

May 1997

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Recommended Citation

Ishimura, Koji (1997) "The State of Taxpayers' Rights in Japan," *Revenue Law Journal*: Vol. 7 : Iss. 1 , Article 8.
Available at: <http://epublications.bond.edu.au/rlj/vol7/iss1/8>

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The State of Taxpayers' Rights in Japan

Abstract

This article outlines the major issues on taxpayers' rights in Japan. It identifies the current position in each area, before making recommendations for reform. The discussion reflects international developments in taxpayers' rights.

Keywords

taxpayers rights, Japan, tax, law

THE STATE OF TAXPAYERS' RIGHTS IN JAPAN*



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This article outlines the major issues on taxpayers' rights in Japan. It identifies the current position in each area, before making recommendations for reform. The discussion reflects international developments in taxpayers' rights.

In Japan, tax procedures are governed by laws of general application such as the National Taxes Common Provisions Law,¹ the National Taxes Collection Law² and the National Taxes Infringement Control Law,³ as well as individual substantive tax laws such as the Income Tax Law,⁴ the Corporation Tax Law,⁵ or the Consumption Tax Law.⁶ However, all of these tend to be expressed in terms of the *obligations* of the taxpayer. There is little systemic recognition of the *rights* of the taxpayer.

In developed countries, a major revolution has been under way to establish the concept of "taxpayers' rights". To this end, existing administrative procedure laws and specific tax procedure laws have been supplemented with new provisions to control the powers of the tax authorities and attempts have been made to raise the consciousness of the taxpayer by creation of measures such as a

* This article is adapted from Koji Ishimura (ed), *The State of Taxpayers' Rights in Japan: A Survey of the Legal Situation* (1995 Institute for International Trade Law, Asahi University).

¹ *Kokuzei Tsûsoku Hô* (Law No 66 of 1962).

² *Kokuzei Chôshû Hô* (Law No 147 of 1959).

³ *Kokuzei Hansoku Torishimari Hô* (Law No 67 of 1990).

⁴ *Shotokuzei Hô* (Law No 33 of 1965).

⁵ *Hôjînzei Hô* (Law No 34 of 1965).

⁶ *Shôhizei Hô* (Law No 108 of 1988).

Declaration of Taxpayer Rights,⁷ a Taxpayers' Charter,⁸ a Taxpayers' Bill of Rights,⁹ etc. The respective governments and tax authorities are thus making plain their commitment to fairness and transparency in tax procedures.

In contrast to this situation abroad, the Japanese government and tax authorities show no sign of promoting the fairness and transparency of tax procedures, or taxpayers' rights in general. Academics¹⁰ and the *zeirishi* (certified tax accountant) community¹¹ have been criticising this position for many years.

WHAT ARE TAXPAYERS' RIGHTS?

The meaning of taxpayers' rights

In recent years, with the diversification and increasing complexity of Japanese society, various rights that are not provided for in the Constitution are starting to be recognised, such as taxpayers' rights, the right to privacy, the right to know, the right to access to sunlight, the right to scenery and environmental rights. It is clear, then, that taxpayers' rights are a relatively new concept in Japan. There are no provisions in current Japanese legislation setting out the contents of taxpayers' rights, with the result that the specific contents of taxpayers' rights are currently under dispute. Most *zeirishi* are of the opinion that the most important element of taxpayers' rights is the right to procedural fairness, and they have

⁷ Revenue Canada, *Declaration of Taxpayer Rights* (1985).

⁸ Inland Revenue & Customs and Excise, *Taxpayer's Charter* (1986, 1991).

⁹ Omnibus Taxpayer's Bill of Rights (US) (1988); Taxpayer Bill of Rights 2 (1996).

¹⁰ See Ishimura Kôji, *Charters of Taxpayers' Rights in Developed Countries* [Senshin-shokoku no Nôzeisha Kenri Kenshō] (1993) Part 1.

¹¹ *Zeirishi* are Japanese tax professionals. Tokyo *Zeirishi* Association [Tôkyô Zeirishikai], *Prospectus for Legal Consolidation of Tax Administration* [Zeimu Gyôsei no Hôteki Seibi ni kansuru Yôkô] (1993), reproduced in (1993) 437 *Tôkyô Zeirishi Kai* [Tokyo *Zeirishi* Circles] 4; Tokyo Regional *Zeirishi* Association Research Department [Tôkyô Chihô Zeirishikai Chôsa-bu], *The Enactment of the Administrative Procedures Law and the State of Tax Administrative Procedure (Second Opinion Paper)* [Gyôsei Tetsuzuki Hô Seitei no Ugoki to Zeimu Gyôsei Tetsuzuki no Arikata ni tsuite (Dainiji Ikensho)] (1992); Materials from the 1990 JFZA (Japan Federation of *Zeirishi* Associations) Public Forum "Problems with Tax Administrative Procedure" [Zeimu Gyôsei Tetsuzuki no Sho-mondai ni tsuite].

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lobbied the government and the National Diet to create legislative guarantees in this area.¹² On the other hand, many academics and taxpayer associations favour the view that the main focus should be on democracy for taxpayers, in particular constitutionally-based rights to control the way the government collects and spends tax revenue.¹³

The conservative approach of the Japanese government

In 1990 the OECD published a report titled *Taxpayers' Rights and Obligations: A Survey of the Legal Situation in OECD Countries* ("the OECD report"). The report contains a comparative analysis of taxpayers' procedural rights in OECD countries. The Japanese system is discussed.

What response have the Japanese government and administration displayed to the OECD report and the diversified approaches to procedural rights discussed there? At the parliamentary Finance Committee Meeting on 27 February 1992, debate centred on the need for a legislated charter of taxpayers' rights and the current state of protection of such rights. In response to a question by the representative of the Japan Social Democratic party, the Minister of Finance and the Director of the Taxation Bureau of the Ministry of Finance answered to the effect that:¹⁴

Charters of taxpayers' rights in other countries merely restate existing rights held by taxpayers, and do not expand taxpayers' rights. Even in countries without a charter, including Japan, there is sufficient protection for taxpayers within the bounds of the existing system. Therefore, there is no need to introduce such a charter by legislation.

Clearly, the Japanese government and administration are not positive towards establishment of taxpayers' rights and the

¹² JFZA Tax System Consultative Committee [Nihon Zeirishikai Rengōkai Zeisei Shingikai], *The State of Tax Administration Procedures (Second Opinion Paper)* [Zeimu Gyōsei Tetsuzuki no Arikata (Dainiji Ikensho)] (1990).

¹³ See Kitano Hirohisa, *Principles of Tax Law* [Zeihōgaku Genron <Daisanpan>] (3rd ed 1992) at 69; Japan Civil Liberties Union [Jiyū Jinken Kyōkai], *Declaration of Taxpayers' Rights* [Nōzeisha no Kenri Sengen] (1986); Citizens for Tax Justice [Fukōhei na Zeisei o Tadasu Kai], *Taxpayers' Charter of Rights* [Nōzeisha no Kenri Kenshō] (1993).

¹⁴ 27 February 1992: 5 123rd Diet House of Representatives Finance Committee Proceedings [Dai-123-kai Kokkai Shūgiin Ōkura Iinkai-giroku] 45.

promotion of fairness and transparency in tax administration procedures.

It cannot be denied that on the face of the OECD report, Japan does appear to have well-developed tax administration procedures. However, if one examines the correlation between the systemic surface and its practical operation, including for instance the various unreasonable audit procedures or the lack of any opportunity for participation by taxpayers in the creation of circulars, it is impossible but to evaluate the Japanese system negatively. There is little evidence of any attempt to protect taxpayers' rights by combination of the concepts of fairness in procedure and taxpayer participation, concepts which should form the foundation of a system of tax procedures.

The current state of taxpayers' rights in Japan

To exercise the public power of taxation fairly, the tax authorities need to obtain the voluntary cooperation and confidence of the taxpayer, and to this end tax procedures need to be fair and transparent. Tax procedures need to be enacted in legislative form in as much detail as possible. Furthermore, information on tax procedures needs to be widely available to the public. By these means, taxpayers are able to participate in tax procedures on an equal footing with the tax authorities. The government and the tax and revenue authorities are urged to promote these practices.

However, Japanese tax administration has developed with the tax authorities in a clearly superior position. Further, tax procedures are extremely opaque so that many decisions are made arbitrarily by the tax authorities. Legislative provisions are loosely-worded, leaving room for wide exercise of discretion by the tax authorities.

The tax authorities create tax circulars based on such broad discretions: it is often the case that they unilaterally force procedures upon the taxpayer, and many details of tax procedure are enforced through administrative guidance. There are particular problems with tax audit procedures, such as their general opaqueness, the abuse of discretionary powers by the tax authorities and coercive administrative guidance.

Legislative drafting for tax laws is done by officials of the Ministry of Finance, ie, the bureaucracy. Members of the National Diet, the elected representatives of taxpayers, are unskilled in tax matters and are not in a position to adequately fulfil their function of

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preparing legislation in this area.¹⁵ Given that the bureaucracy has this grip on the practical power to legislate in the tax area, their opinions have a profound effect on procedural tax legislation. However, the bureaucracy's opinions do not currently include improving procedural fairness by consolidating procedures relating to tax assessment, or increasing public awareness of the kinds of information obtained by the tax authorities through these procedures. On the contrary, there is a strong view in the bureaucracy that it is sufficient if taxpayers who are dissatisfied with the tax authorities' procedures can protect their rights through litigation after the problem has occurred. But the tax authorities on the front line, who actually administer tax procedures, hold the opinion that a high proportion of suits only serves the purpose of hindering efficient administration: even where a problem arises, they tend to use administrative guidance to avoid litigation.¹⁶

Academics and the *zeirishi* associations have long argued for increased fairness and transparency in tax procedures through new legislative provisions. However, the bureaucracy, which holds the actual power to legislate, has not responded to these claims, and no revolution in tax procedures has yet occurred.

The JFZA Report

The Administrative Procedure Law was finally enacted in 1993 after continued resistance from the bureaucracy. As soon as the drafting process commenced, tax specialists such as *zeirishi* and academics produced many statements and reports, aiming to establish procedural rights for taxpayers.

The JFZA's Tax System Consultative Committee published a report entitled *The State of Tax Administration Procedures (Second Opinion Paper)*¹⁷ ("the JFZA report") in November 1990. This report brings together many current issues in tax procedure in Japan, and is an important reference.

¹⁵ See, for instance, Uchibashi Yoshihito, "Diet Members' Draft Bills Left on the Shelf: The Administrative Wall Obstructing Popular Will" [Giin Teishutsu Hôan Tanazarashi: Min'i o Habamu Gyôsei no Kabe] *Nihon Keizai Shinbun* (25 September 1994 morning edition); Igarashi Takayoshi, *Legislation by Diet Members* [Giin Rippô] (1994).

¹⁶ Ishimura, above n 10.

¹⁷ JFZA Tax System Consultative Committee, above n 12.

The basis of tax administration

The JFZA report proposes that tax procedures not be excluded from the operation of the Administrative Procedure Law, contrary to the opinions of the bureaucrats who participated in the legislative process. In addition, the report states that:

In future debate on putting administrative procedures in legislative form, it is necessary to place general and common items in a general administrative procedure law after due consideration is paid to the special nature of tax administration, and items specific to tax administrative procedures should be provided for in separate special legislation.

Specific issues with tax administration procedures

The JFZA report discusses issues in tax administration procedures in relation to stages in the tax audit: procedures are divided into pre-audit procedures, audit procedures and post-audit procedures.

Pre-audit procedures

Illegal administrative dispositions in general in Japan are dealt with through a system of ex post facto relief measures, and in tax administration there are insufficient concrete procedural provisions governing actions before or during a disposition. However, in the UK and USA, based on the belief that freedom and equality cannot be protected without fair administrative procedures, procedures are in place to govern administrative actions at any stage.

In Japan, from the point of view of procedural fairness, at least the following pre-dispositive procedures should be adopted.

(1) *Issuance of Circulars*

Circulars are orders or instructions by a superior administrative body to organs and officials within its jurisdiction, and are not a source of law as such. However, the fact is that circulars serve the important function of filling the gap between law and administration, so much so that tax administration is referred to as "administration by circulars". In addition, circulars have a profound effect on the self-assessment system. Therefore, the following measures should be instituted:

- (a) A structure needs to be established to allow learned persons and organisations of tax specialists to voice

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the opinions of taxpayers during the process of creating circulars. This is to provide procedural safeguards against administrative exercise of legislative power, since there is the possibility that de facto legislation will be implemented in the form of circulars.

- (b) Except where it would breach the public interest or equity in the imposition of taxation, circulars should be made available to the public in writing. This is important for predictability and to allow equal treatment.

(2) *A system of advance rulings*

A system of advance rulings, similar to that existing in the USA, should be adopted as a form of administrative guidance. This would allow taxpayers to seek a ruling from the tax authorities before taking a course of action, and by expressing this opinion the tax authority generates an opportunity to debate the interpretation and application of the law with taxpayers, guarantees predictability and promotes the stability of the self-assessment system.

Audit procedures

Tax audits under the self-assessment system are activities by a tax authority to collect data relating to the facts of the tax case, presupposing primary assessment procedures by the taxpayer and having as their aim the fair and equitable realisation of taxpaying obligations.

(1) *Sending of audit notifications*

From the point of view of the guarantee of procedural fairness in Article 31 of the Constitution,¹⁸ it would be appropriate to introduce a system of sending a notification to the taxpayer and her or his *zeirishi* a reasonable time before a tax audit (say, 14 days), containing details such as the proposed date and place, the type of tax and tax year under consideration, the reasons for the audit, the name and affiliation of the audit officer and what books, records and other documents need to be prepared for inspection.

¹⁸ *Nihonkoku Kenpô* (1947).

(2) *Procedures and notification for extended audits*

Extended audit is a procedure to collect data from third parties to trace the extent of the taxpayer's income, and should not be called upon lightly. It is desirable for the taxpayer and his or her *zeirishi* to be notified and allowed a hearing before an extended audit is put into operation, and the third party should be presented with an audit notification at the time of the audit.

(3) *Establishing necessity for tax audits*

Since tax audits are an exercise of public power, they need to be based on guaranteed fair procedures.

Tax audits can be divided into four types: assessment audits (for correction or determination), delinquency audits, infringement audits and audits relating to administrative review. However, the question of necessity arises most often in relation to assessment audits, especially those dealing with income tax and corporation tax. If the question of necessity in tax audits is to be determined properly, an objective third party body needs to be established to rule on the issue in individual cases.

(4) *Hearing during audit and notification of audit completion*

During a tax audit, the taxpayer and his or her *zeirishi* need to be allowed a hearing to express their opinions. When the audit is over, the taxpayer should be notified as such in writing by way of a notification of audit completion.

(5) *Presentation of identification*

Tax officials should be required to present their identification when conducting a tax audit, regardless of whether this is demanded by the audit subject.

Post-audit procedures

Assessment of tax under the self-assessment system is ideally meant to be completed by the taxpayer's own return. However, when an error is revealed in that return by a tax audit, the tax authorities may recommend that the taxpayer submit a revised return or may issue a correction disposition.

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(1) *Encouragement of revised returns*

A recommendation to file a revised return following a tax audit is nothing more than a request from the administration with no legal effect whatsoever - the taxpayer can exercise her or his own judgement on whether to adopt the recommended course of action. What many taxpayers probably do not realise is that, by filing a revised return, the path to administrative review and tax litigation is closed off for them. Consequently, it is an absolute necessity to put a stop to recommendations to file revised returns that are issued with the tone of commands.

(2) *Clarification of discretionary powers*

The boundaries of administrative discretion (for instance in the imposition of heavy penalty tax) should be kept to the minimum, based on the principle of "administration by legislation". Further, for legal provisions whose interpretations have not been finally determined, concrete illustrations should be made available in a public circular to gain the understanding and confidence of the public.

(3) *Provision of reasons*

Under the ideals of democracy, if some action disadvantageous to the general public is to be taken, the reasons for this action should be made clear. Attaching reasons when issuing a disposition acts to ensure the caution and reasonableness of the tax authorities' decisions and to control arbitrariness. Further, attaching reasons allows for the smooth running of administrative review and makes taxpayers aware of the processes involved in reaching the conclusions that were reached. Provision of reasons is a central indication of procedural fairness, and needs to be expanded - at the moment, reasons are only required for correction dispositions for blue returns.¹⁹

¹⁹ Under the Japanese self-assessment system there are white (regular) and blue tax returns. Blue returns may be filed for income tax on income from real estate, business and forestry, or for corporation tax, with the approval of the Director of the District Tax Office. Blue return filers must be able to provide books, records and other documents, up to a specified standard, recording details of transactions. Inductive calculations of tax are not permitted for blue return filers. There is also a requirement to attach reasons to a Notification of Correction for blue returns. Failure to attach reasons is in itself enough to invalidate the correction for blue returns. This is not the case for white returns. For keeping appropriate records,

THE ADMINISTRATIVE PROCEDURE LAWS AND TAX PROCEDURES

The legislative history of the Administrative Procedure Law²⁰

The need for a uniform system of administrative procedures enshrined in legislation has been advocated for many years by specialists such as academics and *zeirishi*. However, the bureaucracy displayed strong resistance, so that very little progress was made towards legislating an administrative procedures law. Criticism mounted from various sectors at the inactivity in unifying the fairness, transparency and uniformity of administrative processes.

In this context, in December 1991 the Fair and Transparent Administrative Procedure Sub-Council (*Kôsei, Tômei na Gyôsei Tetsuzuki Bukai*) of what is now called the Interim Council for the Promotion of Administrative Reform (*Rinji Gyôsei Kaikaku Suishin Shingikai*) put together an outline draft for a new administrative procedure law and published its *Report on the Enactment of a Fair and Transparent Administrative Procedure Law*.²¹ Then, in May 1993 the Administrative Procedure Bill and National Taxes' Common Provisions (Amendment) Bill²² were completed and submitted to the National Diet, and were enacted in November 1994.²³

blue return filers are granted various privileges. Historically the blue return system was introduced after the War in accordance with the recommendation of the Shoup Mission (of the Occupation Forces) because traditionally most small business did not keep adequate books and records. The Mission aimed to reform the tax compliance environment. Today, a large number of small businesses are blue return filers.

²⁰ *Gyôsei Tetsuzuki Hô* (Law No 88 of 1993), hereafter "the APL" or "the Law".

²¹ Reproduced in Management and Coordination Agency Administrative Inspection Bureau [Sômuchô Gyôsei-kanri-kyoku], Article-by-Article Interpretation of the Administrative Procedure Law [Chikujô Kaisetsu Gyôsei Tetsuzuki Hô] (1994) 277. For an analysis of the APL in English, see Ködderitzsch Lorenz, "Japan's New Administrative Procedure Act: Reasons for its Enactment and Likely Implications" (1991) 24 *Law in Japan: An Annual* 105.

²² Its full title was Bill Concerning the Adjustment of Related Laws due to Implementation of the Administrative Procedure Law [*Gyôsei Tetsuzuki Hô no Shikô ni Tomonau Kankei-hôritsu no Seibi ni Kansuru Hôritsuan*].

²³ For a concise explanation of the history of the APL, see Kaneko Masashi, *The Administrative Procedure Law* [*Gyôsei Tetsuzuki Hô*] (1994) at 195 ff.

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Special features of the Administrative Procedure Law

Of the many types of administrative process,²⁴ the four categories that were the subject of concrete discussion and were included in the APL were "dispositions in response to applications", "unfavourable dispositions", "administrative guidance" and "notifications". On this point, Article 1 of the APL says:

The aim of this Law is, in relation to dispositions, administrative guidance and notifications, to aspire to greater fairness and transparency ... in administrative management by providing for common matters, and by these means to contribute to the protection of the rights and interests of the Japanese people.

However, the operation of the APL has been almost entirely excluded in the area of tax administration. There has been strong criticism of this fact, which amounts to totally ignoring the demands of *zeirishi* and other tax specialist organisations.²⁵

The management of tax procedures

In relation to the applicability of the APL to the tax field, Article 3(1) (vi) excludes "dispositions and administrative guidance relating to national tax infringement cases" from the ambit of the Law. Further, Article 1(2) of the Law states that, "where there are special provisions in another law, these will take precedence over the Law" and Article 74-2 of the National Taxes Common Provisions Law²⁶ expressly excludes the application of the APL: this combination means that provisions relating to dispositions in response to applications,²⁷ unfavourable dispositions²⁸ and notifications²⁹ are entirely excluded. Consequently, assessment dispositions such as corrections, determinations or administrative

²⁴ See Sonobe Toshio, "Introduction to the Administrative Procedure Law", in Ogawa Ichirô et al (eds), *3 Treatise on Contemporary Administration* [Gendai Gyôsei no Hôteki Seibi ni Kansuru Yôkô] (1993), reproduced in (1993) 437 *Tôkyô Zeirishi Kai* [Tokyo Zeirishi Circles] 4.

²⁵ Tokyo Zeirishi Association [Tôkyô Zeirishikai], Prospectus for Legal Consolidation of Tax Administration [Zeimu Gyôsei no Hôteki Seibi ni Kansuru Yôkô] (1993) reproduced in (1993) 437 *Tôkyô Zeirishi Kai* [Tokyo Zeirishi Circles] 4.

²⁶ *Kokuzei Tsûsoku Hô* (Law No 66 of 1962).

²⁷ Chapter 2 of the Law.

²⁸ Chapter 3 of the Law.

²⁹ Chapter 5 of the Law.

assessment, as well as assessment audits, collection dispositions and delinquency dispositions are all outside the scope of the protection of the APL.

Tax administration as a form of administrative guidance

Administrative guidance is one activity governed by the APL. As general principles for administrative guidance, Article 32 of the Law states that:

- (a) where an administrative body engages in administrative guidance, it must not exceed the boundaries of its duty or its jurisdiction;
- (b) administrative guidance does not have any compelling force at law; and
- (c) an administrative body may not treat a second party disadvantageously because that party has refused to comply with administrative guidance.

The Law lists some further principles for administrative guidance:

- (a) an administrative body should make clear the aims, contents and the names of responsible officers for any administrative guidance;³⁰
- (b) where a second party who is subject to administrative guidance seeks a statement of the administrative guidance in writing, the administrative body must comply with the request;³¹ and
- (c) where an administrative body engages in administrative guidance of many persons with the same objective, the criteria on which the guidance is based should be determined and made public.³²

These provisions may be "general principles" for all administrative guidance, but are excluded from application to tax administration by Article 74-2(2) of the National Taxes Common Provisions Law.³³ It must be said that this exclusionary response to the situation is highly problematic and contradicts the core concepts of the APL. Provisions that govern "administrative guidance" should apply in

³⁰ Article 35(1) "Clarification of the Contents, Aims and Responsibility for Administrative Guidance".

³¹ Article 35(2).

³² Article 36.

³³ For more details, see Takano Toshinobu, "The Partial Amendment to the National Taxes Common Provisions Law under the Administrative Procedure Law" 42(6) *Zeimu Kôhō* 202; Minami Hiromasa, "Towards Transparency and Fairness in Tax Procedure" (1994) 22 *Sozeihô Kenkyû* [Japan Tax Law Review] 1.

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the tax field as much as in any other, until a special law, such as the National Tax Common Provisions Law, makes special provisions for administrative guidance in the tax area. The current exclusion clauses in the National Taxes Common Provisions Law can only be said to show the true character of the APL as a mere legal facade with no legal substance. One situation where the APL *may* apply to a tax procedure, in spite of the exclusion clauses, is the purely voluntary audit.

(1) *Purely voluntary audits and guidance of returns*

In the operation of tax audits, there are some audits that do not necessarily have a basis in legislation but are conducted with the consent of the taxpayer. In purely voluntary audits, there is no duty on the audit subject not to obstruct public officials. Also there is no indirect compulsion to comply with the audit in the form of penalties. It is difficult to categorise such audits. One argument is that such audits ought to be seen as a type of administrative guidance governed by Article 1 of the APL on "Concepts of Fairness and Transparency in Administrative Management" which *does* apply to tax administration. Consultations with the taxpayer for the purpose of collecting assessment data³⁴ should also be seen as a form of administrative guidance.

In addition, supervision of returns and tax consultation, including recommendations to file revised returns, can be interpreted as administrative guidance. Therefore, such administrative acts are governed by the "Concepts of Fairness and Transparency in Administrative Management" of Article 1 and the "General Principles on Administrative Guidance" of Article 32. In other words, there must be a guarantee that the taxpayer will not be at a disadvantage because he or she did not comply with a purely voluntary audit or return supervision or tax consultation, despite having no duty not to obstruct.

It is worth considering that, if there were no exclusion clause like Article 74-2(2) of the amended National Taxes Common Provisions Law, the tax authorities would have to provide the following in implementing administrative guidance:

- (a) specification of the objectives, contents and responsible officer for the guidance;

³⁴ Income Tax Law [*Shotokuzei Hô*] (Law No 33 of 1965) Article 235; Tobacco Tax Law [*Tabakozei Hô*] (Law No 72 of 1984) Article 27(2); etc.

- (b) written explanation of the details of the administrative guidance; and
- (c) publication of the criteria on which the administrative guidance is based (where it is implemented on a large scale or repeatedly).

Further, the activities of the tax authorities would have to:

- (a) not breach the Constitution³⁵ or other laws or regulations;
- (b) not exceed the objectives, authority, the specified activities or the powers of the body; and
- (c) be subject to the doctrine of estoppel.

On a related point, in the implementation of purely voluntary audits, returns supervision or tax consultation, the tax authorities ought, on their own initiative, to inform the taxpayer whether their actions are administrative guidance or are based on law. Further, where the taxpayer is not informed as such, the taxpayer ought to be able to confirm this before agreeing to the procedure.³⁶ It is extremely important to bear in mind that the APL may apply to the tax area in these respects, albeit only through the "Concepts of Fairness and Transparency in Administrative Management", the "General Principles on Administrative Guidance" and "Clarification of the Contents, Aims and Responsibility for Administrative Guidance".

Strategies for the future

The current situation where the APL has virtually no application to tax procedures is a direct reflection of the negative attitude of Ministry of Finance bureaucrats towards the applicability of the APL to tax procedures. The enactment of the APL certainly does not mean that the proposals for reform of tax administrative procedures in the JFZA report³⁷ can be forgotten: there is no change to the urgent need for reform in the area of tax procedures. What legislative responses are possible in this context?

³⁵ *Nihonkoku Kenpô* (1947).

³⁶ See Kitano Hirohisa, *The Structure of Contemporary Tax Law* [Gendai Zeihô no Kôzô] (1972) at 322.

³⁷ JFZA Tax System Consultative Committee [Nihon Zeirishikai Rengôkai Zeisei Shingikai], *The State of Tax Administration Procedures (Second Opinion Paper)* [Zeimu Gyôsei Tetsuzuki no Arikata (Dainiji Tôshin)] (1990).

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(1) *Reform of existing legislation*

One option would be to reconsider the exclusion provisions in the APL and Article 74-2(2) of the National Taxes Common Provisions Law.

There are many provisions in the APL that would be invaluable if the Law were made to apply to tax procedures. For example, fair procedures would be ensured for all kinds of dispositions if the provisions on unfavourable dispositions were applied to tax administration. Procedures for offering explanations, hearings, requests for inspection of documents, participation of an interested third party in a hearing, provision of reasons for an unfavourable disposition, etc, would all become applicable to assessment dispositions. If procedures under current tax laws were reviewed in light of these standards, the taxpayer's procedural rights would be satisfactorily protected.

If the reason that the APL was made inapplicable to tax administration was that it was enacted in haste without waiting for a true consensus to be reached, then no time should be lost in reviewing its applicability to the tax area with the aim of making the majority of the Law applicable, now that the Law has been enacted.

If the Law became generally applicable to tax procedures, it would be necessary to create a new tax administrative procedure law or to amend the National Taxes Common Provisions Law to provide for procedures specific to the tax area. As already alluded to, the categories covered by the APL are confined and, as pointed out in the JFZA report, the issues that need to be tackled in achieving fairness and uniformity in tax procedures are multifarious. To respond to this situation, even if the applicability of the APL is expanded to cover tax procedures, provision must be made to cover the specific details of tax procedures.³⁸

(2) *Enactment of a special tax procedure law*

Another option would be to accept the position under the APL and enact a new procedural law specific to the tax field. This is the

³⁸ The Tokyo *Zeirishi* Association favours this approach, and has published an opinion paper on adjustments to the National Taxes Common Provisions Law. See Tokyo *Zeirishi* Association [Tôkyô Zeirishikai], *Opinion Paper on Consolidation of the National Taxes Common Provisions Law* [Kokuzei Tsûsoku Hô no Seibi Jûjitsu ni Kansuru Ikensho] (1994).

approach adopted in Germany. Germany has a General Administrative Procedure Law,³⁹ but it does not apply to tax administration. Instead, the Tax Basic Law⁴⁰ contains detailed provision on tax procedures. In adopting this approach, Japan would be able to incorporate the necessary provisions into the National Taxes Common Provisions Law.

A variation on this same theme would be to create special laws such as a Tax Administration Procedure Law, and a Tax Audit Procedures law. This is the practice followed in France.⁴¹

ISSUANCE OF CIRCULARS

An Overview

As expressed in the JFZA report,⁴² problems with the fairness and uniformity of Japanese tax administrative procedure are multifarious. One problem area is fairness in circular issuance procedures.

Circulars (*tsûtatsu*) are commands or directions by a superior administrative agency to its subordinate bodies or officials, but have no binding force on taxpayers.⁴³ However, it is not possible for taxpayers or tax specialists to interpret or apply tax laws or to check the validity of specific treatment by the tax authorities, without consulting tax circulars. In other words, circulars do virtually have the force of law, and do have de facto binding effect on the taxpayer.⁴⁴

³⁹ *Verwaltungsverfahrensgesetz* (BGB1 1976 IS.1253).

⁴⁰ *Abgabenordnung* (AO1977, Stand: 1 Juni 1990).

⁴¹ See Ishimura, above n 10 at 52 ff.

⁴² JFZA Tax System Consultative Committee [Nihon Zeirishikai Rengôkai Zeisei Shingikai] *The State of Tax Administration Procedures (Second Opinion Paper)* [Zeimu Gyôsei Tetsuzuki no Arikata (Dainiji Tôshin)] (1990).

⁴³ Article 14(2) of the National Government Organisation Law [*Kokka Gyôsei Soshiki Hô*] (Law No 120 of 1948) states:

Each minister, committee and agency director has the power to issue instructions and circulars to bodies and officials within his or her jurisdiction in order to command or direct in relation to the activities of that ministry, committee or agency.

⁴⁴ The circulars with the most effect on taxpayers' rights and duties are the so-called interpretive circulars, rather than the operational circulars. National taxes are mostly assessed according to the self-assessment mode, under which the taxpayer herself or himself makes the primary assessment of tax

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In particular, in recent years the tax authorities have started a trend of issuing copious circulars with the aim of closing loopholes in the tax laws. Article 84 of the Constitution⁴⁵ states that taxes must be imposed only by legislation: there has been mounting criticism by academics and tax specialists of the current situation where taxes are virtually imposed by circular.⁴⁶ While it is not possible to deny the necessity for circulars, there are increasing calls for reconsideration of the current position where circulars are a unilateral act of the tax authorities.

Participation of interested third parties in the issuance process

It goes without saying that tax circulars should be issued only within the confines of tax laws and regulations: the tax authorities must not use tax circulars to usurp the legislative function. In order to produce circulars that are not flawed in this way, it is necessary to institute a screening system in the process of issuing circulars to involve taxpayers and other interested third parties.

Circulars can be divided broadly into basic circulars (*kihon tsûtatsu*) and individual circulars (*kobetsu tsûtatsu*). There is a precedent for consultation of taxpayers and interested third parties in the case of the basic circular covering the Corporation Tax Law.⁴⁷ The Corporation Tax Law Basic Circular Review Council (*Hôjinzei Hô Kihon Tsûtatsu Seibi Shingikai*) was in operation over the three or so years following the amendment of the Corporation Tax Law in 1965. However, since then there have been no similar councils.

On the other hand, there have never been any such councils in relation to individual circulars - the tax authorities have always been able to issue and publish such circulars without any input from taxpayers or tax specialists. The opinion has been put that the effectiveness of the circulars in closing loopholes would be weakened if they could only be issued after publication and hearings.

liability. Tax circulars are supposed to be internal standards of the tax authorities that have no binding legal effect on the taxpayer, but since taxpayers make reference to published tax circulars when binding themselves by their own assessment, the circular can be said to have a binding effect.

⁴⁵ *Nihonkoku Kenpô* (1947).

⁴⁶ See Kitano Hirohisa, "Taxation by Circular, Administration by Circular" in Kitano Hirohisa (ed), 1 *Research on Precedents: Treatise on Japanese Tax Law* [Hanrei Kenkyû: Nihon Zeihô Taikêi] (1978) 51.

⁴⁷ *Hôjinzei Hô* (Law No 34 or 1965).

However, the Constitution is quite clear in prohibiting the executive from performing a legislative function. Even if the aim of issuing the circulars is to ensure equity in sharing the tax burden through closing loopholes, it is not permissible for the executive to make law.

Consequently, for circulars that affect the rights and obligations of taxpayers, regardless of whether they are basic circulars or individual circulars, it is necessary to introduce a system whereby they are finalised and issued only after going through procedures allowing taxpayer participation. Further, where the tax authorities adjudge the need for an urgent issuance, the circular should be issued provisionally, on the condition that it will be subjected to a hearing within, say, six months. For such circulars that affect the rights and obligations of taxpayers, this procedure should be enshrined in legislation as soon as possible, after due consideration by the National Diet.⁴⁸

Why have greater participation?

The National Diet, as the legislative arm of government, conducts effective politics through being composed of the elected representatives of the people. Likewise, the executive arm of government makes effective policy decisions through obtaining the participation of interested third parties. In this sense, it is very important for the tax authorities to hear the opinions of interested third parties such as taxpayers and *zeirishi* in issuing circulars. A guarantee of participation by such interested parties is also a step towards the goal of open tax administration.⁴⁹

Certainly, participation of interested parties in the issuance process for circulars can be praised as the incorporation of public will. However, the down-side is that it gives the tax authorities a broad discretion to make circulars freely. A guarantee of participation by interested parties in the issuance process should not be seen as support for the free use of delegation of legislative power.

⁴⁸ See Ishimura, above n 10 at 20 ff.

⁴⁹ See further, Galler Linda, "Emerging Standards for Judicial Review of IRS Revenue Rulings" (1992) 72 *Boston University Law Review* 841.

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A SYSTEM OF ADVANCE RULINGS

An overview

It has been suggested that a system of advance rulings be considered as one link in the consolidation of tax administration procedures, and the JFZA report advocates this in its section on "Creation of an Advance Rulings System".⁵⁰ Currently, a system of advance pricing agreements is in place for transfer pricing taxation, based on the US advance rulings system. The Japanese and US systems differ slightly. The Japanese system of advance pricing agreements for transfer pricing taxation provides rulings on actual transactions, whereas the US system resolves hypothetical legal problems.⁵¹

Tax laws, regulations and circulars are becoming increasingly complex. In this context, it is indispensable for the tax authorities to be able to issue written rulings in answer to queries addressing taxpayers' individual circumstances.

If such a mechanism were in place, the flow-on beneficial effects would include the following:

- (a) The taxpayer would be able to avoid unnecessary disputes with the tax authorities. This would lead to a reduction in the number of cases of post-dispositive relief such as objections, National Tax Tribunal (NTT) review and litigation.
- (b) The accumulation of rulings would create a kind of precedent system. The taxpayer would be able to consult prior rulings to gauge how his or her transaction would be treated.
- (c) Where a ruling had been issued, any ensuing tax audit could be implemented much more simply, being confined solely to confirmation of the facts.

In this way, the adoption of a system of advance rulings would benefit the tax authorities as well as the taxpayer.

⁵⁰ JFZA Tax System Consultative Committee, above n 12.

⁵¹ For details on the US system, see Meldman RE and Petrie RA, *Federal Taxation: Practice and Procedure* (4th ed 1992) at ch 14.

The current system in Japan

Japan currently has a system of advance pricing agreements for transfer pricing taxation.⁵² However, this system is based on resolution of practical problems, not legal issues. Advance pricing agreements permit confirmation from the tax authorities of the appropriateness of prices between parent companies and subsidiaries. Where the tax authorities determine that there is no problem, this can be taken as a green light for that transaction. This provides the taxpayer with predictability and legal stability.⁵³

Further, the Customs and Tariffs Law provides for a system of "pre-assessment instruction".⁵⁴ Under this system, Customs Houses must endeavour, for the smooth and correct operation of the self-assessment system, to provide appropriate instruction when information is requested by taxpayers or interested parties as to classifications under the customs rates table, tax rates or taxable bases in relation to particular imported goods. This system can also be taken into consideration in formulating an advance rulings system for Japan.⁵⁵

Advance rulings and freedom of information

Even if a system of advance rulings is established as a part of pre-assessment procedures, the system cannot claim to be complete without information disclosure provisions or freedom of information legislation. The reason is that, because advance rulings are of their nature supposed to be for confirmation between individual taxpayers and the tax authorities, some of the rulings may become public, but many will not.

⁵² Individual Circular: On the Advance Recognition of Arm's Length Price Calculations on Intercompany Transactions [Kobetsu Tsūtsu: Dokuritsukigyō-kan Kakaku no Santei-hōhō-tō no Kakunin ni Tsuite] (1987 Sachō 5-1 Gai-2-ka Kyōdō).

⁵³ For details on the transfer pricing taxation system, see Gomi Yūji, *Question and Answer: Taxation of Transfer Pricing (New Edition)* [Q&A Iten Kakaku no Zeimu (Shinpan)] (1992).

⁵⁴ *Kanzei Hō* (Law No 61 of 1954) Article 7(3).

⁵⁵ A feature of advance rulings at the moment is that they are in place only for international matters such as transfer pricing taxation and customs and tariffs. In other words, an element of public relations towards foreign countries is in evidence. It is hard to understand why there is no corresponding system for domestic matters.

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Advance rulings are the epitome of pre-assessment procedures: the taxpayer examines the prior rulings and adjusts his or her own transaction to avoid problems. In this way, it is possible to curtail the need for relief at later stages. Advance rulings are extremely important from the point of view of preventative law. A comprehensive system is needed in Japan as soon as possible: at the same time, a system of disclosure of advance rulings is also necessary.⁵⁶

TAX AUDIT PROCEDURES

Issues with tax audit procedures

The locus of the problem

Tax audits can be grouped into four categories.

- (a) *Audits under individual tax laws.* These are audits provided for in the various substantive tax laws, such as the Income Tax Law,⁵⁷ the Corporation Tax Law,⁵⁸ the Inheritance Tax Law,⁵⁹ and the Consumption Tax Law,⁶⁰ as well as audits as a precursor to administrative review.⁶¹ These audits are also referred to as "assessment audits", "audits for tax assessment" or "audits under substantive tax laws".
- (b) *Delinquency audits.* These audits aim to appraise the scope in the assets of a defaulting taxpayer under the National Taxes Collection Law.⁶²
- (c) *Audits under the National Taxes Infringement Control Law.*⁶³ These audits aim to collect data where the taxpayer is under suspicion of tax evasion, ie, fraud or some other improper conduct.

⁵⁶ As discussed below.

⁵⁷ *Shotokuzei Hô* (Law No 33 of 1965) Article 234.

⁵⁸ *Hôjinzei Hô* (Law No 34 of 1965) Article 153.

⁵⁹ *Sôzokuzei Hô* (Law No 73 of 1950) Article 60.

⁶⁰ *Shôhizei Hô* (Law No 108 of 1988) Article 62.

⁶¹ National Taxes Common Provisions Law [*Kokuzei Tsûsoku Hô*] (Law No 66 of 1962) Article 97.

⁶² *Kokuzei Chôshû Hô* (Law No 147 of 1959) Articles 142 ff.

⁶³ *Kokuzei Hansoku Torishimari Hô* (Law No 67 of 1900).

- (d) *Purely voluntary audits*.⁶⁴ These audits may not necessarily have a basis in legislation, but are conducted as a form of administrative guidance. The various types of extra-legal inquiry can be placed in this category.

Of these types of audit, that with most relevance for the ordinary taxpayer is the audit under individual tax laws. In the operation of the tax system, these audits are the most common. These audits "are not to be interpreted as audits for criminal investigations".⁶⁵ In other words, they are "voluntary audits" conducted in the pursuit of normal administrative goals and are, by nature, only possible with the consent of the audit subject. However, uncooperative taxpayers may be subject to "penal servitude of up to one year or a fine of up to ¥200,000".⁶⁶ Taxpayers are judged uncooperative if they "refuse to answer tax officials' questions or answer falsely, or resist, evade or obstruct an audit",⁶⁷ or if they "produce books, records or other documents containing false information in relation to an audit".⁶⁸

In this way, assessment audits are voluntary audits in character, but are enforced indirectly through penalties. Although the audits are voluntary, in some cases they will take on the character of an investigation of criminal responsibility. However, the provisions in current legislation are extremely rudimentary: audits are permitted simply "when necessary", a test which is clearly inadequate in procedural terms. It is not surprising, then, that many problems should arise in the implementation of audits. The main reason for the friction created between taxpayers and the tax authorities in conducting audits lies in this inadequacy of procedural provisions.

Perspectives for reform

There are many problems with tax audits. On this point, the JFZA report⁶⁹ raised five particular areas of concern, namely:

- (a) sending of audit notifications;
- (b) procedures for extended audit and the presentation of the audit notification;
- (c) revealing the reasons for the audit;

⁶⁴ For examples, see Kitano, above n 36 at 321.

⁶⁵ For example, Corporation Tax Law Article 156.

⁶⁶ For example, Corporation Tax Law Article 162.

⁶⁷ Corporation Tax Law Article 162(2).

⁶⁸ Corporation Tax Law Article 162(3).

⁶⁹ JFZA Tax System Consultative Committee, above n 12.

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- (d) hearings during the audit process and notification of audit completion; and
- (e) confirmation of the necessity of any audit.

These issues all arise from inadequacies of the current legislation, but the courts are also to blame for not criticising the inadequacies and on occasion upholding them. A typical example is the negative attitude of the court towards requirements of prior notification of an audit or the provision of reasons, saying that "there is no provision in law" or "it is not a general requirement under the law".⁷⁰ Therefore, in order to erase procedural inadequacies, it will probably be necessary to amend the express provisions in the legislation.

The particular issues in tax audits will now be discussed.

(1) *Sending audit notifications*

The JFZA report makes the following points regarding audit notifications (*chôsa tsûchisho*):

From the point of view of the guarantee of procedural fairness in Article 31 of the Constitution, it would be appropriate to introduce a system of sending a notification to the taxpayer and his or her *zeirishi* a reasonable time before a tax audit (say, 14 days), containing details such as the proposed date and place, the type of tax and tax year under consideration, the reasons for the audit, the name and affiliation of the audit officer and what books, records and other documents should be prepared for examination.

This proposal by the JFZA is based on the German example for field audits.⁷¹

In Japan, there is no system of preceding audits with "contact letters" as a form of notification. However, adopting this kind of system is very important for protecting taxpayers' procedural rights. As pointed out previously, ordinary assessment audits are backed by penalties but are classified as voluntary. Therefore, they differ in nature from criminal investigations. A contact letter is a preliminary pre-audit measure to enquire when would be a convenient time to call on the taxpayer. Therefore, if the proposed

⁷⁰ See *Japan v Hirota* (Supreme Court, 10 July 1973) 27(7) *Keishû* 1205; *Fujiwara v Director of Meguro Tax Office* (Tokyo High Court, 26 December 1973) 20(1) *Shômu Geppô* 105; *Terada v Japan* (Tokyo District Court, 29 May 1975) 21(7) *Shômu Geppô* 1542.

⁷¹ *Abgabenordnung* (1977, Stand: 1 Juni 1990) Articles 193 and 194.

date is inconvenient, another date that is mutually agreeable will be negotiated. For normal audits, it is not considered that the taxpayer will be concealing or destroying evidence - the audit is voluntary, and the taxpayer may even rewrite the accounts before the audit, if he or she so desires. Where there is the suspicion of tax evasion and the authorities wish to conduct a surprise audit to establish whether a crime has occurred, they should obtain a warrant under the National Taxes Infringement Control Law. In many countries, such as the United States and Canada, regular audits must be preceded by a contact letter in normal circumstances.

The tax authorities would argue that contact letters merely reduce administrative efficiency and serve no useful purpose. However, for Japan to retain its place in international society, it is no longer possible to avoid introducing such audit notifications. If the tax authorities do not begin to issue such notifications on their own initiative, it will be necessary to amend the National Taxes Common Provisions Law or include provisions in a new tax audit procedure law to create a legislative duty to do so.

(2) *Procedures for extended audit and presentation of audit notification*

The JFZA report makes the following statements concerning procedures for extended audits and the presentation of audit notifications:

Extended audit is a procedure to collect data from third parties in order to trace the extent of the taxpayer's income, and should not be called upon lightly. It is desirable for the taxpayer and his or her *zeirishi* to be notified and allowed a hearing before an extended audit is put into operation, and the third party should be presented with an audit notification at the time of the audit.

The Income Tax Law sets out the persons who are subject to questioning and examination (ie, those who have a duty not to obstruct public officials) as:⁷²

- (a) persons with a tax debt or considered to have a tax debt;
- (b) persons obliged to submit withholding tax collections; and
- (c) third parties having transactional relations with persons having a tax debt.

⁷² Income Tax Law Article 234.

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Of these, (a) refers to audits of the taxpayer herself or himself, whereas (b) and (c) refer to so-called extended audits. By contrast, the Corporation Tax Law merely states the carrier of the duty not to obstruct public officials as "the corporation".⁷³ Therefore, it is not clear exactly which physical persons bear this duty.

Extended audits can, on occasion, have a detrimental effect on the level of trust in an enterprise and there are reports that they are sometimes conducted as a form of harassment. Amongst these cases there are many that seem to be more issues of human rights than purely of taxation, but there is no denying that, as stated above, extended audit procedures are barely provided for in express tax legislation.

In similar situations in the United States, a summons on a third party record-keeper is always issued. To maintain effectiveness, the format is not entirely voluntary. Detailed provisions are contained in the tax code.⁷⁴

In Japan, to take the example of a financial institution, Tax Office personnel can appear on the doorstep with a Financial Institution Account Audit Certificate (*kin 'yû kikan no yochokin-tô no chôsasho*) in hand and claim unlimited access to the financial information of not only the account-holder or someone thought to be an account-holder, but also of persons who have banking relations with such persons, all without giving any of these account-holders prior notice or allowing them the opportunity to object. Incidentally, at present, the same audit certificates are presented upon extended audits for criminal investigations under the National Taxes Infringement Control Law, but there are concerns that this breaches the requirement for a warrant in Article 35 of the Constitution⁷⁵ and Article 2 of the National Taxes Infringement Control Law. This point needs to be carefully reviewed from a different perspective from assessment audits.

If assessment audits are to be reformed through amendment of the National Taxes Common Provisions Law or the creation of a tax administrative procedure law or a tax audit procedure law, provision must be made for notification of an extended audit, whatever the head of tax under investigation. Notification should

⁷³ Corporation Tax law Article 153.

⁷⁴ Internal Revenue Code (USA) 1984, s 7609 ("Special Procedures for Third Party Summonses").

⁷⁵ *Nihonkoku Kenpô* (1947).

be sent to the taxpayer, his or her *zeirishi*, any other persons subject to the primary audit, and the third party subject to the extended audit. It should contain the proposed date and time of the audit and detailed reasons for the audit. An opportunity to oppose the audit should be granted. In addition, the tax authorities should reimburse banks and other third parties for actual costs, such as human resources when photocopies are made at the bank's premises. Concrete provisions are also required in this area.

Of course, even under present law, the situation would be different if financial institutions were more responsive to the position of their clients, rather than immediately complying with tax authorities. They could, for instance, demand reasons for the request to see the account-holder's account details, make the tax authority define narrowly what information is required and provide only that information in an envelope. The burden of protecting privacy would then be cast on the tax authority, not the financial institution. If these procedures were followed, the tax authorities would probably desist from presenting the rather vague audit certificate and asking to see everything that the financial institution holds on a particular client, and might instead request access in writing with reasons attached and with the information required narrowly defined. Further, they might notify the taxpayer and all others related to the information to be accessed. The financial institution should adopt the attitude of revealing information only if there is no objection from the taxpayer. The Banks Associations should take the lead in creating guidelines for tax audits and financial privacy from the point of view of protecting clients' financial privacy and should encourage voluntary compliance through the banking industry, while at the same time encouraging the tax authorities to abide strictly by such procedures. By these means, some degree of procedural reform could be achieved even within the confines of current law.

Regardless of whether Japan goes as far as adopting the administrative summons system of the United States, at the very minimum there is the need for legislative action to make audit procedures in relation to third parties more transparent by giving prior notification of the details of the extended audit and allowing the opportunity to oppose it.

By way of reference, in Germany the *Abgabenordnung* was amended in 1988 by insertion of Article 30(a) (Protection of Bank Clients). Under this amendment, where a bank client opens an account upon satisfaction of identification requirements, there are limitations on

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access to that account for the sake of extended audits. Specifically, the amendment imposes a duty to respect the fiduciary relationship between the financial institution and the client, and prohibits periodic repeated access to the account.

(3) *Revealing the reasons for the audit*

As mentioned previously, under a self-assessment system, action by the tax authorities is dependent upon initial filing of a return by the taxpayer. Therefore, except for where the law permits audits before the statutory deadline in exceptional circumstances, such as where the taxpayer seeks a reduction in provisional tax,⁷⁶ there will be no reason for holding preliminary audits before the deadline for filing returns. Further, the tax laws permit an audit "when necessary": the Supreme Court has held that an audit is "necessary" when there is "objective necessity, taking into account the specific circumstances of the case such as the objectives of the audit, the items to be audited, the manner in which the contents of the claim or return are described, the state of the accounts ledgers, the form of the business, etc".⁷⁷ In this decision, the court held at the same time that "prior notification of the date, time and place of implementation, notification of the reasons and the specific necessity of the audit are not compulsory legal elements" for a tax audit, and expressed reluctance to regard notification as compulsory. Therefore, on the basis of this judgment, the tax authorities do not necessarily have to be able to present objectively reasonable reasons to conduct an audit. However, from the taxpayer's point of view, he or she is unable to assess whether the tax authorities' audit is based on reasonable necessity unless he or she receives a statement of reasons.⁷⁸

To overcome the effect of this decision and protect the procedural rights of the taxpayer, it is necessary to have an express legislative provision. Logically, if a duty is imposed on the tax authority to send notification of the audit, then there should also be a requirement to reveal the specific reasons for the audit. Further, there is the need to guarantee the taxpayer the right to dispute the reasonableness of those reasons. In addition, in relation to unreasonable audits such as preliminary audits, it is necessary to provide expressly in legislation that failure to cooperate does not amount to the criminal offence of obstructing an audit. These

⁷⁶ See Income Tax Law Articles 111 ff.

⁷⁷ *Japan v Hirota*, above n 70.

⁷⁸ See *Japan v A Taxpayer of Shizuoka City* (Shizuoka District Court, 9 February 1972) 659 *Hanrei Jihô* 36 for a similar judicial opinion.

legislative measures are indispensable to increasing the fairness of audit procedures.

(4) *Hearings during the audit process and notification of audit completion*

The JFZA report makes the following points in relation to hearings during an audit and notifications of audit completion (*chôsa shûryô tsûchi*):

During a tax audit, the taxpayer and his or her *zeirishi* need to be allowed a hearing to express their opinions. When the audit is over, the taxpayer should be notified as such in writing by way of a Notification of Audit Completion.

Where the taxpayer states to the audit officer during the audit that he or she wishes to consult her or his *zeirishi*, there needs to be a legal mechanism to allow postponement of the audit after setting an approximate resumption date. Further, the *zeirishi* should be given true representative powers as in the United States, so that the taxpayer does not need to attend the audit in person.

The right to have a specialist present during a tax audit is not provided for expressly in legislation, except for a few provisions in the *Zeirishi* Law.⁷⁹ For this reason, debate on this right to representation has focussed on these provisions. However, debate continues over recognition of the right, because "tax representation" under the *Zeirishi* Law is not strictly a form of agency and is not accompanied by detailed exposition of the powers of the representative as in the Code of Civil Procedure.⁸⁰

For this reason, it is not uncommon for the tax authorities to make no allowance, even if the taxpayer needs to wait for the attendance of the *zeirishi*, or if the time or date of the audit is inconvenient for the *zeirishi*. Further, it is also problematic that there is no legal provision for the *zeirishi* to explain facts or answer questions in place of the taxpayer.

In order to counter such problems, the view has been put by the *zeirishi* associations and others that the right to representation at tax audits should be included in Article 2(1)(i) of the *Zeirishi* Law.

⁷⁹ Specifically, see *Zeirishi* Law [*Zeirishi Hô*] (Law No 237 of 1951) Articles 2(1)(i), 30 and 34.

⁸⁰ *Minji Soshô Hô* (Law No 29 of 1890) Articles 79 ff. (Litigation Representatives and Advisers).

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However, the right to representation should not be viewed as mainly a question of the legal position of *zeirishi*: the right to representation is a right of the person subject to the audit (which might be someone other than the taxpayer), who can be represented by non-*zeirishi* such as attorneys and third party advisers.

If these facts are included in considerations, the right to representation should be framed more in terms of the taxpayer's procedural rights. There is an urgent need to allow the taxpayer to have representation, whether this occurs by amendment of the National Taxes Common Provisions Law or through enactment of a new tax administrative procedure law or tax audit procedure law. On the other hand, there should also be some sort of provision made in the *Zeirishi* Law or elsewhere for the *zeirishi*'s obligation and right to attend the audit when requested.

In relation to notifications of audit completion, it is very important to systematise this type of notice. This issue of completion notices needs to be considered in conjunction with the requirement to issue a contact letter for arranging the initial time for the audit.

In Japan, because there is no requirement or custom of issuing contact letters, it is often unclear in relation to which tax period an audit is being conducted. It is hard to prevent a preliminary audit where it is made out to be an audit of a previous tax period. The fact that there is no restriction on re-audits in the tax laws also tends to cause confusion in this area.

Bearing these factors in mind, it is of great importance to systematise written audit completion notifications or Return Confirmation Notifications (*shinkoku zenin tsûchi*), from the point of view of ensuring procedural fairness and controlling preliminary audits.

(5) *Establishing the necessity of the tax audit*

The JFZA report points out the following in relation to establishing necessity for tax audits.

Since tax audits are an exercise of public power, they need to be based on guaranteed fair procedures. ...If the question of necessity in tax audits is to be determined properly, an objective third party body needs to be established to rule on the issue in individual cases.

Currently, legal regulation of tax audits is extremely sparse. The provisions merely say that an audit may be conducted "when

necessary".⁸¹ The Supreme Court has stated that this necessity must be an "objective necessity".⁸² Therefore, an audit cannot be implemented on the unilateral necessity of tax authorities. Having said this, one court decision is not sufficient authority to ensure compliance. In particular, there are special audit groups within the National Tax Administration, such as the Information and Examination Section, which conduct *de facto* compulsory investigations: there is no way of putting a check on such audits, which is not a healthy situation. In order for voluntary audits to be truly voluntary, there needs to be some sort of express legislative check in place. The precise meaning of the "objective third party body" in the JFZA proposal is not certain. However, on a related point, in the United States there is a Taxpayer Ombudsman (recently replaced by a Taxpayer Advocate).⁸³ In Australia⁸⁴ and New Zealand⁸⁵ there is also a complaints review system or a taxpayer service unit to provide relief against maladministration. In England, a third party Revenue Adjudicator handles complaints from taxpayers.⁸⁶ However, in Japan, even if such relief bodies were established within the tax authorities, it would be difficult to put an end to *forcible* audits. Unless there is a body to protect taxpayers' rights that has a strong sense of independence, for instance an ombudsman that reports to the National Diet, it would be very difficult to change the current practices of the tax authorities. Therefore, it would be necessary to accompany the enactment of a tax audit procedure law with the establishment of the office of Parliamentary Taxpayer Ombudsman.

(6) *Information Gathering Procedures Accompanying Audits*

In Japan there are virtually no provisions under current law to regulate the collection of materials by the tax authorities, such as the taking possession and photocopying of books, records and other documents. It is not unknown for audit officers to go through the handbag or desk drawers of the audit subject without obtaining consent, even during voluntary audits. Even though such practices

⁸¹ For instance, see Income Tax Law Article 234.

⁸² *Japan v Hirota*, above n 70.

⁸³ Internal Revenue Code 1984 Section 7811.

⁸⁴ Australian Taxation Office (ATO), *The ATO Service Principles* (1989).

⁸⁵ Inland Revenue (New Zealand), *Problem Resolution Officer, Tax Problems?* (1990).

⁸⁶ Revenue Adjudicator's Office (UK), *How to Complain about the Inland Revenue* (1993).

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have been identified as problematic in the past, there has been no move to regulate the tax authorities' acts in this area.⁸⁷

Depending on the items being inspected, there are those that would lead to the audit subject being liable to penalty if they could be removed or photocopied. Typical examples are doctors' medical records, registers of the dead, or congregation lists of a religious organisation. These documents must be protected from removal or photocopying to maintain the privacy and personal human dignity of the patient or believer,⁸⁸ as well as to prevent breach of the duty of confidentiality on the part of the doctor or religious organisation.⁸⁹ In particular, if a doctor or religious organisation discloses secrets without valid reason, "by direct oral or written communication or by leaving a document containing secrets where it can be read by others", then the patient or believer can seek a prosecution under Article 134 of the Criminal Code. Audit officers of the Tax Office tend to justify taking possession of or photocopying medical records or registers of the dead by pointing out that they have a duty of confidentiality as public servants, so there is no real problem. However, for the doctor or religious organisation there is no waiver of the duty of confidentiality under Article 134 of the Criminal Code for reason that the person to whom the confidence is revealed is a public servant.

There is thus the need to provide concrete provisions in legislation in relation to collection of sensitive information of this type, for instance by requiring personal approval from the patient or believer before the doctor or religious organisation can reveal the documents.

The tax authorities can also independently collect information from various sources without the taxpayer's knowledge or cooperation. For example, Article 235(2) of the Income Tax Law and Article 156-2 of the Corporation Tax Law provide for requests for cooperation to other administrative bodies. Under these provisions, the tax authorities "can, where it is necessary for an audit, request that a

⁸⁷ In a case publicised on 27 March 1995, audit officers went upstairs at the taxpayer's private residence without the consent of the taxpayer or his family, examined drawers and disturbed underwear and other private possessions. The taxpayer argued to the Kyoto District Court that the audit officers' actions were illegal as an abuse of power and sought damages accordingly. The court held the audit illegal for lack of content and ordered the government to pay damages of ¥600,000. See *Nihon Keizai Shinbun* (28 March 1995 morning edition).

⁸⁸ Constitution of Japan Article 13.

⁸⁹ Criminal Code [*Keihô*] (Law No 45 of 1909) Article 134.

public body or governmental organisation allow access to or provide records or materials that would be of reference for the audit, or seek other cooperation".

These requests for cooperation are allowable only when there is "reasonable necessity": this is obvious from the above Supreme Court decision. Thus, requests for cooperation that are not based on reasonable necessity are illegal. However, under current law the taxpayer is not even able to find out whether any request for cooperation occurred. Therefore, it is not possible to control obtaining of information by unnecessary requests for cooperation.

The significance of the right of privacy in the current age lies in how the "right to informational privacy" is guaranteed. In other words, the challenge is to go beyond the mere "right to be left alone" and put in place a right to control personal information.

From the point of view of this modern type of privacy right, a taxpayer should be notified of any request for cooperation and what information was provided. Then the taxpayer will be able to control his or her personal information. If such notification was required and if it became clear that the tax audit on which the request was based was found illegal, or that cooperation was requested beyond what was necessary, then the taxpayer would be able to seek damages from the government.

In this way, in relation to collection of information in tax audits, reform is very important from the point of view of the protection of privacy. The debate must go beyond the duty of confidentiality of public servants. It goes without saying that concrete legislative measures must be put in place to increase the fairness and transparency of procedures.

Issues with Post-audit Procedures

Under a self-assessment system, the amount of the tax debt is initially assessed by the taxpayer in his or her tax return. However, where it is determined by an audit that there is an error in the taxpayer's return, a revised return may be filed, a correction disposition may be issued, etc. Such dispositions that occur after an audit are known collectively as post-audit procedures (*chôsa-go tetsuzuki*).

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Recommendation to File a Revised Return

In recent years in Japan, recommendations or encouragements to file a revised return, a type of administrative guidance, have been problematic amongst post-audit procedures. The issue arises when a tax audit reveals facts on the basis of which tax officials promote to the taxpayer the option of filing a revised return. If the taxpayer files a revised return, he or she is then unable to dispute the outcome through administrative or judicial review. The particular problem at present is with tax officials forcing taxpayers to file revised returns. In other words, the tax officials who do not want the taxpayer to be able to appeal the outcome confront the taxpayer with the possibility of the continuation or upgrading of the audit (or some other disadvantage) unless the taxpayer files a revised return. Of course, it is not illegal or inappropriate for the tax authorities to merely promote revised returns to the taxpayer as an aspect of administrative guidance. It only becomes a problem when there is no mutual agreement between the taxpayer and the tax official in relation to the revised return, but it is made out that the taxpayer has freely consented.

This type of forced revised return is clearly a case of administrative guidance that breaches the principles of the Administrative Procedure Law.⁹⁰ Furthermore, depending on the circumstances, some are of the opinion⁹¹ that there could be an abuse of the public servants' position.⁹² The crime of abuse of public servants' position is established when a person with a position in the public service forces a second party, on the strength of the former's position as a public servant, to do something that the second party was not legally obliged to do. Further, if a forced revised return was found to constitute an abuse of the public servant's position, the execution of the act would not be mitigated by the crime of obstruction of public administration.⁹³

The biggest reason why forced revised returns are so prevalent is the fact that audit officers on the front line are pursued by statistical norms, so that they lead an existence almost like insurance salespersons. Put in another way, audit officers who respect the litigation rights of taxpayers are not necessarily well received

⁹⁰ *Gyôsei Tetsuzuki Hô* (Law No 88 of 1993).

⁹¹ For instance, Kitano Hirohisa (ed), *Contemporary Dictionary of Tax Law (Second Edition)* [Gendai Zeihô Jiten (Dainihan)] (1992) at 344.

⁹² See Criminal Code Article 193.

⁹³ Criminal Code Article 95(5).

within upper echelons of the tax authorities, while those officers who raise extra revenue *are* well received.

There needs to be a legislative response or the creation of guidelines to protect the taxpayer in these areas, including measures to train tax officials that forcing revised returns is prohibited and to proscribe setting work standards according to statistical norms or quotas.

Provision of Reasons

Another issue with increased fairness in audit procedures is the requirement to attach reasons to any disposition. At present, the typical example of providing reasons is the case of a correction disposition for a blue return.⁹⁴ However, this is the exceptional case. There are many situations where reasons are not required, such as correction or determination relating to a white return, correction or determination relating to inheritance tax or consumption tax, notification of denial of permission to file a blue return,⁹⁵ and imposition of a heavy penalty tax.⁹⁶

Providing reasons for dispositions has great significance in contributing to increased fairness in administration and also reinforcing the taxpayer's appeal rights. If reasons are made clear, it becomes very easy for the taxpayer to seek post-dispositive relief such as administrative review. Therefore, it should be a matter of priority to require the tax authorities to provide reasons for all dispositions, either through amendment of the Administrative Procedure Law or enactment of a new tax administrative procedure law. It is also important to require tax authorities to instruct the taxpayer of options relating to the availability of appeals such as administrative review.

TAX DATABASES AND INFORMATIONAL PRIVACY

Introduction

Despite Japan's status as an "information society", computerisation of Japanese administrative bodies has fallen far behind private enterprise. The government has therefore given priority to the

⁹⁴ See Income Tax Law Article 155; Corporation Tax Law Article 130.

⁹⁵ See Income Tax Law Article 146; Corporation Tax Law Article 124.

⁹⁶ National Taxes Common Provisions Law Article 68.

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policy of establishing databases for the information held by administrative bodies.⁹⁷ In line with this governmental policy, the National Tax Administration has been taking steps to implement the KSK (*Kokuzei Sôgô Kanri*) System since 1988 with the aim of producing a total database of tax administrative information. In addition, the government is proceeding with the introduction of de facto national identification (ID) numbers under the guise of "tax file numbers", based on multi-purpose shared use of information held by individual administrative bodies. By this means, the government will be able to exercise surveillance over a variety of information on the public. The eventual aim is to build a distributed processing comprehensive national database.

On the other hand, there is currently no general freedom of information law at the national level and no specific disclosure law for tax matters. Although the information held by administrative bodies is not publicly available, there has been little criticism of the situation. The public has become used to in camera administration. If the KSK System, national ID numbers and a national database are introduced, Japan will be a long way along the path to becoming a surveillance society.

Timetable for Introduction of the KSK System

In 1988 the National Tax Administration set about the introduction of the KSK System to put all tax-related information on database.⁹⁸ In addition, from July 1991 the management of taxpayer files was rationalised, so that they were arranged according to the taxpayer, not according to the head of tax, as previously. At the same time,

⁹⁷ For instance, see the statement of the then Prime Minister Hosokawa on 21 September 1993 at the 128th Session of the National Diet; Interim Council for the Promotion of Administrative Reform [Rinji Gyôsei Kaikaku Suishin Shingikai], *Final Report* [Saishû Tôshin] (1993), at Section VI (4)(e); Administrative Information System Liaison Committee [Gyôsei Jôhō Shisutemu Kaku-shôchō Renraku Kaigi], *Basic Policy Statement on Creation of a Database for National Administrative Bodies* [Kuni no Gyôsei Kikan ni Okeru Databêsu Seibi ni Kansuru Kihon Hôshin] (1987); Administrative Information System Liaison Committee [Gyôsei Jôhō Shisutemu Kaku-shôchō Renraku Kaigi], *On Planned Improvements to Administrative Handling of Information* [Gyôsei-jôhō-ka no Keikakuteki Suishin ni Tsuite] (1994).

⁹⁸ For details on the circumstances of the introduction of the KSK System, see Ishimura Kôji, *Issues with Transparency of the National Tax Administration and the KSK System* [Kokuzeichô, KSK Shisutemu no Tômeika no Kadai] (1995) at Chapter 1.

the following basic objectives for taxpayer management were revealed:

- (a) to create a system that allows different types of taxpayer to be grouped together for tax management purposes;
- (b) to have capacity to link with systems of other administrative bodies through OSI, unlike the ADP System currently in use in the National Tax Administration;
- (c) to create a national network;
- (d) to automate the input of alterations to data; and
- (e) to create a system that can make use of tax file numbers.

The KSK System is being developed based on these objectives, and should be ready for operation by about 1997.

Introduction of de facto National ID Numbers

In March 1988, the government's Tax Research Commission (*Zeisei Chōsakai*) established the Sub-committee to Debate Tax File Numbers (*Nōzeisha-bangō-tō Kentō Shō-iinkai*) and set in process the debate on introduction of tax file numbers in Japan. The Sub-committee published reports in 1989 ("the 1989 Report") and in 1992 ("the 1992 Report").⁹⁹ In these reports, the following options were outlined for assigning numbers to individuals and non-individuals.

(1) *Non-individuals*

Corporations or unincorporated organisations could be assigned numbers either according to new numbers created by the tax administration, or according to pre-existing registration numbers on the business register or corporations register.

⁹⁹ Tax Research Commission Sub-committee to Debate Tax File Numbers [*Zeisei Chōsakai Nōzeisha-bangō-tō Kentō Shō-iinkai*], *Report of the Sub-committee to Debate Tax File Numbers* [*Nōzeisha-bangō-tō Kentō Shō-iinkai Hōkoku*] (1988); Tax Research Commission Sub-committee to Debate Tax File Numbers [*Zeisei Chōsakai Nōzeisha-bangō-tō Kentō Shō-iinkai*], *Report of the Sub-committee to Debate Tax File Numbers* [*Nōzeisha-bangō-tō Kentō Shō-iinkai Hōkoku*] (1992). For details on the introduction of a tax file number system in Japan, see Ishimura Kōji, *Tax File Numbers and Privacy* [*Nōzeisha-bangō-sei to Puraibashī*] (1990) at Chapters 1 and 2.

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(2) *Individuals*

The method of assigning tax file numbers to individuals has ramifications for the everyday lives of the public. The reports examine the following models for assigning numbers:

- (a) *The US/Canadian model.* Under this system, numbers already assigned for social security purposes are expanded in application to cover all administrative uses, including tax. If this system were to be adopted in Japan, it has been decided that the existing public pension numbers would be used, so this system is sometimes referred to as the "pension number system".
 - (b) *The Scandinavian model.* In Sweden and Norway, every national and resident foreigner is assigned a number upon birth or arrival. If this system were to be adopted in Japan, the Residents Registration and Alien Registration systems would be adapted. This system is also known as the "birth number system" or the "resident registration system".
 - (c) *The Italian/Australian model.* In Italy and Australia, the tax authorities assign a special number for tax administration purposes. The Japanese tax authorities already use a numbering system for management of taxpayer files, so the Italian/Australian model could be applied by consolidation of these numbers.
- (3) *Selection of a Model by the Government's Tax Research Commission*

Tax file numbers are to be used only for tax administration. Persons to whom numbers are assigned need not be the whole of the general public, but merely taxpayers. Therefore, the body assigning the numbers should be the tax authorities.

If "pure" tax file numbers were to be adopted, the only option in relation to individuals would be the Italian/Australian model. However, the Tax Research Commission expresses the view in the 1988 Report that the Italian/Australian model is expensive to operate in relation to the advantages obtained, and excludes it from consideration for Japan. The Report then discusses only the other two models. In other words, the government's Tax Research Commission favours a numbering system that can be applied to administration generally (including welfare and police matters) as

well as to use by the private sector, not just to tax administration. Thus it would seem that the Tax Research Commission is aiming to adopt a multi-purpose national ID number system under the cloak of the tax file numbering system.¹⁰⁰

(4) *The Common ID Number System Council*

A mere two months after the establishment of the Sub-committee to debate Tax File Numbers by the Tax Research Commission, another group was established, made up of representatives of 13 national administrative departments, and called the Liaison and Debate Council for Relevant Administrative Bodies in Relation to an ID Number System for Taxation and Administration Generally (*zeimutô gyôsei bun 'ya ni okeru kyôtsû bangô seido ni kansuru kankei-shôchô renraku kentô kaigi* - "the Common ID Number System Council"). The aim of this group was cooperation and discussion towards the adoption of a common ID number system that could be applied across the board to tax and other administrative areas. Administrators of almost all single-purpose ID systems, such as passports and drivers' licences, participated in this group. In contrast to the Sub-committee to Debate Tax File numbers, this group did not make the contents of its meetings publicly available. However, together with the Sub-committee to Debate Tax File numbers, this group can be seen as favouring a de facto national ID number system under the guise of tax file numbers.¹⁰¹

Government Plans for a Comprehensive National Database

Various administrative bodies are proceeding with putting the information they hold on databases in line with the Policy Statement of the Administrative Information System Liaison Committee with the aim of achieving a distributed processing comprehensive national database. The National Tax Administration's KSK System is one flank of this national database.

Currently, the comprehensive database envisaged by the government is of the distributed processing type, not concentrated processing. In other words, the national database would be constructed by each administrative body creating its own database in line with their own administrative requirements, assigning numbers

¹⁰⁰ See Ishimura Kôji, *What are Tax File Numbers?* (Iwanami Booklet No 331) [Nôzeisha-bangô-sei to wa Nani ka (Iwanami Bukkureito 331)] (1994) at 13.

¹⁰¹ Ibid at 15.

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to each individual as required and using the databases of other bodies. In this format, a vertically divided form of administration unique to Japan will develop, without intruding on the existing powers of the various administrative bodies, but allowing bureaucrats to access required information.

As already pointed out, groups such as the Sub-committee to Debate Tax File Numbers and the Common ID Number System Council are aiming to implement a multi-purpose ID number system, not just a tax file number system. This corresponds to the distributed processing national database envisaged by the government. It is favoured because bureaucrats want to use an ID number that will act as a kind of master-key to access databases of other administrative bodies. By using this master-key, bureaucrats will gain instant access to various information on citizens and will be able to police citizens with ease.

In this way, the distributed processing comprehensive national database and national ID numbers have been presented as indivisible.

The Need for Infrastructure Development

A number of organisations has opposed the government's attitude of forcing its plan on the public without sufficient consideration of the taxpayer/citizen's "right to know" and her or his privacy. There is also a reaction against bureaucrats' unilateral and opaque policy-making decisions in this area. In addition, the negative views represent dissatisfaction with the situation where the government's Tax Research Commission and its Sub-committee to Debate Tax File Numbers are composed almost entirely of bureaucrats, so that the reports of these bodies merely ratify the opinions and policies of the bureaucrats.¹⁰²

If there is no intervention in the use of the numbers by private organisations, then companies, schools, etc, will each use the ID numbers to create their own databases. "Group-ism" is often regarded as a feature of Japanese society and it can be said that there is still insufficient social consciousness of privacy rights. In this social context, there is a danger that privacy will be abused, as

¹⁰² For more detail on the roles and problems with the various councils and advisory bodies established by administrative bodies in Japan, see Uchibashi Yoshihito, "Councils - Unrelated to Public Opinion" [Shingikai, Min'i wa Haruka Tōku], *Nihon Keizai Shinbun* (9 October 1994 morning edition).

information harvested from the ID numbers is commercialised. Further, bureaucrats will become able to access wide-ranging information on citizens through use of the master-key: as a result, they will be able to exercise control over citizens, not through physical power as in the past but through data, which could lead to abuse of private information by power and a revisitation of the police state.¹⁰³

(2) *The Need to Allow Public Access to Information Held by the Tax Authorities*

A great quantity of information will be fed into the KSK System, but it can be divided broadly into taxpayer information (for individuals and corporations/organisations) and administrative information.

Taxpayer information is essentially a record of the assets of the taxpayer. Therefore, if the taxpayer requests it, such information should be revealed to the taxpayer.

Currently, it would in principle be possible to seek the information held in the database under the Personal Information Protection Law.¹⁰⁴ However, the Personal Information Protection Law is heavily influenced by the opinions of administrative bodies, since it was drafted by the Management and Coordination Agency's Administrative Management Bureau (gyôsei-kanrikyoku), so tends to lean in their favour.¹⁰⁵

This bias in favour of the administration can be seen in the fact that the Law makes "fair and smooth operation of administration" the central aim, whereas "protection of individuals' right and interests" is merely supplementary. The bias also finds expression in the limited applicability of the Law. For instance, the Law applies to administrative bodies only, and not private organisations. The Law applies only to information processed by computer, and not to

¹⁰³ For details, see Ishimura, above n 10 at 94.

¹⁰⁴ *Kojin Jôhō Hogo Hô* (Law No 95 of 1988). The formal title is the Law Relating to Protection of Computer Processed Personal Information held by Administrative Bodies [*Gyôsei Kikan no Hoyû suru Denshi Keisanki Shori ni Kakaru Kojin Jôhō no Hogo ni Kansuru Hôritsu*].

¹⁰⁵ The current Personal Information Protection Law was criticised by all sectors from its draft stages on the basis that it did not adequately protect citizens' informational privacy. For instance, see Japan Federation of Bar Associations [Nihon Bengoshi Rengôkai], Opinion Paper on the Draft Personal Information Protection law [*Kojin Jôhō Hogo Hôan ni Taisuru Ikensho*] (1988).

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information processed manually.¹⁰⁶ The Law contains no restrictions on collection of sensitive information. The Law not only excludes many areas from its operation, but also expressly limits access to certain types of information.¹⁰⁷ The Law allows the administration to veto access to information that would otherwise be available if the administration finds it inconvenient.¹⁰⁸ The Law allows use for purposes other than the original purpose at the discretion of the administrative body.¹⁰⁹ And the Law makes insufficient provision for administrative review or complaints.¹¹⁰

In relation to corporate taxpayers, there is currently no law that allows access to information. In other words, corporate taxpayers have no way of accessing information on their tax returns and other documents held by the tax authorities, whether it is processed manually or by computer, so there will be little protection for corporations when the KSK System is introduced.

Next, in relation to administrative information held internally by the tax authorities, it is possible to say that these are the property of the people. Therefore, citizens in principle have the right to access currently unavailable information. In most developed countries, including the United States, Canada and Australia, there are freedom of information laws to protect the public's "right to know". However, in Japan there is still no freedom of information law at the national level.¹¹¹

In many developed countries, including the United States, there are special provisions in the tax laws to allow access to information held by the tax authorities. Individual and corporate taxpayers can use these provisions to gain access to administrative information.¹¹² In Japan, too, there is a need for national information disclosure law, but also freedom of information provisions in the National Taxes Common Provision Law for access to information held by the tax

¹⁰⁶ Personal Information Protection Law Article 1.

¹⁰⁷ Personal Information Protection Law Articles 3, 7 and 14.

¹⁰⁸ Personal Information Protection Law Article 7(2).

¹⁰⁹ Personal Information Protection Law Article 9.

¹¹⁰ Personal Information Protection Law Article 20.

¹¹¹ There are many freedom of information regulations at the local government level, including Tokyo Prefecture. For instance, see Tokyo Public Documents Access Ordinance [*Tôkyôto Kôbunsho Kaiji Jôrei*] (Tokyo Prefectural Ordinance No 109 of 1984).

¹¹² For instance, see the US Internal Revenue Code 1984 Articles 6103 and 6110.

authorities.¹¹³ In addition, there is a pressing need to consider the Canadian example and discuss instituting a parliamentary ombudsman such as a Privacy Commissioner or Information Commissioner¹¹⁴ to handle complaints.

In Japan, the bureaucrats, who hold the de facto legislative power, are extremely negative towards amending the Personal Information Protection Law or introducing a freedom of information law or an ombudsman system, as would be required to fully protect the rights of the taxpayers/citizens. There is no hint of abandoning the current in camera administration and establishing open administration. Under such circumstances, the introduction of the KSK System and national ID numbers, and eventually the comprehensive national database, are issues of major concern. Many business groups and citizens' groups have begun to express fears that if the government's plans are implemented without the preparation of an infrastructure to protect human rights, the tax authorities will become an unwieldy and unaccountable entity, which taxpayers and tax specialists who represent them will not be able to withstand.¹¹⁵

THE TAX OMBUDSMAN SYSTEM

Introduction

In Japan, there have been sporadic reports of tax officials adopting a dismissive attitude towards the audit subject during a tax audit or harassing the audit subject with imprudent words. There are also problems such as the tax authorities hinting at future advantages or disadvantages in suggesting that the taxpayer retain a retired tax official (who may be registered or about to register as a *zeirishi*) as her or his adviser. In addition, there are many reports of maladministration (*kago-gyōsei*) by tax officials, such as errors and omissions.

¹¹³ For details, see Ishimura, above n 10 at 88 ff.

¹¹⁴ See Fraherly DH, *Protecting Privacy in Surveillance Societies* (1989) at Chapter 2.

¹¹⁵ For instance, see Tokyo *Zeirishi* Association Institutions Department [Tōkyō Zeirishikai Seidobu], *Memorandum on Issues with the KSK System* [KSK (Kokuzei Sōgō Kanri) Shisutemu ni Kansuru Mondaiten ni Tsuite (Memorandum)] (1994); Japan Federation of *Zeirishi* Associations (JFZA) [Nihon Zeirishikai Rengōkai], *Opinion Paper on the 1995 Amendments to the Tax System* [1995-nendo no Zeisei Kaisei ni Kansuru Kengisho] (1994) at Sections 6.9 and 10.

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Taxpayers could feasibly commence court action in relation to such harassment or maladministration. However, the protracted nature of litigation is a continuing problem in Japan, and there is also the consideration of its high monetary cost. For this reason, in most cases of harassment or maladministration, the taxpayer does not go to court. Although litigation has been on the increase in recent years in Japan, it is still not a "litigation society" like the United States: there seems to be a general Japanese reluctance to sue even after suffering disadvantage at the hands of the tax authorities.

Zeirishi associations and academics have been proposing that a complaints review system be established to allow relief to taxpayers by means of simple and non-litigious procedures.¹¹⁶ As a result, taxpayers will not have to "grin and bear it" when they suffer harassment or maladministration, and it will be possible to provide speedy resolution to disputes.

The Current Complaints Review System

In most developed countries, an ombudsman system has been established to deal with complaints relating to administrative bodies. There are two broad models for ombudsman systems. One model has the ombudsman appointed by the legislature and completely independent of the executive, such as the Parliamentary Commissioner in England¹¹⁷ or the Commonwealth Ombudsman in Australia.¹¹⁸ The other model has the ombudsman appointed by the executive, although independent of other administrative bodies. Examples of this type are the Revenue Adjudicator within the UK

¹¹⁶ For instance, see Tokyo Regional *Zeirishi* Association [Tôkyô Chihô Zeirishikai], *The Enactment of the Administrative Procedure Law and the State of Tax Administration Procedure (Second Opinion Paper)* [Gyôsei Tetsuzuki Hô Seitei no Ugoki to Zeimu Tetsuzuki no Arikata ni Tsuite (Dainiji Ikensho)] (1992) at 17; Tokyo *Zeirishi* Association [Tôkyô Zeirishikai], *Prospectus for Legal Consolidation of Tax Administration* [Zeimu Gyôsei no Hôteki Seibi ni Kansuru Yôkô] (1993) reproduce in (1993) 437 *Tôkyô Zeirishi Kai* [Tokyo *Zeirishi* Circles] 4; Ishimura, above n 10 at 90 ff.

¹¹⁷ See, for example, Bradley AW, "The Role of the Ombudsman in Relation to the Protection of Citizens' Rights" (1980) 39 *Cambridge Law Journal* 304; Bartlett RT, "The Ombudsman in Taxation: A Tripartite Perspective" (1988) 5 *British Tax Review* 164.

¹¹⁸ See, for example, Tomasic R and Fleming D, *Australian Administrative Law* (1991) Chapter 3; *Commonwealth Ombudsman (Australia), Guide: What the Commonwealth Ombudsman Can Do for You* (1992).

Inland Revenue¹¹⁹ or the Taxpayer Ombudsman within the US Internal Revenue Service.¹²⁰

Ombudsmen can be further divided into general ombudsmen, who deal with complaints relating to all aspects of administration, and special ombudsmen, who deal with complaints only in a specialist area such as privacy or tax. An example of the former is the Parliamentary Commissioner in England. Examples of the latter are the Privacy Commissioners in Canada and Australia,¹²¹ the Revenue Adjudicator in England and the US Taxpayer Ombudsman.¹²²

With this structure in mind, the features of the Japanese ombudsman system can be outlined as follows.

(1) *The Administrative Problem Resolution Program of the Management and Coordination Agency*

The Management and Coordination Agency (*sômuchô*), which can be considered the general overseer of the executive, contains an Administrative Problem Resolution Program (*gyôsei sôdan seido*)¹²³ to deal with complaints relating to the business of the various administrative bodies.

Under this system, it is possible to complain about all areas of the administration. Complaints are heard by approximately 200 Problem Resolution Officers (*sôdan tantô shokuin*)¹²⁴ at the Administrative Inspection Bureaus (*gyôsei kansatsu kyoku*) and

¹¹⁹ See Revenue Adjudicator's Office (UK), *How to Complain About the Inland Revenue* (1993).

¹²⁰ See Internal Revenue Service (US), *How to Use the Problem Resolution Programs of IRS* (1991).

¹²¹ See Privacy Commissioner's Office (Australia), *Guide to the Federal Privacy Act* (1991); Privacy Commissioner of Canada, *Annual Report 1990-91* (1991).

¹²² For details on the ombudsman systems in the various countries, see Caiden G (ed), 1 and 2 *International Handbook of the Ombudsman* (1983).

¹²³ For more detail, see Miyachi Seirô, "Administrative Resolution of Complaints", in Ogawa, Ichirô et al (eds), 3 *Treatise on Contemporary Administrative Law* [Gendai Gyôseihô Taikêi] (1984) 269; Management and Coordination Agency Administrative Inspection Bureau [Sômuchô Gyôsei-kansatsu-kyoku] (ed), *The Ombudsman System* [Ombudsman Seido] (1986).

¹²⁴ Outline for Handling Administrative Complaints Mediation [Gyôsei Kujô Assen Toriatsukai Yôryô] (Management and Coordination Agency Instruction No 21 of 1984) Article 4.

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Offices (*gyōsei kansatsu jimusho*) in 47 locations around the country, as well as by about 5,000 Administration Problem Resolution Volunteers (*gyōsei sōdan iin*)¹²⁵ in various locations. Complaints can be made in person, by telephone (or fax), in writing, etc. There is no limitations period for complaints.¹²⁶

(2) *The Tax Counsellors System within the National Tax Administration*

Tax Counsellors (*zeimu sōdankan*) within the National Tax Administration have three main functions.¹²⁷ The first is to engage in consultation relating to the interpretation and application of tax laws, return filing and application procedures, and tax administration generally. The second is to dispose of complaints relating to dispositions (including omissions and factual matters) by heads or employees of the tax authorities and the performance of employees' duties in tax administration. The third is to conduct research and planning in relation to the consultation and complaints review already mentioned.

Evaluation of the Current System

When a taxpayer has a complaint relating to tax administration, under the current system, he or she can make use of structures within the Management and Coordination Agency or the National Tax Administration. However, these existing complaints review structures have been criticised for "lack of uniformity, specialisation and independence".¹²⁸ For instance, under the Administrative Problem Resolution Program of the Management and Coordination Agency, the officer who handles the complaint will not necessarily be a specialist in tax, so the taxpayer may be left feeling uneasy whether there has been an accurate resolution of the complaint. Further, there are absolutely no safeguards to assuage the taxpayer's psychological fears that making a complaint could lead

¹²⁵ Administrative Problem Resolution Volunteers Law [*Gyōsei Sōdan Iin Hō*] (Law No 99 of 1966) Article 2.

¹²⁶ Outline for Handling Administrative Complaints Mediation Articles 2ff. For details of complaints review figures, see Management and Coordination Agency [*Sōmuchō*] (ed.), *Management and Coordination Agency Annual Report* [*Sōmuchō Nenji Hōkokusho*] for each year. In 1993 there were about 230,000 cases of administrative consultation, of which 43,000 cases (18%) were complaints.

¹²⁷ Ministry of Finance Organisation Ordinance [*Ōkurashō Soshiki Kitei*] (Ministry of Finance Ordinance No 37 of 1949) Article 101-4.

¹²⁸ Tokyo *Zeirishi* Association, above n 116 at Section IV.

to a retaliatory tax audit as a kind of punishment. Thus, while the Administrative Problem Resolution Program may be appropriate for general complaints relating to maladministration, it has not obtained the trust of taxpayers as a resolution method for complaints against the tax administration.

On the other hand, in relation to the Tax Counsellors System within the National Tax Administration, there are serious problems with independence and accessibility. Further, there is great uncertainty about the qualifications and powers of Tax Counsellors. In particular, it is hard for the taxpayer to have confidence in Counsellors who cannot issue stay orders and have no independent investigative powers.

Further, areas where reform is required in both systems have been isolated as:

- (a) the establishment of a published precedent system for complaints;
- (b) the publication of an annual report; and
- (c) knowledge of the existence of the system and the courtesy of counsellors.

The Tokyo Zeirishi Association's Proposal

As already mentioned, in May 1993 the Tokyo *Zeirishi* Association published the *Prospectus for Legal Consolidation of Tax Administration*¹²⁹ ("the Prospectus"). Section IV of the Prospectus is entitled "Complaints Review". After pointing out the limitations of the current system, it proposes the establishment of a new "independent specialist complaints review body comprised of knowledgeable and experienced people in order to provide fair and speedy disposal of complaints". In terms of the categorisation in the section on the current complaints review system, the proposal is to establish a specialist ombudsman within the executive. Further, the proposal extends to requiring the new body to submit an annual report to the House of Representatives Finance Committee.

In putting these proposals into effect, there are many issues to be resolved as to, for example, the qualifications of the "knowledgeable and experienced people", the procedures for making complaints and the format of the annual report. However, there is no argument with the fact that an independent specialised body is

¹²⁹ Ibid.

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needed to provide fair and speedy disposal of complaints from taxpayers. It is to be hoped that the proposals will be realised as soon as possible.

CONCLUSION

The Japanese tax administration system has always been based on the premise that the tax authorities were the dominant party.

In recent years, many countries have taken positive steps to reinforce the fairness and transparency of their tax administration systems. This is in part because modern tax systems require increased voluntary co-operation from the taxpayer. This co-operation is likely to be forthcoming, if there is mutual trust and understanding between the taxpayer and tax authorities, and if a comprehensive set of taxpayers' rights has clearly been institutionalised and protected. Taxpayers' rights have to be seen in the broader context of human rights that are enumerated in a number of international conventions. Therefore, the protection of taxpayers' rights has to be realised as an international obligation of the government of Japan.