

## **How to address increasing inhabitant tax delinquency as a result of the tax revenue source transfer**

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The so-called *trinity reform* (involving comprehensive reforms of national subsidies, local tax allocation and allocation of tax revenue sources) resulted in the transfer of ¥3 trillion of tax revenue sources from personal income tax to individual inhabitant tax in fiscal 2007. While the transfer increased local governments' independent revenue sources, it also increased the potential for tax delinquency. Until the reform, local governments had depended to a significant extent on the transfer of state-collected taxes for their finances. Certainly, securing independent revenue sources is indispensable to the devolvement of power to local governments, but the transfer was likely to increase the incidence of individual inhabitant tax delinquency— this was the fear shared by the writer and local government officials. And our fear proved to be justified. Local tax delinquency, which had been in decline since fiscal 2002, rose again in fiscal 2007 subsequent to the commencement of the tax revenue source transfer. This rise was caused by a ¥130 billion increase in individual inhabitant tax delinquency.

It is feared that local tax collection will be adversely affected by the aftermath of last year's global recession. Nor can any optimism about future collection be entertained. How local taxes can be collected efficiently is an issue that needs to be urgently addressed and resolved by all local governments.

In this paper, I will first examine why individual inhabitant tax delinquency rises; then, based on the cause of such delinquency and the levels of delinquency that existed before and after the transfer, I will consider how local governments should deal with this problem.

### **1. Why individual inhabitant tax collection is difficult**

Two of the most prominent characteristics of individual inhabitant tax are the timing of taxation and the method of collection. First, because the tax is computed on the basis of personal income tax earned in a year, it must necessarily be collected in the following year. Unlike personal income tax, which is subject to a tax filing, inhabitant tax is assessed and imposed by the local government. Inhabitants are so seldom mindful of the tax that in many cases they are surprised and upset at receiving a tax notice. Second, municipalities collect prefectural inhabitant tax at the same time as municipal inhabitant tax. Each prefecture pays municipalities under its jurisdiction a "collection handling fee" for collecting prefectural tax, and does not directly engage in collection itself.

Another general feature of local tax collection is that unlike national tax specialists, local government employees in charge of tax collection are not employed to undertake tax collection

services in many cases. They simply happen to be assigned to the tax collection job. What's more, local governments now seek to take on "generalist" employees. These employees are reassigned to a different job every three years, and the accumulation of any tax collection know-how that occurs during the three-year service period comes to a halt.

All the above leads to the following conclusions: inhabitants are rarely tax-conscious, local government officials in charge of collection are not educated or trained in the way national tax specialists are, and prefectures are basically incapable of direct collection.

## 2. The difference between individual inhabitant tax delinquency "before" and "after" the transfer of tax revenue sources

Table 1 shows the delinquency amounts recorded in pre-transfer fiscal 2006 and post-transfer fiscal 2007. The overall amount of local tax delinquency grew by ¥51.6 billion, which includes an increase of ¥130.0 billion in individual inhabitant tax delinquency. These figures show that delinquency for all the other taxes fell by a total of ¥78.4 billion. Thus, the table indicates a significant increase in inhabitant tax delinquency, a sign that the extent of delinquency is serious. Let us take a look at the ratio of individual inhabitant tax delinquency to the outstanding delinquent balance for all local taxes: the ratio rose by as much as 5.63%, increasing from 36.13% to 41.76%. Nevertheless, while the ratio of individual inhabitant tax delinquency to overall individual inhabitant tax revenue happens to have dropped by 0.93%, in contrast to the declining rate, the delinquent amount swelled by ¥130.0 billion. This phenomenon occurred because the amount of tax revenue collected grew with the transfer of tax revenue sources and a lower delinquency rate did not necessarily result in a fall in the delinquent amount.

Table 1 Increase in individual inhabitant tax delinquency because of tax revenue source transfer  
(Unit: billion yen)

	FY2006	FY2006	Changes
Outstanding delinquent balance (on all local taxes)	1,924.5	1,976.1	51.6
Individual inhabitant tax delinquency (amount)	695.3	825.3	130.0
Individual inhabitant tax delinquency (as a percentage)	36.13%	41.76%	5.63%
Individual inhabitant tax revenue	9,103.3	12,311.1	3,207.8
Delinquency rate for the above	7.64%	6.70%	-0.93%

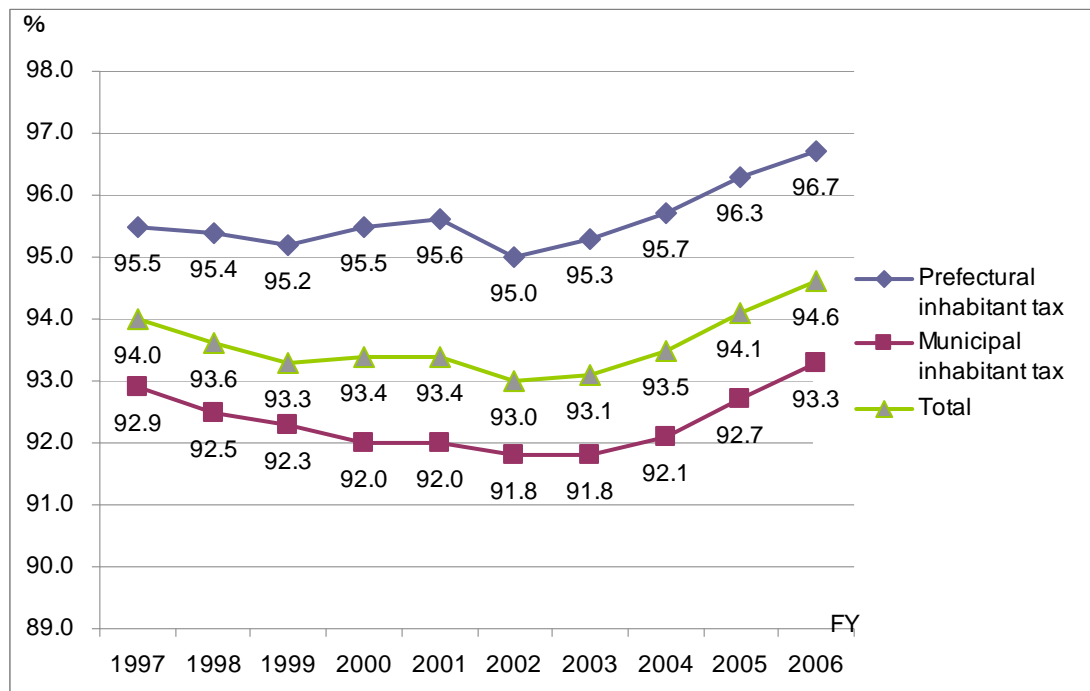
Note: Figures for fiscal 2007 were checked with the Ministry of Internal Affairs and Communications (MIC).  
Source: Data from the MIC website and MIC hearings were compiled by the writer.

### 3. Tax collection efforts should be stepped up

After the collapse of the economic bubble, the local tax collection rate continued on a downward trend, falling to 95% for prefectural taxes and 91.8% for municipal taxes in fiscal 2002. These rates then started increasing, rising to 96.7% and 93.3%, respectively, in fiscal 2006 (Figure 1).

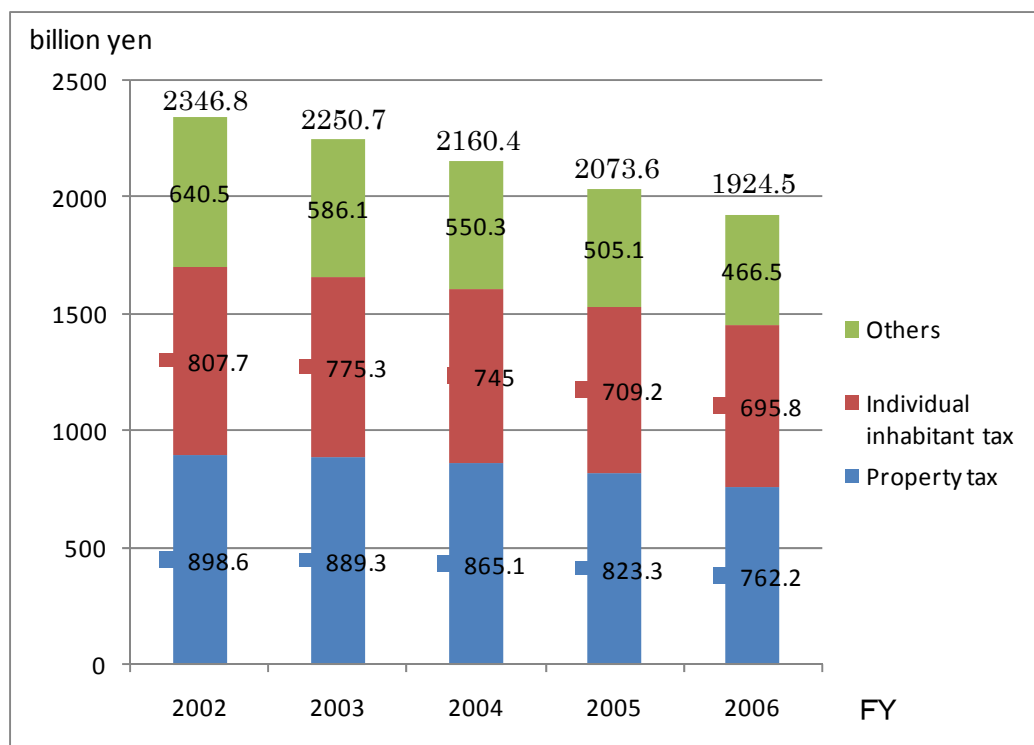
A look at outstanding delinquent balances shows that the balance for local taxes (cumulative) hit a peak in fiscal 2002 at ¥2,346.8 billion before gradually dropping to ¥1,924.5 billion in fiscal 2006 (Figure 2).

Fig. 1 Tax collection rates in municipalities



Source: Ministry of Internal Affairs and Communications

Fig. 2 Change in outstanding delinquent balance for local taxes (cumulative)



Source: Partial extracts from the MIC website as compiled by the writer.

[http://www.soumu.go.jp/main\\_sosiki/jichi\\_zeisei/czaisei/czaisei\\_seido/ichiran02\\_20.html](http://www.soumu.go.jp/main_sosiki/jichi_zeisei/czaisei/czaisei_seido/ichiran02_20.html)

The recovery in tax revenue collected between fiscal 2002 and fiscal 2006 is partly attributable to the economic rebound. However, to a greater extent, it was made possible by the expansion of payment channels implemented during those years, such as electronic tax return filing, payments at convenience stores, electronic payments via multi-payment networks, and payments via credit cards. Another factor that contributed to a decrease in the outstanding delinquent balance is the utilization of private sector services such as the Internet public auction and phone reminder services introduced. Another initiative that is particularly effective in reducing individual inhabitant tax delinquency is joint collection activities carried out by prefectures and municipalities. At present, some 37 local governments are engaged in joint collection efforts.

The global recession spawned by the financial crisis is likely to contribute to an increase in individual inhabitant tax delinquency this year. The writer believes it is important that each local government continues to adhere to the basics of collection: prompting tax payments within the time limit using all available channels, such as electronic tax return filing, local convenience stores, and credit card systems. The government should also make all possible efforts to secure early collection by means of proactive reminders by phone and letter, thereby reducing delinquency for the current year. As for longstanding delinquency, it is important to work to realize fairness in collection through the adoption of coercive collection methods.