansion of social security programs; (2) special tax reductions for food should not be introduced; (3) special benefits should be provided to low-income families to mitigate the tax increase; and (4) an invoice system should be introduced. However, the Hoshi paper's influence on the government's decision-making was limited.

POLITICAL DYNAMICS UNDER THE NEW CT SYSTEM

Unique political dynamics may be generated under a multi-rate general indirect tax system. If a certain type of commodities is levied at a lower tax rate, the producers of such commodities receive a favorable treatment. Thus, politicians can win support in the election from those who produce such commodities. Japan only introduced a reduced CT rate (8%) for food, thus creating frustration among those who produce inedible daily necessities such as feminine hygiene products.

Since the Japanese population is estimated to continue aging in the coming three decades, further increases in the CT rate will be inevitable[16]. Politicians and various business groups will inevitably raise their requests for reduced CT rates for particular types of commodities, for which they are concerned.

The demarcation between food and non-food is also an unsolved problem. Even now, those who sell commodities categorized as non-food in the government's guidelines petition the government to have a revision of its guidelines[17]. In addition, every time a new type of food businesses in a "gray zone" emerges, it generates a debate as to how to define food.

The introduction of the invoice system, which is scheduled by 2023, will also exert a considerable impact on businesses. While this reform is necessary for improving efficiency and transparency in taxation, a heavy burden for small and medium-sized enterprises will be introduced. Currently, small and medium-sized enterprises receive favorable treatment such as the tax exemption and presumptive taxation (as discussed in Section 3). However, large-sized enterprises (and some academics) often criticize these treatments as unreasonable. The introduction of the invoice system can be an opportunity for the government to remove these favorable treatments.

CONCLUSION

On October 1, 2019, a new CT system will become effective in Japan. The CT will shift from today's single-rate system to a multi-rate system whereby a reduced rate will be applied to food. This reform may generate an impression of the government's favorable treatment to the food industry. However, in reality, considering the increasing burden of clerical work for tax payment, it is unclear whether this tax rate reduction benefits the food industry. For some small and medium-sized enterprises such as family-run grocery stores, this burden will be too heavy to continue to run their business. Thus, the new system may also promote the realignment of the food industry.

The CT reform should be seen as the beginning of further reforms. CT rate increases will be on the national agenda for meeting the increasing fiscal expenditures for the operation of the public security systems. However, under the pressure of interest groups, the CT rate reduction will also be a focus of the political debate. As such, October 1, 2019 will be the dawn of a new era in Japan's political dynamics.

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[1] Sato, Motohiro, "Kourigyo IT-ka no Okure Kadai (Retailers' Slow response to the Development of Intellectual Technology)," *Nikkei Business Daily,* page 22, December 10, 2015.

[2] In addition, unlike the US, Japan does not have a third-party reporting system for tax evasion. For more details, see Honjo, Tasuku (2008), "Beikoku Zeimu Gyosei no Koritsuka no Hiketsu wa Nanika (The Background for the US's High Efficiency in Tax Collection)," *Zeidai Journal,* No. 8.

[3] 1973 is known/perceived as the first year of the welfare era because, in that year, the Japanese government operated a large expansion of the social welfare system, including the provision of free medical services for the elderly.

[4] In addition to the unpopularity of the CT, a large money scandal among LDP politicians, known as the "Recruit Cosmos shares-for-influence scandal," was revealed in 1988. This created a difficult situation for the Takeshita administration. The LDP's approval rating in the public opinion polls fell to abysmal levels (i.e., around 8%).

[5] "Eki-zei Fukuramu Kenen (Increases of the Part of the Consumption Tax Legally Retained by Business Operators Resulting in their Economic Profit)," *Nihon Keizai Shimbun*, morning edition, page 5, October 29, 2015.

[6] In 1986, the Japanese government estimated that Japan's total fertility rate would be leveled-off around 2.0. In contrast with the government's estimates, in 1989, Japan's total fertility rate was 1.57, the historical lowest. Japan's total fertility rate continued declining to reach 1.26 by 2005. Since then, while Japan's total fertility rate slightly recovered to 1.45 in 2015, but then, it began declining again. In 2018, Japan's total fertility rate was 1.42.

[7] Hosokawa announced a plan to replace the CT with a new general indirect tax, known as the "Welfare Tax," within five years. However, his plan was the equivalent of increasing the CT rate from 3% to 7% by simply renaming the tax.

[8] Consumers tried to purchase unperishable commodities earlier than they planned; this forward-spending demand is called "last-minute rise."

[9] The ratio between the outstanding national debt and GDP in Japan surpassed that of Italy in 2000. Since then, the debt/GDP ratio in Japan has been the highest among high-income OECD countries (Organization for Economic Cooperation and Development, *OECD Economic Outlook*, No. 104, 2018).

[10] For details on the My Number Card system, see Good, Yoshihisa, "Japan Introduces a Unified Personal Identification Number System," *EAI Background Brief* (National University of Singapore) No. 1091,

2015.

[11] If a consumer buys a commodity for the cost of 100 yen at a grocery store, he/she pays 110 yen if the CT rate is 10%. Therefore, compared to the 8% CT tax, he/she pays an additional 2 yen, and the refund should thus be 2 yen. Dividing 2 by 110, we obtain 1/55.

[12] When the MOF presented the tax refund plan, it set the limit at 4,000 yen per family member per year. However, this limit was only provided as an example.

[13] According to Shigeki Morinobu, a professor at Chuo University, the MOF taskforce team’s plan is much better than a tax rate reduction, which is popular in European and North American countries. See“Eki-zei Fukuramu Kenen (Increases of the Part of the Consumption Tax Legally Retained by Business Operators Resulting in their Economic Profit),” *Nihon Keizai Shimbun*, morning edition, page 5, September 11, 2015.

[14] In addition to food, newspapers are also included in the list for the CT rate reduction to 8%.

[15] The Hoshi Paper is downloadable at https://sites.google.com/view/suggestiondifftax.

[16] According to the Japanese government, in 2018, the share of the elderly (aged 65 or higher) will keep increasing at least until 2065. Details on the government’s estimates (in 2017) can be downloaded at: https://www8.cao.go.jp/kourei/whitepaper/w-2018/html/gaiyou/s1_1.html.

[17] For example, *mirin*, which is used for cooking (not for drinking), is not comprised in the CT rate reduction in the government’s guidelines because *mirin* includes a light degree of alcohol. However, in daily cooking, *mirin* is casually used just as soy sauce, which is in the list of the CT rate reduction in the government’s guidelines. Thus, *mirin* producers complained at the government’s guidelines.