

# Financial Services Tax News

Financial Services Tax Group

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## The Tax Commission's report on recommended changes for individual taxation

The Tax Commission ("Commission"), an independent governmental advisory body, released its report on June 21, 2005 on recommended changes to the individual taxation regime. The report introduces guidelines for drastic tax reforms on or after the 2006 tax year that seek to achieve a simple, neutral and fair tax system for individuals.

We summarize below the main issues of the report.

### 1. Review of income classification

#### (i) Income classification

##### (a) Employment income

The Commission notes the necessity to examine the cutback of the earned income deduction and the expansion of an allowance to claim a deduction for expenses, in large part due to the decreased need to make a special deduction for employment income due to recent changes in the employment system and job market.

##### (b) Retirement income

The report highlights the result of the current calculation formula, i.e., that the amount of available deduction to a corporation paying retirement income increases considerably if the taxpayer works more than 20 years for the company. The report also points out the potential for the 50% retirement income exclusion, which is applied to short term employment as well, to be considered to have a tax avoidance element. The Commission notes the necessity to review the tax neutrality of the current retirement taxation system and its suitability for the current working environment.

(c) Business income

The report also points out the logic under the current system of self-assessment reporting to allow business expenses based on correct bookings to be deductible. The report also notes the necessity of seeking more appropriate taxation for the current variety of business structures being used, such as Kumiai structures.

(d) Capital gain

The Commission points out that the potential tax avoidance result of the current system's taxing long-term capital gains at half the individual's marginal rate while allowing capital losses to offset the individual's other aggregated income. The report notes the possibility that separate taxation of capital gains and losses on the sale of assets other than land, building and stocks should be considered.

(e) Real estate income

The Commission notes the possibility to abolish the separate classification of real estate income when calculating an individual's taxable income.

(f) Occasional income

The Commission notes the possibility of aggregating the classification of occasional income with the classification of miscellaneous income due to a lack of a reasonable basis for maintaining separate income classifications for these items of income.

(g) Miscellaneous income

With respect to public pension income, the Commission notes the necessity to establish a separate classification for that income and to also review the appropriateness of the current public pension deduction system along with the prior mentioned review of the employment income deduction. The report notes the possibility to unify the taxation of miscellaneous income streams derived from asset management into a single classification, considering the equalization of tax system.

(ii) Unification of taxation on income from financial assets

The Commission notes that they will take over the report, "The Basic View on the Unification of Taxation on Income from Financial Assets", which was issued by a sub-committee of the Commission on June 2004, and emphasized the necessity of examining the simplicity and neutrality of the current tax system with regards to taxation of income from financial assets and providing recommendations to achieve such objectives.

## **2. Rationalization of administration**

(i) A system of taxpayer identification number

The Commission notes the necessity of introducing a system of taxpayer identification numbers, which will contribute to making the system more appropriate and fair and making information collection more efficient. It is essential to introduce a system of taxpayer identification numbers in order to match profit/loss incurred from financial assets and reported on individual tax returns with submitted payment records from related financial institutions.

(ii) Burden of proof

The burden of proof is generally on the side of the government under the current tax regime. The Commission notes, however, the necessity of introducing a new system in which a taxpayer should assume the burden of proof in some specific instances.

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