Tentative Presumptive Taxation

Akiyuki Asatsuma

Professor, College of Law and Politics, Rikkyo University

Abstract

Mainly in the United States, it has recently been argued that the tax agency should not stick to the realization basis but collect more tax earlier tentatively and presumptively to improve taxpayer compliance (real taxpayers may request a tax refund later). This procedure may be translated into *suikei kazei* (estimation taxation) in Japanese. More suitably, it may be called a tentative presumptive taxation. Taxation proposals taking advantage of economic knowledge are attractive but could change the idea that income realization and income personal attribution should be defined by private law. This may not necessarily be wrong. If such change occurs, arguments that private law effects should be respected by reference to "the principle of statute-based taxation" may decline.

I. Introduction

Mainly in the United States, it has recently been argued that the tax agency should not stick to the realization basis but collect more tax earlier tentatively and presumptively to improve taxpayer compliance (real taxpayers may request a tax refund later). This procedure may be translated into *suikei kazei* (estimation taxation) in Japanese; however this article does not discuss *suikei kazei*. This procedure may be called tentative presumptive taxation. This article considers an acceptable range of tentative presumptive taxation and thinks about an influence to "the principle of statute-based taxation" of the Japanese Constitution, Article 84, when tentative presumptive taxation is accepted.

It is traditionally and commonly thought that when a taxable person gets a taxable thing (income, if there is no exceptional situation), it is called a realization[1], and that the timing of realization is judged with legal standards as a general rule (and there are some exceptional situations with illegal income[2] or control standards[3]). However, the definition of the Schanz-Haig-Simons global income concept is <income = consumption + net wealth growth>, and this definition has no legal standards as a transaction. If we look at the income tax system from the viewpoint of economics, to grasp the income of a certain taxpayer's needs, amount of consumption, and amount of net wealth growth only. In short, the issue of income seems to be an issue of fair market valuation. To judge income realization with legal standards

[1] Supreme Court, 8 March 1974, Minshû vol. 28, no. 2, p. 186.
[2] Supreme Court, 9 November 1971, Minshû vol. 25, no. 8, p. 1120.
[3] Supreme Court, 24 February 1978, Minshû vol. 32, no. 1, p. 43.

might be strange from the viewpoint of economics with deductive thinking from the definition of global income concept. It might be thought as mysterious why tax lawyers make reference of private law when treating income taxation in contexts of not only procedural matters but also substantial matters.

In chapter II or below, the realization principle in income taxation is a root of evil of tax deferral or lock-in effect[4]. It is not surprising if a person thinks that judging income realization with reference of legal standards is bad. Moreover, recent proposals of income taxation (especially, financial income taxation) have a tendency to be proposals of tax systems which rarely induce realization problems with reference of legal standards. I graduated from legal faculty and have not sufficiently studied economics, but financial income taxation proposals with the help of ideas of economics seems to me good sense. However, a lawyer should study how and to what extent we can neglect realization with reference of legal standards in the income tax system.

Many readers will have little interest with an issue: can we say that there is no limitation on legislation of deemed income taxation mechanisms with little reference of legal standards if we write something in statute? It is commonly thought that constitutional binding on legislative discretion of tax statute is weak[5]: therefore it is commonly anticipated that legislative discretion of tax statute which amends the income realization principle is also wide. However the story does not end. In the future, if legislation of tax statute with little reference of legal realization will be accepted as common, it induces breakings to traditional tax jurisprudence which has respected private law effects because of the principle of statute-based taxation when discussing the relation between tax law and private law. However, I emphasize the next sentence. Now, I do not plan to argue a certain conclusion in a certain case in saying <breakings to traditional tax jurisprudence> from the standpoint of opposing the idea of respect with private law effects. This article only treats anticipation of the future when tax legislation with little reference of income realization principle will be common.

Traditional tax jurisprudence treats income realization and personal income attribution with reference of private law. It is because today's tax statute cannot sufficiently legislate criteria of income realization and personal income attribution. There is a question. Is it impossible to grasp income with no reference of private law? Or, legislation to grasp income or other taxable things in tax statutes is not impossible if our tax jurisprudence research will be developed in the far future, but now, tax jurisprudence is not sufficiently developed and tax statute reluctantly legislate to grasp income or other taxable things with reference to private law? I have such questions. This article's discussion concerning tentative presumptive taxation might be able to give us some hints with the question above. The relation between tax law and private law have been commonly discussed in the context of interpretation, but discussion of tentative presumptive taxation might be able to give us hints about the relation

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4 NAKAZATO, Minoru, et al., *Sozeihou Gaisetsu* (Treatise on Japanese Taxation), pp. 119-121 (2nd ed., Yûhikaku, 2015, written by ASATSUMA, Akiyuki).

5 Supreme Court, 27 March 1985, Minshû vol. 39, no. 2, p. 347.

between tax law and private law in the context of legislation.

In this article, for ease of calculation, the interest rate/discount rate is 3% per year, the calculation method is compound, and the tax rate is 40% unless otherwise noted. I, as a tax jurisprudence student, do not believe in the global income concept: therefore I have a doubt whether financial income taxation improves social welfare. However pro- or con-global income concept is not the task of this article. This article presupposes the global income concept unless otherwise noted. This article uses <___> as a clarification of breaks and uses '___' "___" as citation. This article does not use job titles or honorific titles.

Chapter II reviews financial income taxation proposals concerning harm from the debt/equity distinction and realization principle. This article's main task is not substantial matters of a desirable income tax system, but it is needed to introduce why financial income taxation proposals have a tendency to be tentative presumptive taxation, because financial income taxation proposals in an American tax jurisprudence context are not well-known in Japan. Generally, debt/equity distinction favors debt investment and disfavors equity investment. Moreover, the realization principle gives rise to harm of tax deferral and lock-in effects. If we adopt the mark-to-market principle, we can remove harm from the realization principle: moreover debt/equity distinction might be unnecessary and it means corporate income taxation might also be unnecessary. However tax proposals directly introducing the mark-to-market principle does not seem to be mainstream in American tax jurisprudence. Rather, it seems to be well-acknowledged and presupposed that taxation can be done only in timing of realization to a certain extent: therefore, in order to approach tax effects of the mark-to-market principle as a consequence with presupposition of taxation timing in realization, tentative presumptive taxation of <(1) regardless of whether debt investment holders or equity investment holders, deemed interest income equivalent to time value of money is constructively included in the income tax base every year; (2) tax basis is adjusted every year; and (3) when debt/equity holders' final gain or loss became realized and definite, then the difference amount between the realized amount and basis amount is included in the tax base> are frequently discussed for reducing harm from the debt/equity distinction and realization principle.

Chapter III reviews tentative presumptive taxation proposals not only in the context of financial income taxation. With a viewpoint of prospect theory, there is a proposal that, in the field of small enterprise taxation with tax evasion problems because of cash business, collecting more tax earlier tentatively and presumptively and giving right of tax refund claim later will improve tax compliance. This proposal can have possibilities of development not only in the context of small enterprise taxation if we have an image of tax procedures with a third-party in collecting and paying taxation such as withholding tax. These tax proposals roughly labeled as a deviation from an idea in which tax shall be imposed on true income earners in the right timing of income realization.

Chapter IV discuss that, with reference of transfer pricing tax legislations which can be

called as the frontier of (not tentative but) presumptive taxation, deviation from an idea in which tax shall be imposed on true income earners in the right timing of income realization might give rise to some effects for relation between tax law and private law and today's respect for effects of private law from the traditional tax jurisprudence might be weakened.

II. Tentative presumptive taxation proposals reducing harm from debt/equity distinction and realization principle

II-1. Harm from debt/equity distinction and realization principle

II-1-1. Debt/equity distinction

It is common that corporations' income and shareholders' income are separately taxed in today's income tax system. Therefore, debt/equity distinction is serious. Suppose that Mr. A (or Ms. A) who is an individual has shares of B corporation as equity investment: generally dividend payments from B co. is not deducted from B co.'s taxable income calculation, and therefore economic double taxation on income occurs between B co. and Mr. A[6]. Suppose that Mr. A has bonds issued by B co. as a debt investment: generally interest payments from B co. are deducted from B co.'s taxable income calculation, and therefore economic double taxation on income does not occur between B co. and Mr. A. Equity investment in a corporation is relatively disfavored. Equity investment can be inefficiently reduced and debt investment can be inefficiently increased. Moreover, investment to corporations can be inefficiently reduced and investment to partnerships can be inefficiently increased, because, among forms of equity investment, economic double taxation on income does not occur between a partner and a partnership: it means that today's income tax system gives rise to distortions in electing forms of entities[7].

II-1-2. Realization principle and tax deferral

Next, the realization principle[8] gives rise to harm of tax deferral and lock-in effects. In this section we look at tax deferral.

Suppose that corporate income tax is lighter than individual income tax and that earnings through B co. are not included in the taxable income of Mr. A as a shareholder unless B co. makes dividend payments to Mr. A: tax deferral can give advantages to taxpayers. In extreme, suppose that Mr. A's income is taxed at a 40% rate and B co.'s income is taxed at a 0% rate.

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6 This article does not discuss the Japanese Corporate Tax Act, Articles 23 and 23-2 which treats double taxation between parent companies and subsidiaries.

7 It is well-known that many taxpayers in Japan elect forms of a corporation rather than a partnership because of wage deduction and splitting income among families. This article does not discuss it.

8 Built-in gain/loss is not includable into taxable income until an event (for example, sale) occurs.

For example, Mr. A invests an after-tax amount of 1 at the beginning of year 1 directly (it means not through B co.) and the before-tax rate of return is 3% per year. At the end of year 1, before-tax income of 0.03 arises, income tax amount of 0.012 arises, after-tax income amount of 0.018 is included in the investment principal amount of 1, and, at the beginning of year 2, 1.018 is reinvested. If Mr. A repeats it ten times, then the after-tax amount at the end of year 10 is $1 \times \{1 + 0.03 \times (1 - 0.4)\}^{10} = 1.018^{10} = 1.19530237$.

For example, Mr. A invests an after-tax amount of 1 at the beginning of year 1 into B co., and B co. reinvests the amount of 1 at a rate of return of 3% per year. At the end of year 1, an income amount of 0.03 arises, the amount of 0.03 is included in the investment principal amount of 1, B co. makes no dividend payment to Mr. A, and, at the beginning of year 2, 1.03 is reinvested. If B co. repeats it ten times, then the amount at the end of year 10 is $1 \times \{1 + 0.03 \times (1 - 0)\}^{10} = 1.03^{10} = 1.34391638$. If B co. pays all to Mr. A, then the income of Mr. A is $1.03^{10} - 1$, tax amount of $(1.03^{10} - 1) \times 0.4$ arises, and finally Mr. A can consume $(1.03^{10} - 1)(1 - 0.4) + 1 = 1.20634983$. This result is desirable for taxpayers than the result in the preceding paragraph. Therefore, tax deferral is generally desirable for taxpayers[9].

In Japan in the near past, the highest individual income tax rate with local tax was 50%, and the corporate income tax rate with local tax was over 40%. The difference between the individual income tax rate and corporate income tax rate was small: at that time it was not a significant problem that tax deferral could be desirable for taxpayers. Under Abenomics, however, the corporate income tax rate was reduced[10] and the difference between the individual income tax rate and corporate income tax rate was becoming large[11].[12]

II-1-3. Realization principle and lock-in effects

Next, the realization principle gives rise to harm of lock-in effects.

Suppose that Mr. A bought B co.'s shares with a basis of 0 in the past and at the end of year 1, the price of B co.'s shares is 1. Suppose that the income tax rate is 40% for individuals

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[9] Long capital gains are lightly taxed in many countries. This article does not discuss it.

[10] The corporate income tax rate with local tax is under 30%, but size-based taxation in local tax is increased: effective corporate tax burden is not dramatically reduced in Japan and it is skeptical whether lowering the corporate income tax rate can induce capital investment in Japan. This article does not discuss it.

[11] Nowadays, optimal taxation theory has a tendency to suggest that the optimal highest individual income tax rate is high (50% - 80%): today's highest individual income tax rate in Japan is 56.155% and value added tax rate is 8% but such a high tax burden in the contexts of the income tax system and consumption tax system can be justified. See KUNIEDA, Shigeki, *Zeisei kaikaku no ronten* (Issues in Tax Reform), Sozei Kenkyû, no. 733, p. 41 (2010.11). This article does not discuss it.

[12] The traditional purpose of CFC (controlled foreign corporation/company) legislation is anti-tax deferral in textbooks in the United States, and is not anti-tax deferral but anti-tax avoidance in the Japanese context: I also think that American and Japanese CFC legislation can hardly be explained as anti-tax deferral, but this article does not discuss it. See TAKAHASHI, Gen, editorial supervisor, *TAX HAVEN TAISAKU ZEISEI NO KAISETSU* (EXPLANATION ON ANTI-TAX HAVEN LEGISLATION), p. 92 (Seibunsha, 1979).

and 0% for corporations.

First strategy (repurchasing strategy): Mr. A sells B co.'s shares at the end of year 1 at the price of 1. Capital gain of 1 is realized, 40% tax is imposed, and Mr. A pays a tax amount of 0.4. At the beginning of year 2, Mr. A invests 0.6 to buy shares of another corporation (C co.). Suppose that before-tax risk free rate of return is 3% per year, C co. also earns 0.018 ($=0.6\times 3\%$), and Mr. A sells the C co.'s share at the price of 0.618 at the end of year 2. A capital gain of 0.018 is realized and Mr. A pays a tax amount of 0.0072. Mr. A's after-tax amount at the end of year 2 is 0.6108. If the risk free rate of return of 3% is r and the tax rate of 40% is t, then it means $(1-t)+(1-t)r(1-t)$.

Second strategy (keeping strategy): At the end of year 1, suppose that Mr. A does not sell the B co.'s share and keeps them: therefore capital gain of 1 is not realized. Suppose that, in year 2, B co. earns 3% which is equivalent of before-tax risk free rate of return, and, at the end of year 2, Mr. A sells the B co.'s share at the price of 1.03. Capital gain of 1.03 is realized, and Mr. A pays tax amount of 0.412. At the end of year 2, Mr. A's after-tax amount is 0.618. It means $(1+r)(1-t)=(1-t)+r(1-t)$.

Under realization principle, keeping strategy is generally advantageous for taxpayers than repurchasing strategy. It means {keeping strategy} − {repurchasing strategy} = $\{(1-t)+r(1-t)\}-\{(1-t)+(1-t)r(1-t)\}=tr(1-t)>0$. Therefore investment can be distorted.

In the context of international capital investment, when B co. is a foreign corporation (especially in no or light tax countries), postponing repatriation of funds from the foreign corporation to Mr. A as a shareholder in a home country is advantageous for taxpayers. It is called as lock-out effects, inspired from lock-in effects.

II-2. Mark-to-market principle will resolve problems

Taxation method in line with global income concept (income = consumption + net wealth growth) is not realization principle but mark-to-market principle. If we adopt mark-to-market principle, taxable income of a certain individual is determined by valuation of his consumption and his asset[13]. Suppose that Mr. A has shares of B co. If we adopt the mark-to-market principle and A's taxable income is determined only by looking at the value of A's shares (it means that we can neglect whether dividend payments or sale of A's shares occur or not), then corporate income taxation is not needed. Even if Mr. A has not shares but bonds of B co., debt/equity distinction problems will disappear under mark-to-market principle.

It is well-known that enforcement of mark-to-market principle under global income concept is difficult. There are two main issues: first is the difficulty of financing cash for paying tax when capital gains are not realized, and second is the difficulty of valuation and capturing.

First difficulty of financing is eased if a taxpayer can borrow money. If the taxpayer can

[13] This article does not discuss tax unit issues concerning couples or families.

borrow money but his interest rate is higher than the risk free rate of return, then national fisc can lend money to the taxpayer at risk free rate.

Second, the difficulty of valuation and capturing, it is needed to make some formal standards for valuation in order to make enforcement easy. For example, I have proposed a model in line with the mark-to-market principle concerning double- or multitier interests in trusts[14], but the model is too hard to enforce: therefore if the model is legislated, some simplified formal standards of valuation (it means formal rule) are needed. Rule-based mark-to-market principle will not be the equivalent of the realization principle which looks at sale or other types of disposition, but can be close to the current taxation methods in which the realization principle is not perfectly accomplished because depreciation does not look at legal disposition and because some types of realized capital gain are not taxed with non-recognition legislations.

Moreover, it has already been explained that there is resemblance between difficulty of enforcement of the mark-to-market principle and necessity of corporate income taxation[15]. It is difficult to finish all matter of taxation at the stage of members (shareholders, partners, trust beneficiaries, etc.) and we need to calculate income at the stage of entities (corporations, partnerships, trusts, etc.): this point shows the resemblance between the difficulty of the mark-to-market principle and the difficulty of a tax system without corporate income taxation. A supplementary explanation is needed when we say that the calculation of income is only able to be done at the stage of entities. If we accept tax deferral problems and we adopt not the global income concept but the consumption type income concept like William D. Andrews, then we do not need to calculate income at the stage of entities, because tax equity is not harmed even if timing of taxation is deferred until dividends or other distributions from entities flow to members. If we adopt a consumption type income concept with an expensing method[16] (discussed in II-5-1) and we do not have corporate income taxation, then members who receive dividends every year are not necessarily subject to tax earlier and are treated less favorably at the disadvantage of the time value of money than members who receive dividends some years later, because the former members can reinvest the earlier received dividends with deductions and can have the opportunity to get a return of the time value of money. Concerning capital gain/loss taxation, not only the mark-to-market principle

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[14] ASATSUMA, Akiyuki, *Sintaku zeisei kenkyu: eikoku jire (Astall jiken oyobi Mayes jiken) no shoukai to kinyû shotoku kazei model no ouyou* (Trust Taxation Study: Review of English Cases (Astall case and Mayes case) and Application of Financial Income Taxation Model), Sozei Kenkyû, no. 769, p. 156 (2013.11). I proposed a calculation model for double- or multitier interests in trusts for securitization of housing loan etc. and a calculation model for double- or multitier interests in trusts in a case in which one of the heirs gets preferential income flow from a certain inheritance property and another heir gets the stock right of the inheritance property after the first heir has died. A real example is Tokyo High Court, 29 August 2014, case number Heisei 24 (Gyou-ko) 466.

[15] MASUI, Yoshihiro, *Soshiki keitai no tayouka to shotoku kazei* (Diversity of Entities and Income Taxation), Sozeihou Kenkyû, no. 769, p. 1, at 12 (2002).

[16] NAKAZATO, note 4, pp. 112 and 162 (written by ASATSUMA, Akiyuki and YOSHIMURA, Masao).

but also the realization principle do not infringe tax equity if we permit tax deferral with the consumption type income concept.

Note that the resemblance between the difficulty of the mark-to-market principle and the difficulty of the tax system without corporate income taxation under the global income concept does not always relate with the existence or non-existence of the legal personality of entities[17]. Moreover it does not always relate with necessity or unnecessity of double taxation between shareholders and corporations. Even if we adopt corporate income taxation, we can eliminate double taxation through paid dividend deduction methods. In reality, moreover, paid dividend deduction methods with entities which applied corporate income taxation are not rare.

Even if legislation in the income tax act defines taxable income as <income = consumption + net wealth growth>, and the amount of consumption and net wealth growth is legislated to be valued with mark-to-market principle, such legislation does not necessarily violate the principle of statute-based taxation of the Japanese Constitution Article 84. Such a legislation in the income tax act would be different from the income tax act in the real world in which income is grasped with reference of private law. However, such difference would not be serious as discussed earlier, because such legislation with mark-to-market principle would need rule-based mark-to-market valuation.

II-3. Middle between global income concept and consumption type income concept

This article generally presupposes the global income concept, but if we presuppose the consumption type income concept, even realization-based taxation is too early, because, under the consumption type income concept with an expensing method, even realized income shall not be subject to tax if the realized income is reinvested: tax deferral until timing of consumption is a good taxation method in line with the consumption type income concept. The global income concept with the mark-to-market principle would eliminate the necessity of corporate income taxation and the consumption type income concept with taxation timing of consumption would also eliminate the necessity of corporate income taxation.

It has already been discussed that the realization principle is a compromise between the global income concept and consumption type income concept[18] [19].

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[17] The Japanese tax system has a strong correlation with the application of corporate income taxation and existence of legal personality, but some entities with legal personality are not necessarily subject to corporate income taxation in other countries (United States, France, Germany, etc.).

[18] I make examples below with reference of LEE, Chang-Hee, *Sozei Seisaku No Bunseki Wakugumi (Jou)* (Analyzing Framework of Tax Policy (First Part)), Jurist, no. 1220, p. 119, at 124 (2002).

[19] Terrence R. Chorvat, Perception and Income: The Behavioral Economics of the Realization Doctrine, 36 Connecticut Law Review 75 (2003) discusses that the realization principle is based on human psychological perception because people have tendencies to fix gains early even though tax deferral is a favor for taxpayers. It is not frequently cited but I think that it is interesting.

For example, suppose that, at the end of year 0, Mr. A receives a right that will give him cash of 1000 at the end of year 1, 1000 at the end of year 2, and 1000 at the end of year 3. How can we calculate the income of Mr. A? Under the global income concept with the mark-to-market principle, the income of the amount of the right in fair market value 2829($= 1000/1.03 + 1000/1.03^2 + 1000/1.03^3$) arises at the end of year 0. At the end of year 1, the fair market value of the right is decreased to 1913($= 1000/1.03 + 1000/1.03^2$). In year 1, Mr. A's valuation loss of the right is 915[20] and the cash receipt is 1000, therefore Mr. A's income in year 1 is 85. At the end of year 2, the fair market value of the right is decreased to 971($= 1000/1.03$). In year 2, Mr. A's valuation loss of the right is 943[21] and the cash receipt is 1000, therefore Mr. A's income in year 2 is 57. At the end of year 3, the fair market value of the right is decreased to 0. In year 3, Mr. A's valuation loss of the right is 971 and cash receipt is 1000, therefore Mr. A's income in year 3 is 29. If we calculate Mr. A's income in line with the global income concept, his income in year 0, 1, 2, and 3 is (2829, 85, 57, 29).

If we adopt cash methods, then his income is (0, 1000, 1000, 1000). The cash method is suitable with the consumption type income concept if Mr. A consumes 1000 every year. The concept of time value money tells us that (2829, 0, 0, 0) = (0, 1000, 1000, 1000) because 2829 is calculated as such: the income calculation of (2829, 85, 57, 29) under the idea of the global income concept imposes a heavier tax burden than under the consumption type income concept. The realization method stands in the middle between the mark-to-market method and cash method[22]. Therefore, the realization principle is a compromise between the global income concept and consumption type income concept.

This article does not discuss the global income concept vs. consumption type income concept deeply. It has already been discussed that the difference between the global income concept and consumption type income concept is the time value of money, and, in quantity, the time value of money is not so large[23]. In examples in the preceding paragraph, the time value of money is (0, 85, 57, 29) out of the global income concept calculation of (2829, 85, 57, 29). This article presupposes 3% per year[24], but the true time value of money might be smaller.

Moreover, an acceptable income tax system in reality (heavier tax on labor income and lighter tax on capital income) would not be largely different regardless of whether we start from the global income concept or consumption type income concept as an ideal type of

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[20] $2829 - 1913 = 916$, but $(1000/1.03 + 1000/1.03^2 + 1000/1.03^3) - (1000/1.03 + 1000/1.03^2) \fallingdotseq 915$.

[21] See note 20.

[22] However, I cannot tell with certainty that income calculation with realization principle is (2829, 85, 57, 29) or (0, 1000, 1000, 1000). This example might show ambiguity of realization principle.

[23] NAKAZATO, note 4, at 237 (written by KOHYAMA, Hiroyuki); MASUI, Yoshihiro, *SOZEIHOU NYÛMON* (INTRODUCTION TO TAX LAW), at 165 (Yûhikaku, 2014); Joseph Bankman & Thomas Griffith, Is the Debate Between an Income Tax and a Consumption Tax a Debate About Risk? Does it Matter?, 47 Tax Law Review 377 (1992).

[24] In note 23, I say that the time value of money is small, but, it might be a contradiction to say that there has not been consensus about a risk free rate of return. See Thomas J. Brennan, Perils of Partial Mark-to-Market Taxation (http://ssrn.com/abstract=2313214) at 15.

income tax system.

Even if we start from the global income concept, there is fear of capital flight if we impose the same tax burden on capital income and labor income: therefore lighter tax on capital income would be acceptable. In reality, almost all countries do not believe in the consumption type income concept, but there are tendencies to impose light tax on capital income.

Even if we start from the consumption type income concept, there is fear whether we can impose a sufficiently heavy tax burden on labor income (or consumption amount if we adopt an expensing method) from the viewpoint of tax equity against inequality among rich and poor people, because there is fear of an insufficient grasp of labor income amount or consumption amount or fear of top earners' expatriation from their countries: therefore capital income taxation might not be zero although the tax burden on capital income would be lighter than on labor income and the ideal type of tax exemption of capital income from the standpoint of the consumption type income concept might not be able to be accomplished.

There seems to be normative pros or cons for lighter tax on capital income[25], but in reality, many countries adopt lighter tax on capital income regardless of whether dual income taxation is expressly adopted or not[26]. A middle type of income tax system from the viewpoint of theory between the global income concept and consumption type income concept is, in reality, adopted in many countries.

II-4. Taxation on deemed income of time value of money and adjustment of basis

II-4-1. Proposals intending to come close to effects of market-to-market principle taxation even though not adopting mark-to-market directly

If we adopt the global income concept, taxation in line with mark-to-market principle would not give rise to harm of tax deferral and lock-in effects. Moreover, such a tax system would eliminate the necessity of corporate income taxation and eliminate problems of debt/equity distinction.

Enforcement of the mark-to-market principle is burdensome, but there are some methods of imposing tax in the timing of realization but avoiding the effects of tax deferral although such methods are not mark-to-market principle. One legislative example is the OID rule[27].

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[25] For example, KANEKO, Hiroshi, *SOZEIHOU* (TAX LAW), 21st ed., at 204 (Kôbundô, 2016) states, "asset type income has the biggest ability to pay and labor type income has the smallest ability to pay", although I do not agree with him.

[26] For an opposite example, however, KANEKO, note 25, p. 204 also states, "[Japanese] Income Tax Act adopted the idea that a heavier tax on asset type income = lighter tax on labor type income", although I do not agree with him.

[27] HASHIMOTO, Shinichirô, *Time-value to bet -- houjinzei wo meguru kinyû shôhin no tax planning* (Time-value and Bet -- Tax Planning of Financial Instrument in Corporate Tax), Jurist, no. 1276, p. 124 (2004); HASHIMOTO, Shinichirô, *OID rule no derivative heno kakuchô* (Application of OID Rule to Derivatives), Kokka Gakkai Zassi, vol. 118, no. 5=6, p. 600 (2004).

Since the 1990s in American tax jurisprudence, there have been many discussions in order to tackle the harm of tax deferral and lock-in effects. We do not distinguish debt/equity and the time value of money and bet, deemed income as normal returns equivalent to the time value of money arises every year. The tax basis is correspondingly adjusted every year, and finally during a time when the uncertainty is dissolved (for example, in the sale of properties), the difference between the realized price and the basis is recognized as a taxable gain/loss as the bet's extraordinary return.[28]

For example, Kleinbard proposed the BEIT (Business Enterprise Income Tax)[29]. Roughly speaking, at the stage of an individual investor, the normal return equivalent to time value is deemed to arise every year, at the stage of an enterprise regardless of having legal personality or not, deemed expense deduction equivalent to time value is allowed regardless of debt/equity distinction, and, at the stage of the investor, the tax basis is correspondingly adjusted every year. Mainstream financial income taxation proposals in American tax jurisprudence since the 1990s show a goal of <taxation on deemed income equivalent to the time value of money and basis adjustments>, and such basis ideas are useful not only in the United States. In American tax law, there have been challenges on long term capital gains/losses, but such ideas would be able to eliminate light taxation on long capital gains.

II-4-2. Adjustments of inside basis and outside basis

There are troubles concerning adjustments of an inside basis (basis of assets belonging to entities (partnerships, trusts, and corporations)) and an outside basis (basis of interests of members (a partner's interest in a partnership, a beneficiary's interest in a trust, and a shareholder's share of a corporation)).

If a member is a shareholder and an entity is a corporation, then taxation of the corporation[30] (inside basis issues) and taxation of capital gain/loss of the share of the

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[28] In ASATSUMA, note 14, I mainly introduced Reed Shuldiner, General Approach to the Taxation of Financial Instruments, 71 Texas Law Review 243 (1992), but there are many discussions. Schuldiner said that distinction between anticipated deferral and unanticipated deferral is important: if a taxpayer does not know win or lose about unanticipated deferral, then such deferral will give him an expected return of 0. Schuldiner's model has also a weak point. There are some situations in which one price is set for a unit of two or more assets. We should divide the price among assets but dividing methods of the price is not only one.
HASHIMOTO, note 27 and KOHYAMA, Hiroyuki, *Sozeihou niokeru nendo kizoku no riron to houteki kouzou* (1 - 5 finished) (Chronological Attribution Theory in Tax Law and Attribution in Law), Hôgaku Kyôkai Zassi, vol. 128, no. 10, p. 2399, no. 12, p. 3160, vol. 128, no. 1, p. 99, no. 2, p. 331, no. 3, p. 587 (2011-2012) discussed tax deferral in detail.

[29] Edward D. Kleinbard, Designing an Income Tax on Capital, in Henry J. Aaron, Leonard E. Burman & C. Eugene Steuerle, ed., TAXING CAPITAL INCOME 165-205 (The Urban Institute Press: Washington, DC, 2007); Edward D. Kleinbard, Rehabilitating the Business Income Tax (June 2007).

[30] When we use the words, inside basis and outside basis, we mainly look at capital gain/loss taxation. This article also looks at income taxation at the stage of an entity, such as corporate business income taxation.

shareholder (outside basis issues) are rarely adjusted. Therefore, there is double taxation between the corporation and the shareholder.

If we look only at an inside basis and neglect the outside basis, for example, corporations' income is taxed and shareholders' income as received dividends or capital gain/loss of shares is not taxed, then the double taxation problem is eliminated. It means that received dividends exclusion is applied not only to corporate shareholders but also to individual shareholders. In this tax system, a progressive tax rate cannot be applicable to individuals' income.

If we neglect the inside basis and look only at an outside basis, for example, corporations' income is not taxed and shareholders' income as received dividends or capital gain/loss of shares is taxed, then the double taxation problem is also eliminated. Moreover, a progressive tax rate can easily be applicable to individuals' income. It means the abolishment of corporate income taxation. Instead, the tax deferral problem becomes more serious than now.

<Taxation on deemed income equivalent to the time value of money and basis adjustments> means that we mainly look at an outside basis and that we weaken the tax deferral problem. Therefore, the effects of this tax method are close to the effects of the mark-to-market principle applicable to shares.

II-4-3. Source tax jurisdiction and residence tax jurisdiction

International taxation is not the main target of this article, but the relation between an inside basis and an outside basis resembles a relation between source tax jurisdiction and residence tax jurisdiction.

Suppose that T_p is the individual personal income tax rate, T_c is the corporate income tax rate, T_s is the tax rate in the source country, and T_r is the tax rate in the residence country. Remedies of double taxation in the international tax system (full remedies and partial remedies) and remedies of double taxation between corporations and shareholders (full remedies and partial remedies) can be illustrated similarly as follows:

Foreign tax deduction method $(1-T_s)(1-T_r) \fallingdotseq$ Classical method $(1-T_c)(1-T_p)$
Foreign income exemption method $(1-T_s)(1-0)$
$\fallingdotseq$ Received dividends exclusion method $(1-T_c)(1-0)$
Source countries' exemption method $(1-0)(1-T_r) \fallingdotseq$ Partnership method $(1-0)(1-T_p)$
Foreign tax credit method $(1-T_s-(T_r-T_s)) \fallingdotseq$ Imputation method $(1-T_c-(T_p-\alpha T_c))$[31]

Roughly speaking under today's international tax system, business profits of a PE (permanent establishment) located in a source country is subject to source tax jurisdiction, and residence tax jurisdiction allows foreign tax credit as remedies for international double taxation. Outside basis taxation (residence-based taxation) is not abolished but inside basis taxation (source-based taxation) takes priority.

[31] If we adopt 100% imputation method, then $\alpha = 100\%$.

The foreign income exemption method is close to the idea which looks only at an inside basis and neglects the outside basis.

On the other hand, a direction weakening source tax jurisdiction like source countries' exemption method (by the way, this direction has weak support because of arguments of anti-BEPS: base erosion and profit shifting) is close to the idea which neglects the inside basis and looks only at an outside basis.

If we place greater value on tax equity among individuals, then we have tendencies to place greater value on the outside basis and to place greater value on residence tax jurisdiction. If we carry through outside basis taxation on individuals, then we do not need corporate income taxation. Moreover we do not need CFC (controlled foreign corporation/company) legislation. Economics academicians in the League of Nations[32] proposed source countries' exemption method: that story was not so strange from the viewpoint that the ultimate purpose of income taxation is the equitable allocation of tax burden among individuals.

In international settings, however, there are issues of not only equitable allocation of tax burden among individuals but also allocation of taxing rights among countries. The latter issue cannot neglect the inside basis and source tax jurisdiction. It is difficult to say whether there is consensus to say that this issue is about inter-nation equity[33]: however, in the end, the League of Nations did not adopt economics academicians' proposals which neglects source tax jurisdiction[34].

Moreover, because of lighter taxation on capital income and difficulties of grasping foreign bank accounts of residents from the viewpoint of residence countries, <placing greater value on an outside basis and residence tax jurisdiction> was not easy to enforce in the 20th century. Difficulty of enforcement of outside basis taxation and residence-based taxation does not necessarily give a theoretical foundation of placing greater value on an inside basis and source tax jurisdiction. But we can easily say that the fact that we, in the 20th century, elected the idea that source tax jurisdiction had priority in cases of existence of PEs is not odd.

It is very difficult to foresee whether the idea that an inside basis and source tax jurisdiction has priority is also suitable in the 21st century or not.

On the one hand, we can see an atmosphere in which equitable allocation of tax burden

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[32] League of Nations: Economic and Financial Commission, REPORT ON DOUBLE TAXATION: submitted to the Financial Committee: by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp (Geneva, 5 April 1923).

[33] Richard Musgrave & Peggy Musgrave, Inter-nation equity, in MODERN FISCAL ISSUES. ESSAYS IN HONOR OF CARL S. SHOUP 63, at 68 (University Microfilms International, 1972).

[34] See TANIGUCHI, Setsuo, *Model sozei jôyaku no tenkai (1) -- sozei jôyaku nioeru "kokkakan no kôhei" no kôsatsu* (Development of Tax Treaties (1) -- Discussion about "Inter-Nation Equity" in Tax Treaties), Kônan Hôgaku, vol. 25, no. 3&4, p. 77 (1985); FUCHI, Keigo, *SHOTOKU KAZEI NO KOKUSAITEKI SOKUMEN* (INTERNATIONAL ASPECTS OF INCOME TAXATION), chapter 2 (Yûhikaku, 2016).

among individuals has become serious like conflicts between the 99% vs. 1%[35] (although it is mysterious that such an atmosphere is not seen in Japan). Such equitable allocation of tax burden would have possibilities that we make a goal of placing greater value on an outside basis and residence tax jurisdiction.

On the other hand, the viewpoint of allocation of taxing right among countries does not disappear also in the 21st century, and we can also see an atmosphere in which anti-BEPS gives rise to revenge of an inside basis and source tax jurisdiction[36]. This point can lead to misunderstandings, so I should treat this point carefully. The third preceding paragraph stated that we, in the 20th century, elected to place greater value on an inside basis and source tax jurisdiction. This statement can lead to strangeness to readers. In general, the UN Model Tax Convention placed greater value on developing countries' taxing rights, and the OECD Model Tax Convention placed greater value on developed countries' taxing rights. The OECD placed greater value on residence tax jurisdiction than source tax jurisdiction and the OECD Model Tax Convention was more widespread than the UN Model Tax Convention. However, placing greater value on something needs a standard for comparison. The OECD Model Tax Convention certainly placed greater value on residence tax jurisdiction than the UN Model Tax Convention but smaller value than economics academicians' proposals in the League of Nations (note 32). In general, theory has a strong point in comparison, but a standard for comparison itself cannot be deducted from theory. People would say that the OECD Model Tax Convention placed greater value on residence tax jurisdiction, but if we compare the relation between source tax jurisdiction and residence tax jurisdiction and the relation between an inside basis and outside basis (relation between taxation at the stage of entities like corporations and taxation at the stage of members like shareholders), I would like to say that even the OECD Model Tax Convention placed greater value on source tax jurisdiction[37]. However the international tax law system in the 20th century as represented by the OECD Model Tax Convention has loopholes for enforcement of source tax jurisdiction: for example, paid interest deduction, avoidance of PE status, and avoidance of recognition of source of income. Moreover such loopholes have become more vulnerable (loopholes existed since the 20th century so I elect the expression of "more vulnerable") against big enterprises since the end of the 20th century to the beginning of the 21st century. Therefore, we might be also say that anti-BEPS movements in 2010s have a goal of revenge of source tax jurisdiction.

A goal of placing greater value on an outside basis and residence tax jurisdiction for

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[35] See N. Gregory Mankiw, Defending the One Percent, 27 J. Econ. Perspectives 21-34 (Summer 2013) and other articles in that paper.

[36] Lee A. Sheppard, Revenge of the Source Countries?, 106 Tax Notes 1362 (March 21, 2005).

[37] Adams played leading roles in international tax policy making in early times in the United States and he had an idea that source tax jurisdiction had superiority concerning business income. See, Thomas S. Adams, Interstate and International Double Taxation, in LECTURES ON TAXATION 101, at 106 (Roswell Magill ed., Commerce Clearing House, 1932); Michael J. Graetz & Michael M. O'Hear, The "Original Intent" of U.S. International Taxation, 46 Duke L.J. 1021, at 1027 (1997); FUCHI, note 34, p. 250.

equitable allocation of tax burden among individuals and another goal of placing greater value on an inside basis and source tax jurisdiction because of anti-BEPS movements are not necessarily contradictory. The former goal can lead legislations for more effective enforcement of individual residence tax jurisdiction through preparing ways of breaking bank secrets[38] even if a resident individual has assets or sources of income in foreign countries. The latter goal can lead legislations for more effective enforcement of enterprise source tax jurisdiction. Those goals are not necessarily contradictory. Coordination of both goals has already been discussed in academic tax jurisprudence, like the BEIT proposal by Kleinbard: on the other hand, in practical levels and political or diplomatic levels such as the OECD negotiations, such coordination has not yet been sufficiently discussed. Therefore, I cannot easily foresee whether the tax world will place greater value on residence tax jurisdiction or source tax jurisdiction in the 21st century.

Moreover, <placing greater value on source tax jurisdiction> in the preceding paragraph contains very confusing elements.

Not a small number of tax scholars (regardless whether the majority or not) seem to recommend destination-based taxation in the context of enterprise taxation[39]. Destination-based taxation is traditionally used in the context of value-added taxation. Tax scholars who recommend destination-based taxation seem to place little value on distinction between the context of value-added taxation and corporate income taxation. If <placing greater value on source tax jurisdiction> can include possibilities of destination-based taxation, then <placing greater value on source tax jurisdiction> is not an impossible election.

Against the recommendation of destination-based taxation, source tax jurisdiction in the context of income taxation traditionally presuppose that taxing rights are allocated to countries in which producing activities are done. Since 2015, the OECD uses a phrase of “value creation”. It is roughly close to the allocation of taxing rights in line with the origin-base in the context of value-added taxation. Why does the OECD use “value creation” instead of origin, place of producing activities, or exporting countries? I guess that some people tend to argue that countries of demand are also important countries of economic activities which should be allocated taxing rights, but such an idea is controversial, so the OECD uses “value creation” which does not clearly support or eliminate countries of demand. There might be different ideas of allocation of taxing rights among countries when using a phrase of “value creation”. However, the international tax law system since the 20th century in which the “no taxation without PE” rule exists has long adopted a system in which demand itself does not give foundation of the allocation of taxing rights. Therefore, if we do not care about the political and diplomatic atmosphere in which people use a phrase of “value creation” and we do care about the traditional international tax system since the 20th century, then the allocation

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[38] See, Jeremiah Coder, IRS Pays Birkenfeld $ 104 Million Whistleblower Award, 2012 WTD 177-1.

[39] Michael J. Graetz & Rachael Doud, Technological Innovation, International Competition, and the Challenges of International Income Taxation, 113 Columbia Law Review 347 (2013); reviewed by MASUI, Yoshihiro, Sozei Kenkyû, no. 762, p. 272 (2013.4).

of taxing rights in line with “value creation” roughly means origin-based taxation. However, if revenue of origin-based taxation cannot exceed the value of administrative services from the origin country (because if tax revenue exceeds services, then real producing factors like factories or humans will expatriate, and such fear of tax competition is serious), then one of two main roles of the tax system (financing for public goods and redistribution for relief of poor people) cannot be accomplished: origin-based taxation cannot make funds for redistribution. It does not mean complete elimination of origin-based taxation, but such tax would be weak. If <placing greater value on source tax jurisdiction> means origin-based taxation in line with a traditional international tax law system since the 20th century, then, I cannot anticipate that we will place greater value on source tax jurisdiction in the 21st century.

<Placing greater value on source tax jurisdiction> can have two meanings discussed in the preceding two paragraphs. Therefore, discussion is confusing and I cannot foresee whether we will place greater value on residence tax jurisdiction or source tax jurisdiction.

To say simply, however, the forecast that origin-based taxation will not be able to stand in a central position in the tax system shows the possibility that the meaning of residence tax jurisdiction and source tax jurisdiction in today’s corporate income tax system will be weakened. It has already been discussed that income tax allocates taxing rights to a country in which an investor resides, corporate tax allocates taxing rights to an origin country, and value-added tax allocates taxing rights to a destination country[40]. This type of discussion does not care about the fine difference between residence tax jurisdiction and source tax jurisdiction in today’s corporate tax but thinks that, roughly saying, corporate tax is origin-based taxation: such a rough picture seems to be reasonable. Moreover, corporate tax as origin-based taxation will be a vulnerable tax which cannot make tax revenue beyond compensation for administrative services in order to redistribute for poor people under the pressure of international tax competition. Therefore, the meaning of residence tax jurisdiction and source tax jurisdiction (especially in the context of corporate tax) seems to become weakened. Residence-based taxation in the context of individual investors’ income taxation and destination-based taxation in the context of value-added tax seems to become grown.

If we can effectively enforce an outside basis and residence tax jurisdiction in the context of an individual income tax system, then necessity of residence tax jurisdiction and CFC legislation in the context of a corporate income tax system becomes weakened[41]. In the 20th century, sufficient enforcement of an outside basis and residence tax jurisdiction in the

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[40] Institute for Fiscal Studies, MIRRLEES REVIEW: TAX BY DESIGN (Oxford University Press, 2011), chapter 18 Corporate taxation in an international context; WATANABE, Satoshi, *Denshi shôtorihiki to kazei* (Electronic Commerce and Taxation), Sozei Kenkyû, no. 776, p. 161, at 168 (2014.6).

[41] Some people argue that CFC legislation is back-up for insufficient enforcement of transfer pricing tax system but I do not agree with them. Readers might have a question why I refer to the unnecessity of CFC legislation. I believe that in order to enforce inside basis and source tax jurisdiction, even a perfect transfer pricing tax system plays an insufficient role and that formulary apportionment looking at real producing factors or destination-based taxation are last resorts: but this article does not discuss it deeply.

context of an individual income tax system was nearly hopeless. In the 21st century, however, such enforcement might become more hopeful with sufficient information exchange among countries.

Thus far, it seems to have been a rarely discussed relation between the realization principle and the international tax law system, but, as discussed above, such a relation is very dense. It has already been discussed that the necessity of corporate income tax and the necessity of the realization principle have similar structures: I also argue that the necessity of corporate income tax and the necessity of source tax jurisdiction have a dense relation. Moreover, it has been hoped that the realization principle can steadily grasp taxable income, but I anticipate that the realization principle will be weakened: also in the context of corporate income tax, the transfer pricing tax system tends to become taxation not only on realized income but also on deemed realized income. It is impossible that the realization principle is abolished now, but if the appropriateness of the realization principle (harm of the realization principle had already been well-known but alternative methods were also more unreliable so the realization principle was, in comparison, appropriate) will become less and less reliable, views of the international tax law system might be changed. It is impossible to perfectly enforce an outside basis and residence tax jurisdiction now, but this enforcement will become easy and the necessity of realization will become weakened.

II-4-4. J-Box3 as provision: deemed income taxation equivalent to time value of money and basis adjustment

I have proposed that, in reference of financial income tax system proposals in American tax jurisprudence, Japan should legislate J-Box3 as Box3 in the Netherlands, in which deemed income taxation equivalent to the time value of money every year and basis adjustment will reduce roots and the extent of conflicts between taxpayers and tax authorities[42]. I hope that the realized gain/loss in the timing of some events will be small.

<Deemed income taxation equivalent to the time value of money and basis adjustment> in the context of financial income taxation has four merits. First, we might be able to eliminate the necessity of confusing family business taxation provisions. Second, we might be able to eliminate the necessity of CFC legislation in the context of the individual income tax system. Third, we might be able to eliminate the necessity of corporate income tax[43]. Fourth, we can hope for a built-in stabilizer function because in an economic recession loss tends to appear and taxpayers' compliance might become well.

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[42] ASATSUMA, Akiyuki, Shintakutou wo tsûjita shihon shotoku kazei, shisan iten kazei nioite nouzeisha, kazei toukyoku kan no funsou no tane, teido wo yawarageru kokoromi (Proposition for reducing roots and extent of conflicts between taxpayers and tax authorities in the context of capital income taxation and asset transfer taxation through trusts or other entities), Shintaku Shoureikin Ronshû, no. 36, p. 149 (2015.11).

[43] However, in order to allocate taxing right among countries with political and diplomatic acceptance, it might be needed to enforce taxation at the stage of corporations or other entities in source countries.

However there are demerits. It cannot be easily decided whether <deemed income taxation equivalent to the time value of money and basis adjustment> is applied only to financial instruments or also to real assets as immovable properties. If such a tax system is also applied to immovable properties[44], new issues arise whether property tax and deemed income tax should be adjusted or not. If such a tax system is applied to real assets, new issues arise whether we should treat a holding business through shares of corporations (family corporations and publicly traded corporations) and holding businesses directly (individual business income and immovable property income) similarly or not. I had not discussed those demerits in note 42.

Therefore, my proposition of J-Box3 was not well-established and this article's task is not to discuss it deeply. I anticipate, however, that as remedies for harm from the realization principle, Japanese tax policy will refer to financial income tax system proposals in American tax jurisprudence.

II-5. Other issues of realization principle

II-5-1. Timing difference: correlate penalty with economic condition

For example, conflicts[45] between taxpayers and tax authorities concerning the timing of a certain gain/loss tends to give rise to penalties as additional tax for deficient returns or others, which is the base difference between the filed tax amount and the right tax amount. I think that it is also an example of harm of the realization principle. The economic substance of gain of tax deferral for taxpayers is the time value of money of the tax amount.

For example, a taxpayer argues that his income of 1000 is realized in year 2 but the tax authority argues that his income of 1000 is realized in year 1. In this example, the economic substance of the difference between the taxpayer's argument and the tax authority's argument is (deferred income) × (tax rate) × (deferred time) × (risk free rate of return), therefore it means $1000 \times 40\% \times 1 \times 3\% = 12$. In a lawsuit, the taxpayer's income of year 1 is conflicted, and the base of additional tax for deficient returns is 400. If the taxpayer argues that his income in year 1 is 0 and he will not pay tax after year 2, then 400 is good base, but if the taxpayer argues that his income is 0 in year 1 but is 1000 in year 2, then the good base is not 400 but 12.

Some tax scholars also argued that a cash method is suitable[46]. In the example in the preceding paragraph, the taxpayer would file income of 1030 in year 2 or income of 971 in

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[44] If we include housing, then we can impose tax on imputed income which has not been taxed. See, NAKAZATO, Minoru, *Kin'yû Torihiki To Kazei* (Financial Transactions and Taxation), pp. 178ff (Yûhikaku, 1998).

[45] See, Tokyo High Court, 19 July 2013, Shômu Geppô, vol. 60, no. 5, p. 1089.

[46] NAKAZATO, Minoru, *Shotoku gainen to jikan -- kazei no timing no kanten kara* (Income taxation and time -- from the viewpoint of timing of taxation), in KANEKO, Hiroshi, ed., *Shotoku Kazei No Kenkyû* (Studies on Income Taxation), p. 129 (Yûhikaku, 1991).

year 1[47].

II-5-2. Deadline of net operating loss and immediate tax return for loss

For example, a taxpayer argues that his income of 1000 arises in year 1 and this income is offset with a net operating loss and the tax authority argues that his income of 1000 arises in year 2 and he cannot use his net operating loss.

Traditional tax scholars would think that the deadline of a net operating loss should be abolished, or in an ideal type of income taxation, an immediate tax return for loss should be legislated[48].

The reason why we do not legislate an immediate tax return for loss is the difference between income calculation in tax law and true economic income calculation and its possibilities of misuse of the difference[49]. This article basically presupposes the global income concept, so this article cannot support expensing methods, but if we can adopt expensing methods or other methods in which taxpayers have ways of nearly freely electing the timing attribution of income, then opposition against an immediate tax return for loss would become weakened[50].

II-5-3. Income classification in different year

For example, there was an issue whether a refund for misfiled income tax was includable to inheritance properties or temporary income of heirs[51].

Under an ideal global income concept, we do not classify types of income. Although if we adopt a yield exemption method, we should make a distinction between exempt income equivalent to the time value of money and taxable extraordinary return (plus or minus concerning bet elements), if we adopt an expensing method, we also do not classify types of income. From the viewpoint of an ideal global income concept of an ideal consumption type income concept, inheritance properties and temporary income should be similarly taxed. It is

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[47] If there is retrospective change in year 3, it can be questioned whether right timing attribution of income in concern is year 1 or year 2 (Supreme Court, 20 October 1992, Hanrei Jihô, no. 1489, p. 90). Even if we adopt a cash method, there might be space of discussion of relation between timing attribution of income and base of additional tax for deficient returns.

[48] See, MASUI, Yoshihiro, *KETSUGÔ KIGYÔ KAZEI NO RIRON* (THEORY ON COMBINED ENTERPRISE TAXATION), at 288 (University of Tokyo Press, 2002), although Masui does not support immediate tax return for loss.

[49] MASUI, note 48, p. 290.

[50] However, inter-personal transfer of tax attributes cannot be easily allowed, especially when tax attributes is transferred to a foreign person. See, NAKAZATO, Minoru, *Hôjin kazei no jikûkan (chronotopos) -- Houjin kan torihiki niokeru kazei no chûritsusei* (Chronotopos (timing and location) of corporate taxation -- tax neutrality in transactions between corporations), in festschrift in honor of retirement of professor SUGIHARA, Yasuo, *SHUKEN TO JIYÛ NO GENDAITEKI KADAI* (TODAY'S ISSUES ON SOVEREIGNTY AND FREEDOM), p. 361 (Keisô Shobô, 1994).

[51] Supreme Court, 15 October 2010, Minshû, vol. 64, no. 7, p. 1764.

in the very far future because the Income Tax Act and Inheritance Tax Act are separately legislated now.

II-5-4. Tax rate in different year

For example, a taxpayer argues that income arises in year 1 when the tax rate is 30% and the tax authority argues that the income arises in year 2 when the tax rate is 40% because of his other revenues[52].

If we legislate the tax system in which a taxpayer can choose the timing attribution of his income, then he himself does income smoothing, and therefore conflicts will decrease. Unless policy for a certain high/low tax rate is strong (for example, in wartimes or natural disasters), a taxpayer's choice of timing attribution of his income will enable us to approach a grasping of his true ability to pay, regardless of whether we believe in a global income concept or consumption type income concept.

II-5-5. Expensing method and yield exemption method

This article basically presupposes the global income concept. The global income concept imposes a tax burden on interest income, which gives rise to double taxation.

For example, suppose that Mr. A gets a part of a moor at 0 cost. Mr. A cultivates the land. The land becomes farmland which produces a before-tax return of 300 per year. Ms. B wants to buy the land from Mr. A. If there is no tax, the price of the land is $\frac{300}{1.03^1}+\frac{300}{1.03^2}+\frac{300}{1.03^3}+\ldots+\frac{300}{1.03^\infty}=10000$. If there is 40% tax in line with the global income concept, then Ms. B can foresee her tax burden of 120 every year. Ms. B pays $\frac{180}{1.03^1}+\frac{180}{1.03^2}+\frac{180}{1.03^3}+\ldots+\frac{180}{1.03^\infty}=6000$ to Mr. A. The discounted present value of Ms. B's tax burden is 4000. Mr. A's tax burden on a capital gain of 6000 is 2400. Mr. A can consume 3600. Mr. A's value of labor would be 10000 in a no tax world, but he can consume only 3600 under the global income concept, not 6000. If the tax rate is expressed as t, then it means double taxation as $(1-t)(1-t)$. It has frequently been discussed that the global income concept imposes double taxation on interest income: it means that double taxation as $(1-t)(1-t)$ on an asset value of 10000 arises as time passes.

The expensing method allows Ms. B to deduct payments to Mr. A. If Ms. B pays 10000 to Mr. A, then her tax burden is reduced by 4000, which is equivalent of the discounted present value of her tax burden on a future income of 300 every year. In economic substance, Ms. B's tax burden is 0. In this case, Mr. A gets 10000, pays a tax of 4000, and can consume

[52] Cf. William Vickrey, Averaging Income for Income Tax Purposes, 47 Journal of Political Economy 379 (1969); Lawrence Zelenak, Tax Policy and Personal Identity over Time, 62 Tax Law Review 333 (2009).

6000.

The yield exemption method allows for an exemption on Ms. B's future income of 300 every year[53]. In economic substance, Ms. B's tax burden is 0. In this case, Mr. A gets 10000, pays a tax of 4000, and can consume 6000. This paragraph and the preceding paragraph fit with the consumption type income concept.

Tax policy concerning demerits of double taxation under the global income concept is not the main task of this article, but some tax policy proposals give partial remedies for double taxation. In order to give remedies for taxation under the global income concept, non-specialists of tax might have an image of the yield exemption method. Some legislations[54] concerning exemption on certain types of interest income are not rare. Allowing tax deferrals in reorganization legislations can be seen as close to the yield exemption method. However there doesn't seem to be a question finalized among tax specialists about whether the expensing method or yield exemption method is, in general cases, suitable.

I believe that the expensing method is generally suitable for tax policy discussion. For example, I sometimes feel compassion with taxpayers in cases in which an application of CFC legislation on a foreign subsidiary's capital gain of shares is not good taxation because such gains are realized for reinvestment in new foreign business or for a foreign corporation's reorganization, therefore such a gain has little relation with avoidance[55] of Japanese tax. If we adopt an expensing method, a capital gain of shares will not cause a heavy tax burden when such a realized gain is reinvested. Non-deduction of reinvestment is not good tax policy not only in the context of CFC legislation. The reason of why the global income concept does not hesitate imposing double taxation on interest income is a policy goal of preventing concentration of wealth[56]: deduction or non-deduction of reinvestment does not have a strong relation with preventing a concentration of wealth. Reorganization legislations or exchange non-recognition legislations (Japanese Income Tax Act, Article 58 or Corporate Tax Act, Article 54) is called as allowing tax deferral (and such an explanation is not wrong), but it can also be recognized as issues of deduction or non-deduction of reinvestment.

Accelerated depreciation methods[57] can be seen close to expensing methods. If we adopt true economic depreciation, then tax effects fit with the global income concept, which means taxation on normal returns equivalent to the time value of money. Accelerating or slow-accelerating depreciation would accomplish tax effects which stand between the global income concept and consumption type income concept.

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[53] Yield exemption method has two types: exemption only on normal return or exemption not only on normal return but also extraordinary return.

[54] In order to learn tax clientele, see WATANABE, Satoshi, *ZEIMU SENRYAKU NYÛMON* (INTRODUCTION FOR TAX STRATEGY), p. 21 (Tôyô Keizai Shinpôsha, 2005).

[55] FUCHI, note 34, pp. 363ff.

[56] FUJITANI, Takeshi, *Hieiri koueki dantai kazei no kinouteki bunseki (1-4, finished) -- seisaku zeisei no sozeihougakuteki kousatsu* (Basic analysis on nonprofit organizations taxation (1-4, finished) -- tax policy from the viewpoint of tax law), Kokka Gakkai Zassi, vol. 117, no. 11=12, p. 1021, vol. 118, no. 1=2, p. 1, no. 3=4, p. 220, no. 5=6, p. 487 (2004-2005), especially at p. 34 of part 2.

[57] NAKAZATO, note 4, pp. 162-163 (written by YOSHIMURA, Masao)

<Deemed income taxation equivalent to the time value of money and basis adjustment> in line with the global income concept can easily be transformed to tax proposals in line with the expensing method. The consumption type income concept does not require the deemed income taxation equivalent to time value of money, but if reinvestment is deducted, the deemed income taxation does not inhibit the consumption type income concept. The deemed income taxation is not key. The key is the deduction of reinvestment.

III. Tentative presumptive taxation not only in financial income taxation: derogation from traditional idea of taxation on true personal income attribution and true timing of income realization

III-1. Introduction of tentative presumptive taxation proposals with application of prospect theory

An interesting proposal recommends, with knowledge of prospect theory[58], slightly extra charge of presumptive taxation (it does not correspond to Japanese "*suikei kazei*" (estimation taxation)) with tax refund rights later in the field of small business taxation (typically in individual business income taxation in which tax evasion concerning cash business is serious) in order to improve tax compliance of taxpayers[59].

Why prospect theory? Humans are generally risk-averse about gain and risk-seeking about loss. This proposal tries to apply such tendencies in order to improve compliance. Under ordinal taxpayers' tax return, taxpayers feel that paying tax is a loss, therefore taxpayers become risk-seeking and have tendencies to try to evade tax. On the other hand, if we adopt this proposal of presumptive taxation with tax refund rights, taxpayers will feel that tax returns are a gain, therefore taxpayers will become risk-averse and have weak tendencies to file excessive tax returns.

Japanese salaried workers rarely file a tax return because withholding tax by employers is adjusted at the stage of withholding. On the other hand, in the United States, many salaried workers file a tax return for a tax refund of withheld tax. This proposal tries to apply the filing for a tax refund in the field of small business taxation.

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[58] KOHYAMA, Hiroyuki, *Sozeihou to "hou no keizai bunseki" -- koudou keizaigaku niyoru aratana rikai no kanousei* (Tax law and economic analysis of law -- possibilities of new understanding with behavioral economics), in KANEKO, Hiroshi, ed., *Sozeihou No Hatten* (Development of Tax Law), p. 315 (Yûhikaku, 2010).

[59] Kathleen DeLaney Thomas, Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance, 67 Tax Law Review __ (2014) http://ssrn.com/abstract=2316233. See also, Leigh Osofsky's review (http://tax.jotwell.com/presumptive-collection-an-innovative-proposal-for-a-notoriously-difficult-problem/); Kathleen DeLaney Thomas, The Psychic Cost of Tax Evasion, 56 B.C. L. Rev. (2015) http://ssrn.com/abstract=2494489.

III-2. Why does withholding tax work?

When I read the proposal in section III-1, I had a question: why does withholding tax work? Are employers' business strategies in which employers underwithhold the tax of workers in order to pay higher wages and recruit workers trying to evade taxes effective?[60]

With this question, it can be said that there are fields in which withholding tax does not work well. Not about withholding tax but about the social welfare burden, many small or medium sized enterprises' compliance systems are bad. Ill-compliance of the social welfare burden gives employers a chance to show superficially higher wages to workers. I guess that employers of ill-compliance of the social welfare burden think that they have no intention to recruit workers with superficially higher wages: but the intention is not sufficient evidence of a non-relation between the ill-compliance of the social welfare burden and superficially higher wages.

I do not know the extent of compliance of the social welfare burden, but generally the withholding tax on wages is well worked in Japan and the United States. The reason for workableness is guessed as follows: if there are some workers trying to evade tax concerning withholding tax, their goal cannot be accomplished without creating non-usual expenses when employers truthfully withhold tax. Workers trying to evade tax need cooperative employers. If some employers try to underwithhold tax and to recruit workers trying to evade tax, do such workers believe such employers? Confidential relationships between workers and employers is rare especially when they try to evade tax, unless they are families. From the viewpoint of workers trying to evade tax, they might anticipate more possibilities that employers fail to evade than in actuality. Humans generally have a bias that they anticipate that uncontrollable matters do not go well for themselves. For example, when highjacks or terrorists on the news are widespread, people anticipate more possibilities of accidents with airplanes which is uncontrollable and anticipated less possibilities of accidents with cars which is more controllable than actual: unfortunately such a bias leads to more deaths. I have not yet found a discussion in which such a bias is also applicable to tax evasion. But I guess that reason of workableness of withholding tax (employers' business strategy of underwithholding tax is unworkable) can be partially explained by human bias.

There are many tax evaders who utilize Swiss confidential banks[61], so my guess that third party involvement will help for discouraging tax evasion has not been well established. I do not have enough data for re-counterargument.

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[60] Supreme Court, 2 March 2010, Minshû, vol. 64, no. 2, p. 420 treated hosts and hostesses who are withheld even though they are not workers but individual business persons, but withholding tax base is deducted by ¥5000 × dates. If such deduction is not legislated and hosts and hostesses themselves file tax return with right of tax refund, would it be workable? Would withheld tax be too small?

[61] Gabriel Zucman (translated by HAYASHI, Masahiro, reviewed by WATANABE, Satoshi), *Ushinawareta Kokka No Tomi: Tax Haven No Keizaigaku* (The Missing Wealth of Nations: Economics of Tax Haven) (NTT Shuppan, 2015) translated from Gabriel Zucman, The Hidden Wealth of Nations: The Scourge of Tax Havens (University of Chicago Press, 2015).

III-3. Third party involvement for discouraging tax evasion

A tentative presumptive taxation proposal in section III-1 has little chance to involve a third party in tax compliance, but we can find similarities between sections III-1 and III-2: derogation from the traditional idea that tax shall be imposed on true income personal attribution at true timing of income realization. Such derogation might be able to improve tax compliance and to discourage tax evasion. Withholding tax (not only on wages) has already been usual, there might be a wide space of such derogation.

For example, not only in the context of taxation on workers but also in the context of financial income taxation discussed in chapter II, third party involvement might be able to improve tax compliance and to discourage tax evasion. J-Box3 (section II-4-4) presupposes that people use trust banks in order to manage special accounts, but the manager is not limited to trust banks. The idea of third party involvement is not mine[62]. Moreover, the invoice system in European VAT can be recognized as a utilization of a third party's information for improvement of compliance[63].

IV. Derogation from the idea that income realization and income personal attribution should be defined by private law

Chapter II discussed financial income taxation proposals in which <deemed income taxation equivalent to the time value of money and basis adjustment> is mainstream in American tax jurisprudence. Chapter III discussed tentative taxation and third party involvement not only in the context of financial income taxation but also in the context of small business taxation and wage taxation. Roughly speaking, Chapters II and III discussed that derogation from the idea that tax shall be imposed on true income personal attribution at the true timing of income realization might be able to improve tax compliance (not only discouraging tax evasion).

Japan did not have a strange case law like the *Macomber*[64] case, so under the Japanese Constitution, it seems that the realization principle has no base in the Constitution. It can be easily said that legislative discretion of tax policy concerning realization is wide. Moreover, legislation of the discriminatory[65] tax system not only in the context of procedure but also in the context of substance in order to improve tax compliance is not strongly limited by the

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[62] Slemrod, Brett Collins, Jeffrey Hoopes, Daniel Reck & Michael Sebastiani, Does Credit-Card Information Reporting Improve Small-Business Tax Compliance? (http://ssrn.com/abstract=2515630); Joseph Bankman, Clifford Nass & Joel Slemrod, Using the 'Smart Return' to Reduce Tax Evasion (http://ssrn.com/abstract=2578432)

[63] ASATSUMA, Akiyuki, *Aoiro shinkoku seido no kongo no arikata* (Future of blue tax return), Zeiken, no. 161. p. 42 (2012) introduced some works of Professor Ainsworth. I'm sorry to say that the volume of chapter III is unbalanced because of the failure to adjust the number of words.

[64] *Eisner v. Macomber*, 252 U.S. 189 (1920).

[65] Typical example is blue tax return.

Constitution[66]. This article's task can be blamed that the task does not face Constitutional limitation less seriously than other articles of this paper treating the principle of statute-based taxation. I believe, however, that this task has relation with discussion of <tax law and private law>.

Saying that tax shall be imposed on true income personal attribution at the true timing of income realization sounds like a viewpoint from god: under today's tax statute, decisions concerning income personal attribution and income realization are generally based on private law. Private law does not necessarily show economic substance: therefore, discussion of <tax law and private law> has been accumulated with studies of tax avoidance in the field of interpretative discussions.

This article's task is derogation from the idea that tax shall be imposed on true income personal attribution at the true timing of income realization in order to improve tax compliance. This task is located in the field of legislative discussions (however, saying that the main field of traditional discussion of <tax law and private law> has been located in the field of interpretation does not mean that there has not been discussion in the field of legislation).

In the field of legislative discussions, most clear derogation from the idea of taxation on income which is based on effects of private law is transfer pricing legislation. This chapter discusses, while comparing with transfer pricing legislation, possibilities of tax compliance by way of derogation from the idea of taxation on income which is based on effects of private law, and the possibilities of impact of such derogation to discussion of <tax law and private law>.

IV-1. Comparing with transfer pricing legislation

IV-1-1. Aggressive arm's length in domestic transactions

When we try to approach true income (regardless of whether the global income concept or consumption type income concept), we usually look at effects of transactions ruled by private law. However, there are some cases in which effects of private law are not reliable from the viewpoint of tax. Typical cases are transactions between related persons, in which one party receives a gain and another party receives a loss: such unbalanced transactions are valid from the viewpoint of private law, but some tax instruments such as the Corporate Tax Act, Article 132 (family corporations' transactions can be neglected by tax authorities) are applied and it is deemed that arm's length transactions[67] be done instead[68].

The Corporate Tax Act, Article 22 (2) also deems, supposedly based on *tekisei shotoku*

[66] Supreme Court, 28 February 1962, Keishû, vol. 16, no. 2, p. 212; Supreme Court, 27 March 1985, Minshû, vol. 39, no. 2, p. 247; Supreme Court, 14 December 1989, Keishû, vol. 43, no. 13, p. 841.
[67] KANEKO, note 25, p. 478.
[68] Supreme Court, 29 May 1958, Minshû, vol. 12, no. 8, p. 1254.

sanshutsu setsu (theory of the calculation of fair income)[69], transactions with fair market prices for tax purposes, even when such transactions are prohibited by private law in recent cases[70].

There are some situations in which distribution of income ruled by private law is inappropriate from the viewpoint of tax, and it is allowable that express provisions[71] of reclassification of transactions is applied in order to presuppose that different transactions are deemed to exist for tax purposes although the original transactions are valid in private law. The Corporate Tax Act, Articles 132 and 22 (2) does not expressly provide arm's length transactions or fair market value transactions, but accumulation of case laws has aggressively elected the arm's length standard in order to approach true income.

In the United States, the original intent of IRC, section 482[72] was not an application for international transactions: on the other hand, Japanese transfer pricing legislation is only applied to international transactions. The incentive of transfer of income can occur not only in international transactions which are faced with different tax rates but also in domestic transactions because of the different ability of utilization of net operating loss even though the tax rate is same. Japanese legislation is strange for differentiating international transactions and domestic transactions. However let's carry out a thought experiment. Even if formulary apportionment were more accepted than arm's length in the context of international transactions, would application of the Corporate Tax Act, Articles 132 and 22 (2) in the context of domestic transactions be ruled by formulary apportionment rather than arm's length? I do not think so. Regardless whether formulary apportionment or arm's length were more acceptable in the context of international transactions, arm's length has been aggressively elected in the context of domestic transactions in order to approach true income.

IV-1-2. Passive arm's length in international transactions

Transfer pricing legislation in the context of international transactions also does not deny validity in the field of private law but makes fiction of price for tax purposes concerning transactions between related persons. However, it can be said that transfer pricing legislation in an international settings is not based only on the idea that distribution which is valid in private law can sometimes be an inappropriate reflection of economic substance. It can easily be said that transfer pricing legislation is derogation from the idea that income personal

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[69] Supreme Court, 19 December 1995, Minshû, vol. 49, no. 10, p. 3121 did not clearly mentioned *tekisei shotoku sanshutsu setsu* but tax scholars recognize this case as a leading case of *tekisei shotoku sanshutsu setsu*.

[70] Supreme Court, 24 September 2015, case number Heisei 26 (Gyô-tsu) 385 and Heisei 26 (Gyô-hi) 416.

[71] The Corporate Tax Act, Article 132 is clearly provision of reclassification. There can be doubt whether the Corporate Tax Act, Article 22 (2) is a provision of reclassification or not. This article does not discuss it.

[72] See, MASUI, note 48, p. 163.

attribution is defined by private law: I also argue that transfer pricing legislation is not based on the idea that tax shall be imposed on true income personal attribution from the viewpoint of god. The latter point cannot easily be accepted so I need explanation.

People might think that the goal of transfer pricing legislation is to try to approach the effects of arm's length transactions. I do not think so. The ultimate goal of transfer pricing legislation, especially in the context of tax treaties, should have been an acceptable allocation of taxing rights among countries. An acceptable allocation is tautology. There had been two options for allocation of taxing rights among countries: arm's length and formulary apportionment. And now it is well-known that formulary apportionment has not been accepted. However, the making of group enterprises is based on forecasts that group transactions will provide more value than market transactions (which means arm's length transactions). Arguments against the arm's length standard have also long been reasonable to some degree. However, arguments against formulary apportionment are also reasonable because making a formula was diplomatically difficult among countries[73]. Therefore, I can understand why, in the 20th century when the traditional international tax law system was made, formulary apportionment was not acceptable as a leading standard. However, this understandings does not necessarily show the evidence of rightness of allocating taxing rights in line with arm's length. Electing not formulary apportionment but arm's length was only a compromise[74] in the era of the 20th century. Intra-group transactions and arm's length have been in poor compatibility. I stated in section IV-1-1 that an accumulation of cases concerning domestic transactions has aggressively elected arm's length but there has not been such aggressiveness in international settings. Therefore, this section's title is passive arm's length. Moreover in the 21st century, some taxpayers greedily argue for arm's length in order to avoid a high tax rate[75] and such tendencies are widespread among big enterprises especially in the United States. Therefore, anti-BEPS movements in the OECD, etc., discuss fictions which can hardly be seen in arm's length settings or discuss denying of transactions which can be seen in arm's length settings. For example, of the former, some taxpayers argue that, in the context of transfer pricing legislation of intangibles, hindsight is hardly to be seen in arm's length settings, but tax authorities will rely on hindsight. For example, of the latter, it is easy to see a case in which money providers take risk for developing intangibles in arm's

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[73] EU's CCCTB (Common Consolidated Corporate Tax Base. CCTB as Common Corporate Tax Base is also discussed.) is close to the idea of formulary apportionment. Making formula is not diplomatically impossible in the EU. However, not only making formula but also the harmonization of taxable income calculation might have been diplomatically and technically difficult.

[74] OKAMURA, Tadao, *Kokusai kazei* (International taxation), in IWANAMI KÔZA: GENDAI NO HOU (IWANAMI LECTURES: LAW IN PRESENT DAY), p. 287ff, at 314 (Iwanami Shoten, 1997) stated that "ALS [arm's length standard] without substantive principle was acceptable as a slogan in order to show superficial harmonization".

[75] See, *Xilinx v. Commissioner*, 598 F.3d 1191 (9th Cir., March 22, 2010); *Altera Corp. & Subs. v. Commissioner*, 145 T.C. No. 3 (July 27, 2015), for examples of cost-sharing agreement/arrangement for development of intangibles, in which taxpayers argued that expenses of stock options are not shared in arm's length settings.

length settings and attribution of future profit naturally belongs to the risk taker, but tax authorities will not allow profit attribution to cash-box corporations who provided money and took risk in private law. Anti-BEPS movements in the OECD, etc., discuss transfer pricing legislation supposedly in line with arm's length, but some of movements are hardly based on arm's length: tax authorities seem to care about acceptable allocation of taxing rights tautologically more and more. I stated that part of transfer pricing legislation is not based on the idea that tax shall be imposed on true income personal attribution. Derogation from the arm's length standard is controversial, but I believe that derogation is not itself blamed because the ultimate goal of transfer pricing legislation concerning international transactions has long been acceptable allocation of taxing rights, though it may be tautological. Tautological derogation from arm's length towards acceptable allocation of taxing rights[76] in express manner might be fair.

IV-1-3. Distance between transfer pricing legislation and private law

If we recognize the tautological nature of acceptable allocation of taxing rights among countries, transfer pricing legislation concerning international transactions can derogate from the idea that tax shall be imposed on true income personal attribution. But the latter might be unacceptable. At least, we can say that transfer pricing legislation not only denies artificial distribution of income with the principle of freedom of contracts in private law sense among group enterprises but also denies reliability of non-artificial distribution of income in arm's length settings. The distance between transfer pricing legislation and private law is far.

IV-2. Cases derogating from private law for income tax purpose

Transfer pricing legislation is the most typical example of derogation from private law but there are other examples. Traditionally we have already discussed illegal income issues and controlling standards[77].

IV-2-1. Illegal income: scope of income and timing of income

It has been discussed that Japanese income tax law presupposes the global income concept: therefore illegal income also should be included into taxable income as a matter of

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[76] Acceptable allocation of taxing right among countries is a very political and diplomatic matter and it might be the reason why we can discuss it in honesty.

[77] FUCHI, Keigo, *Shotoku kazei niokeru nendo kizoku no mondai* (Timing attribution issues in income taxation), in KANEKO, Hiroshi, ed., *SOZEIHOU NO KIHON MONDAI* (FUNDAMENTAL ISSUES OF TAX LAW), p. 200ff (Yûhikaku, 2007) refers the concept of *jishu senyû* (self-occupancy) and his argument is very interesting. This article does not discuss it.

scope of income[78]. Even if income tax law presupposes the consumption type income concept, we would not decide that illegal income not be included into taxable income[79].

Not only in the field of scope of income but also in the field of timing of income, illegal income is interesting. A leading case law in note 2 can also explain controlling standards in the field of timing of income in the next section.

IV-2-2. Controlling standards

A leading case law in note 3 concerning a provisional disposition order about an increased charge of rent gave rise to very difficult issues concerning the relation between income taxation and private law. There are three possibilities of timing of income taxation: from an early time, first is timing of requirement of increased charge; second is timing of provisional disposition order; and third is timing of fixedness of judgement.

At first, requirement of increased charge of rent is classified as formation rights in private law and the right occurs at the timing of requirement even though the price of increased charges is not fixed. The requirement is the first possibility of timing of income taxation.

At second, requirement of increased charge of rent is accepted by a lower tribunal but the judgement can be appealed to upper tribunals. In this case the lower tribunal sometimes provisionally makes a disposition order to pay increased rent. This is provisional and it can be hardly classified as fixed in a private law sense even though the rent earner actually receives money. However, the leading case law in note 3 decided that, applied only in this case, the provisional disposition order is good timing of income taxation because the rent earner has control of the money. The standard of this case is called controlling standards. The decision of this case was controversial[80]. But in general, we cannot easily say that controlling standards are not necessary in every case. We need controlling standards in some cases[81]. It means that we need derogation from private law in some cases.

At third, fixedness in private law as fixedness of judgement is good timing of income taxation. The leading case law in note 3 stated that, in general, fixedness of judgement is good timing of income taxation.

We can have three possibilities as above and therefore the relation between realization of income and private law is a difficult issue. There have been contradictions among some real cases. For example, a case[82] concerning timing of temporary income of fair market value of

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[78] KANEKO, Hiroshi, *Terasen to shotokuzei -- shotoku no igi, sonota shotokuzeihou no kaishaku wo megutte* (Banker's fee in gambling and income tax -- meaning of income and other interpretation issues of income tax act), in SOZEIHOU RIRON NO KEISEI TO KAIMEI (FORMATION AND ILLUSTRATION OF TAX LAW THEORY), p. 434ff, at 435 (Yûhikaku, 2010, first published 1964).

[79] Under limited income concept which do not have income categories of temporary income or miscellaneous income, illegal income can give rise to serious issues. This article does not discuss it.

[80] Review by NAKAZATO, Minoru, Hôgaku Kyôkai Zassi, vol. 96, no. 11, p. 1483 (1979).

[81] Supreme Court, 14 October 2004, Zeimu Soshô Shiryô, no. 254-9779.

[82] Tokyo District Court, 10 March 1992, Shômu Geppoô, vol. 39, no. 1, p. 139. Basis of the land is also an interesting issue. This article does not discuss it.

land which was acquired because of long period occupancy, did not adopt the timing of start of occupancy because of Civil Code, Article 144's retroactive effects[83]; did not adopt the timing of fixedness of judgment which is based on the general norm stated by the leading case law in note 3 and which is also argued by the taxpayer; did not adopt the timing of duration to fulfill the occupancy requirement[84]; and did adopt the timing of declaration[85] of long period occupancy, which resembles the first standard[86] discussed in the third preceding paragraph which the leading case law in note 3 did not adopt.

We can hardly decide the timing of income realization without reference of private law, but in some cases, private law gives us two or more non-conclusive possibilities concerning the timing of income realization. Civil law professors would say: the timing of transfer of the title is not necessarily fixed to one point and the focus point can be changed with reflection of legal issues, and therefore, tax lawyers should not rely on civil law professors and tax law matters should be discussed by tax lawyers.

It does not mean that we can neglect private law. One typical case of derogation from private law is controlling standards. The fact that private law does not always give us conclusive factors shows that tax law issues cannot fully rely on private law but also on tax policy itself.

I do not say that it is bad. To say it in a modest way, tax policy is inevitable concerning the timing of income realization. To say it in a non-modest way, the tax statute must comprehensively provide the timing of income realization or other tax issues, but words in today's tax statute are not enough (for example, Income Tax Act, Article 36 (1) uses phrases "*shûnyû subeki kingaku* (includable amount)" that cannot lead to a conclusion among three possibilities in section IV-2-2); and therefore, we must reluctantly refer private law.

There are two ways of thinking: (1) private law is the base of economic effects and application of the tax statute not reluctantly but naturally refers to private law; or (2) the ideal tax statute should comprehensively provide tax requirements (Tatbestand in German) but now we reluctantly refer to private law because of non-comprehensive provisions in today's tax statute. I give lectures in line with (1) law faculty and law schools as a teacher, but as a student of tax law, I cannot easily reject (2).

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[83] Osaka High Court, 25 July 2002, Hanrei Times, no. 1106, p. 97 can be seen to adopt this standard.

[84] NAGATO, Takayuki, *Sozeihou to sokyûkô -- saibanrei, saiketsurei no bunseki kara* (Tax law and retrospective effects -- review analysis of some case law), Tokyo University Law School Law Review, no. 7, p. 28 (2012).

[85] It is said that suspensive condition theory was the reason: Supreme Court, 27 March 1986, Minshû, vol. 40, no. 2, p. 420.

[86] MIZUSHIMA, Atsushi, *Sozei Hanrei Hyakusen* (100 Cases in Tax Law), 6th ed., p. 32 discusses contradictions between the cases in notes 3 and 82 with Shizuoka District Court, 18 July 1996, GyôShû, vol. 47, no. 7=8, p. 632.

IV-3. Questions about ideas that private law is the base of economic effects

IV-3-1. Distinction between private law field and tax law field

In traditional tax jurisprudence, it is believed that private law provides discipline in the market and is the base of economic effects, and therefore, when we discuss about the denial of tax avoidance etc.[87], we must make a distinction between the private law field[88] and tax law field. For example, taxpayers buy rights concerning movie films in order to deduct depreciation costs of the films: however, the court decided that the taxpayers had not bought the rights of the films in the private law field, and in effect, the taxpayer cannot deduct the depreciation costs[89] [90]. This judgment is made in the private law field and therefore traditional tax jurisprudence classified this type of failure of reducing the tax burden not as a denial of tax avoidance but as a non-accomplishment of tax avoidance. The latter type is not called a denial of tax avoidance but a "denial" of tax avoidance by way of fact findings and legal classification in the private law field.

Usually in the private law field, legal effects are based on the true intent of parties but in some cases the court can intervene to find another legal classification not based on the true intent of parties[91]: it is controversial in tax jurisprudence[92]. If we do not accept the intervention of the court in the private law field, we explain the failure of reducing the tax burden not as a denial of legal classification of the true intent of taxpayers but as a non-finding of the true intent of taxpayers as taxpayers argue.

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[87] Definition of tax law is difficult and I believe that the definition by KANEKO, note 25, p. 125 is hard to use (NAKAZATO, Minoru*, Sozeihou niokeru jujitsu nintei to sozei kaihi hinin* (Fact findings and denial of tax avoidance in tax law), in KANEKO, Hiroshi, ed., *SOZEIHOU NO KIHON MONDAI* (FUNDAMENTAL ISSUES OF TAX LAW), p. 121ff, at 136-137 (Yûhikaku, 2007); ASATSUMA, Akiyuki, *Narubeku wakariyasuku shiritai Kaneko sozeihou no sozei kaihi no kangaekata* (How to easily understand Kaneko's tax law and idea of tax avoidance), Zeimu Kôhô, vol. 64, no. 1, p. 87 (2016.1)). Sometimes, denial and "denial" are differentiated in Japanese tax jurisprudence. Therefore, I use phrases such as tax avoidance, etc.

[88] Tokyo High Court, 21 June 1999, Hanrei Jihô, no. 1685, p. 33.

[89] Supreme Court, 24 January 2006, Minshû, vol. 60, no. 1, p. 252 did not mention private law field discussion but the original decision in the Osaka High Court had discussed it.

[90] Tokyo High Court, 30 October 2007, Shômu Geppô, vol. 54, no. 9, p. 2120 made decision concerning entity classification issue between *nin'i kumiai* (general partnership) and *tokmei kumiai* (stille Gesellschaft) in the private law field. TAJIMA, Hidenori's case review in Jurist, no. 1394, p. 122 blamed the conclusion.

[91] OHMURA, Atsushi, *KEIYAKUHOU KARA SHOUHISHAHOU HE* (FROM CONTRACT LAW TO CONSUMER LAW), p. 146ff (Tokyo University Press, 1999).

[92] NAKAZATO, Minoru, *Kazei nogare shouhin nitaisuru sozeihou no taiou* (1-2) (Treating tax escaping schemes in tax law), Jurist, no. 1169, p. 116, no. 1171, p. 86 (1999-2000) is ineloquent about this controversy but NAKAZATO, note 87, seems to be reluctant to accept the possibilities of the intervention by the court. I believe that we should accept the possibilities of the intervention by the court because of OHMURA, note 91.

IV-3-2. Avoidance of limitation in private law and avoidance of tax burden

From the standpoint of accepting the possibilities of the intervention by the court in the private law field, there can be an example in which the court intervenes to find another legal classification not based on the true intent of parties.

Mr. A is near death, and wants to transfer his properties whose value is for example ¥1 billion to his friend, Mr. B. However Mr. C is a son of Mr. A and if Mr. A makes a gift to Mr. B, then half of the properties will be backed to Mr. C because of legally secured portions for an heir. Mr. A tries to avoid limitation of inheritance law (not inheritance tax law): Mr. B provides services to Mr. A and Mr. A provides his properties to Mr. B as a fee for the services. If the fair market price of the services is ¥1 billion, there is no problem. If the price is ¥100, for example, shaking hands, then Mr. C wins?

The court would make Mr. C win. The court might state that the true intent of Mr. A is a gift. However, the true intent of Mr. A is not a gift but a fee for the services because Mr. A truly and deeply hates Mr. C and because Mr. A truly wants to avoid limitation of inheritance law. This argument resembles the argument for depreciation costs of the films because the taxpayers truly want a deduction. It is strange to say that the taxpayers truly want a deduction and that the true intent of the taxpayer is not buying the rights of the films[93]. However, the court in the preceding paragraph would make Mr. C win. Even if the true intent of Mr. A is not a gift, the court can intervene and press for a legal classification of the gift in order to guard the limitation of inheritance law.

In the case in note 89, taxpayers paid ¥8 billion for films. Depreciable property is tangible films, not intangible films. Do you pay ¥8 billion for tangible films and ¥0 for intangible films? ¥8 billion for tangible films and ¥1 billion for the services of shaking hands are strange in a similar extent. Civil law professors think that denial of contracts in order to guard limitation of inheritance law is allowable to the court. Traditional tax jurisprudence think that denial of tax avoidance in the tax law field is not allowable to the court but "denial" of tax avoidance in the private law field is allowable to the court. I guess that denial of tax avoidance is close to denial of contracts in order to guard limitation of inheritance law[94].

Not only in cases of illegal income of mafias, but also in cases of distribution of income

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[93] The original decision in the Osaka High Court in note 89 was strongly blamed by tax lawyers stating that it was because taxpayers wanted a deduction, so the true intent of the taxpayers must have been buying the rights of the films. Osaka High Court's wording was certainly bad, but its idea can be justified with reference of OHMURA, note 91, introduced by FUJITANI, Takeshi case review in Sozeihou Kenkyû, no. 29, p. 165 (2001).

[94] Tax law is said to be infringement but distinction between infringement and non-infringement is not persuasive for me. NAKAZATO, Minoru, *Seitehou no kaishauk to futsûhou no hakken (1-2) -- fukusû no hou ga heizon, kyôgôsuru baai no hou no sentaku toshiteno "sozeihou to shihou" ron* (Interpretation of statute law and discovery of common law (1-2) -- discussion of "tax law and private law" as conflict of laws in cases of two or more laws), Jurist, no. 1368, p. 131, no. 1369, p. 108 (2008) make distinctions between statute law and common law. Tax law is clearly statute law. Limitation of inheritance law seems to also be statute law.

within families or partial society theory, fields in which law does not (or not try to) give order are not rare. I doubt that private law is a base of economic effects as explained in traditional tax jurisprudence. Both private law and tax law seem to have tendencies of intervention. Concerning transfer pricing legislation, tax lawyers have tendencies to make stress on the principle of freedom of contracts: such stress seems to be excessive.

Two ways of thinking again: (1) private law is a base of economic effects and application of the tax statute not reluctantly but naturally refers to private law; or (2) the ideal tax statute should comprehensively provide tax requirements but now we reluctantly refer to private law because of non-comprehensive provisions in today's tax statute. Traditional tax jurisprudence has explained (1) but I cannot easily reject (2).[95]

IV-4. Tentative presumptive taxation proposals and perception of income realization, etc.

Chapters II and III discussed some proposals of tentative presumptive deemed income taxation[96] with understandings of economics in order to tackle problems especially when our income tax system relies on private law. If such proposals become acceptable to Japanese tax jurisprudence of Japanese taxpayers, then discussion of <tax law and private law> can be changed as discussed in chapter IV. It is because tentative presumptive taxation proposals might weaken the feelings that income is ruled by private law.

Also in today's tax jurisprudence, transfer pricing legislation (section IV-1) can weaken the feelings that income is ruled by private law from the viewpoint of anti-BEPS and of acceptable allocation of taxing rights among countries.

Sections IV-2 and IV-3 discussed that (1) private law is a base of economic effects and application of the tax statute not reluctantly but naturally refers to private law; or (2) the ideal tax statute should comprehensively provide tax requirements but now we reluctantly refer to private law because of non-comprehensive provisions in today's tax statute. I provided some elements for supporting (2) standpoint.

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95 Michael Lang, CFC Legislation and double tax treaties, Bulletin for International Tax Documentation, Vol. 57, No. 2, p. 51, at 53-54 (February 2003) aggressively argued that the amount and attribution of income is not ruled by private law but ruled by tax law. I cannot think in such a venturous way.

96 Transfer pricing legislation is presumptive taxation but not tentative taxation. On the other hand, tentative presumptive taxation proposals in chapters II and III are tentative, and therefore, I had thought that rough presumption in some extent can be allowable. However, concerning withholding taxes, case law (Supreme Court, 24 December 1970, Minshû, vol. 24, no. 13, p. 2243 and Supreme Court, 18 February 1992, Minshû, vol. 46, no. 2, p. 77) has established that withholding tax liabilities and final tax liabilities of income earners are separate: therefore later adjustments might not be able to heal the roughness of presumptive taxation.
However, in meeting, Professor SATOH, Hideaki gave me advice that my sadness can be upset. For example, Supreme Court, 6 July 2010, Minshû, vol. 64, no. 5, p. 1277 stated that withholding tax on no-income earners was not illegal, and therefore the final income earner can directly require a tax refund to national fisc. This case law might be able to find route of later adjustment. This article does not discuss it deeply so I would like to discuss in future.

Denial of tax avoidance in which distribution of income ruled by private law is denied and other distribution of income is recognized by tax authorities in the tax law field has been blamed because such denial is contradictory against the Constitutional principle of statute-based taxation. If (2) standpoint becomes acceptable and if the income ruled by private law becomes weakened, such blame might also be changed.

Expressional Constitutional provisions about the principle of statute-based taxation are not widespread among countries, but not all tax legislation is allowable. The existence of the expressional provisions has really changed the way of interpretation of Japanese tax law from the way of interpretation in other countries. This change might be small. When deemed income taxation like transfer pricing legislation and tentative presumptive taxation become usual, then people will rarely care about the principle of statute-based taxation.