

**The decision issued by Osaka District Court with regard to the validity of imposition of additional tax on failure to file the consumption tax return and 2006 tax reform**

Under 2006 tax reform with regard to the National Tax Procedure Law, an amendment is made to the following three (3) issues:

(1) The effective timing of delivery:

Before the amendment, notices issued by the tax authorities are deemed to have been served, given or delivered upon receipt of such notices by recipients. Under the tax reform, certain documents including tax returns designated by the Director of the National Tax Agency are deemed to have been served, given or delivered when the notices are mailed.

(2) An exemption of additional tax on failure to file a return and additional tax on failure to pay a tax:

In certain cases where the withholding tax is paid after the filing due date or tax payment due date, tax imposition of additional tax on failure to file a return or on failure to pay a tax is exempted.

(3) An increase of tax rate of the additional tax on failure to file a return:

The tax rate of the additional tax on failure to file a return is raised from 15% to 20% if the tax amount exceeds 500,000 JPY.

Among the above issues, the raise of tax rate of additional tax on failure to file a return is made with the purpose of strengthening the nature of penalty to cope with a significant increase in number of cases of failure to file a return for income arising from the assignment. While an application of these taxes is under a review, which might give an impression to be inconsistent with the raise of the tax rate at the first glance, 2006 tax reform is an amendment based on policy attention to mitigate the tax imposition of the additional tax. Taking for an example, there is a case brought from a taxpayer who fails to file the consumption tax and local tax returns claiming for a cancellation of the tax disposition to impose the additional tax on failure to file a return (No.107 in 2004). In principle, taxpayers are not allowed to submit the tax return after the filing due date so that in certain cases, the amount of the additional tax on failure to file a tax by the statutory filing due date becomes a significant amount depending on the amount of the final tax. The review on an application of the tax imposition of the additional tax on failure to file a return is made in order to provide certain measures of relief for taxpayers. By way of discussing the

content of the decision of Osaka District Court, more detailed analysis on the implication of 2006 tax return is discussed in this article.

1. An amendment of additional tax on failure to file a return

As a means to ensure the proper self-assessed taxation system and withholding taxation system, there is a tax imposition of additional tax on underpayment (Article 65 of the National Tax Procedure Law (the “Law”)), additional tax on failure to file a return (Article 66 of the Law), additional tax on failure to pay a tax (Article 67 of the Law) and the heavy additional tax (Article 68 of the Law) as administrative measure of sanction.

Under the current law, the tax rate of the additional tax on failure to file a tax is 15%, the same rate of the additional tax on underpayment. The additional tax on underpayment is generally imposed by way of tax correction as a result of the tax audit. Although the tax filing liability is satisfied, the additional tax on underpayment is imposed due to calculation error of taxable income or different view on recognition of facts between the taxpayer and the tax examiner. On the other hand, the additional tax on failure to file a tax is substantially a violation of tax filing liability so that an extent of negligence is larger. Consequently, it is quite reasonable that higher extent of penalty is imposed to the additional tax on failure to file a return by warning against the intentional non-filing.

**An outline of the additional tax implications under the current law**

Additional tax	Basic treatment	Exceptions	Reduction or exemption
Additional tax on underpayment (Article 65 of the Law)	The additional tax at the rate of 15% of the underpaid amount is imposed (10% for the amount that is larger of either (i) 500,000JPY or (ii) the tax amount in the tax return filed by the original tax filing due date)	Underpayment due to reasonable or justifiable reason	In case the amended tax return is filed without expecting the tax correction resulting from the tax audit, no additional tax on underpayment is imposed.
Additional tax on failure to file a return (Article 66 of the Law)	The additional tax at the rate of 15% of the tax to be paid in the tax return filed after the filing due date.	Filing after the filing due date due to reasonable or justifiable reason	In case the tax return is filed after the filing due date without expecting the tax correction resulting from the tax audit, the additional tax on failure to file a return is imposed at the rate of 5%.
Additional tax on failure to pay a tax (Article 67 of the Law)	The additional tax at the rate of 10% of the tax to be paid in the tax return for the tax paid after the paying due date.	Payment after the payment due date due to reasonable or justifiable reason	In case the tax is paid after the payment due date without expecting the tax notice resulting from the tax audit, the additional tax on failure to pay a tax is imposed at the rate of 5%.
Heavy	In case misrepresentation or	None	None

additional tax (Article 68 of the Law)	concealment is noted, heavy additional tax at the rate of 35% is imposed in addition to the above rate.		
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**Amendment under 2006 tax reform**

A: Additional tax on failure to file a return

B: Additional tax on failure to pay a tax

Current Law	Amendment under the reform	Application
A	In case of filing after the filing due date, the additional tax on failure to file a tax is imposed at the flat tax rate of 15%(if a justifiable reason is admitted, the additional tax is exempted) (Article 66, No.1 of the Law).	As for the tax amount exceeding 500,000 JPY, the tax rate is 20%.
	In case of filing after the filing due date without expecting the tax correction resulting from the tax audit, the above tax rate of 15% is reduced to 5% (Article 66, No. 3 of the Law).	Applicable to the national tax which statutory filing due date falls on and after January 1, 2007
	In case of filing within two (2) weeks after the filing due date and the full amount of tax is paid by the payment due date, 5% additional tax on failure to file a return is not imposed provided that the taxpayer has an intention to submit the tax return. (*Note)	
B	In case of payment of the withholding tax after the statutory payment due date of the national tax, the additional tax on failure to pay a tax at the rate of 10% is imposed (if a justifiable reason is admitted, the additional tax is exempted) (Article 67, No.2 of the Law).	In case of payment within one (1) month from the statutory payment due date and there has been no late tax payment after the statutory payment due date, the additional tax on failure to pay a tax is not imposed provided that the taxpayer has an intention to pay the tax by the statutory payment due date.
		Applicable to the national tax which statutory filing due date falls on and after January 1, 2007

\*Note: The same amendment is implemented as for the additional tax on failure to file a local tax return.

As for the additional tax on failure to file a return, if there is any “justifiable reason” for the failure to file a return, no additional tax is imposed. The “justifiable reason” is construed to be restricted to a case of casualty, disconnection of transportation or communication network, etc., that is not attributable to the responsibility of taxpayer, and does not include the negligence of the taxpayer. As to whether the taxpayer foresees an issuance of tax correction or decision by the tax authorities at the time of the submission of the tax return after the filing due date, the administrative guideline provides the following:

“If it is recognized that the taxpayer, being subject to the actual investigation or counter investigation or being pointed out certain issues on which tax authorities have different point of

views, may perceive potential tax audit and that the amended tax return is submitted after the taxpayer becomes aware of the potential tax audit, it is treated that the amended tax return is filed as a result of the "perception of the potential tax audit". However, if the amended tax return is submitted at the stage that the tax authorities communicate the taxpayer with regard to the schedule for the investigation, it is not regarded that the amended tax return is submitted as a result of the "perception of the potential tax audit". (The Administrative guideline issued on July 3, 2000)"

With regard to the additional tax on failure to pay a withholding tax, the taxpayer is exposed to a heavy burden since the taxpayer is a withholding agent who collects the tax from the person who is originally liable to pay the tax. The above guideline (issued on July 3, 2000) provides in the section of "The treatment of additional tax on failure to pay a withholding tax" an exception in case of late payment of the withholding tax due to incidental events. The amendment made under 2006 tax reform with regard to Article 67-2 of the National Tax Procedure Law incorporates the above exception under the guideline into the laws and regulations.

The treatment of the additional tax on failure to pay the withholding tax  
(The Administrative guideline)

1. Treatment of the additional tax on failure to pay the withholding tax

<In case there is a justifiable reason for not paying the withholding tax by the statutory payment due date>

<An exception in case of the late payment due to incidental events>

When collecting the additional tax on failure to pay a tax prescribed under Article 67 of the National Tax Procedure Law, if the underlying tax amount (excluding the tax amount imposed by any tax notice) prescribed under Article 67, Paragraph 1 of the above law has been paid within one (1) month from the date following the statutory payment due date and either of the following is satisfied, it is treated as a case where there is a justifiable reason as stated in the above paragraph:

(1) There has been no late payment immediately before one (1) previous year (for taxpayers who obtains an approval with regard to the special treatment of the tax payment prescribed under Article 216 of Income Tax Law, the period of tax payment including the months of immediately before one (1) previous year);

(2) The payment is late for the first payment due for those who newly become withholding obligators.

\*Note: Those who newly become withholding obligators mean those establishing offices and others newly handling payment of salaries under the jurisdiction (excluding those relocating from

other jurisdictions).

2. Measures to mitigate the imposition of additional tax on failure to filing a return and the decision issued by Osaka District Court

With regard to the late filing of income tax, corporate tax, consumption tax, inheritance tax and gift tax subject to the self-assessment taxation, there is no treatment of the “exception in case of the late payment due to incidental events” prescribed under the Administrative guidance issued on July 3, 2000. In these cases, it is apparent that the failure to file the tax return by filing due date is a violation against the tax liability at the side of the taxpayer so that none of them would dare to oppose to the imposition of the additional tax.

However, a case was brought to Osaka District Court in 2004 overturning the above point of view from a taxpayer, and the court decision was issued on September 16, 2005. The taxpayer submitted the payment slips with regard to the consumption tax and local consumption tax by the statutory filing due date, however, the tax returns were not filed by the said due date. The additional tax on failure to file a return was then imposed to the taxpayer (at the rate of 5% pursuant to Article 66, Paragraph 3 of the National Tax Procedures Law) and the taxpayer claimed the cancellation of the said tax disposition.

Detailed background of the above case is as follows:

The plaintiff paid the consumption tax and local consumption tax (the “consumption taxes”) in the amount of 24.8 billion JPY for the tax period from April 1, 2002 to March 31, 2003 by June 2, 2003 that was the statutory filing due date as well as the statutory payment due date. On June 12, 2003, the tax office staff confirmed an employee of the plaintiff whether the tax returns of the consumption taxes were filed, and it was found that the plaintiff failed to file the tax return, and then filed the tax return on June 13, 2005. The tax authorities issued the tax decision to impose the additional tax on failure to file a return in the amount of 1.2 billion JPY on September 30, 2003.

What were argued in the case in question are (i) whether the submission of the payment slips might be regarded as the “defective tax filing” and that the post submission of the tax return may be regarded as to cure such defect, (ii) whether the ground for imposing the additional tax would be eliminated by treating the said payment as the provisional payment, and (iii) whether the “justifiable reason” provided under Article 66, Paragraph 1 of the National Tax Procedures Law may be recognized in this case. The Osaka District Court rejected claims of the plaintiff and

decided that the original tax disposition to impose the additional tax on failure to file a return is legal.

If we take a look of the decision result only, the decision seems to be quite reasonable. However, it can be imagined that the amount of the additional tax on failure to file a tax was so huge as a result of the negligence that the taxpayer sought for somewhat sympathetic decision for legal purposes.

As to whether the “justifiable reason” provided under Article 66, Paragraph 1 of the National Tax Procedures Law may be recognized in this case, the plaintiff argued as below.

- (1) There is no need to restrict the range to apply the “justifiable reason” which may avoid the imposition of the additional tax in case sympathetic factors that cannot be attributable to the taxpayer’s responsibility such as the case of the casualty exist. Considering the purpose of the provision of the National Tax Procedures Law, it would be appropriate to examine the “justifiable reason” more extensively in separate case.
- (2) When judging the existence of the “justifiable reason”, it should be carefully considered as to whether to impose the sanction for non-filing within the filing due date is appropriate in terms of the purpose of the provision of the additional tax on failure to file a return by taking into account circumstances of this case. Specifically, it is construed that the true purpose and objective of the imposition of the additional tax on failure to file a return is to ensure the implementation of the tax liability and to promote the self-assessment taxation by imposing special economic burden for any violation of the tax filing obligation. However, such purpose and objective are intermediate goal and the ultimate goal is to ensure the tax collection.
- (3) Consequently, in the present case where the tax return and payment slip were already prepared and the tax was duly paid by the original payment due date and only the submission of the tax return was failed, an intention for filing the tax return is apparent and the ultimate purpose of tax collection is already satisfied, it is apparent that there is no appropriateness nor necessity to impose the additional tax on failure to file a return as a sanction. Further, the “justifiable reason” should be recognized in the present case as provided under Article 66, Paragraph 1 of the National Tax Procedures Law.
- (4) By taking into account the provision of “An exception in case of the late payment due to incidental events” under the Administrative guidance issued on July 3, 2000 for withholding tax purposes, the similar concept should be applicable for the additional tax on failure to file a return to admit the “justifiable reason”, and different treatment is rather against the

concept of fair taxation.

If the tax imposition is implemented as prescribed under the tax laws and regulations, the amount of the additional tax is calculated regardless of an intention of the tax authorities. Without mentioning to refer the recent incident of loss incurred at the securities companies caused by erroneous orders, loss due to negligence is not the special case, and as for any loss caused by the negligence of the licensed tax account, one may claim a compensation for such loss. While the presents case has reminded us of a severity of negligence, it seems that the tax authorities as the defendant might have sort of sense of guilt and it is presumed that they amend the requirement of imposition of the additional tax on failure to file the return under the reform for case of (3) in above. However, more strict attention should be paid not to fail to submit the tax return by the filing due date, since heavier penalty would be imposed for the two (2) weeks-late-filing.

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