Research on Japan's Real Property Tax System[*]

by

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1. Introduction

If we consider individual, local governments to be local "clubs" as subdivisions of a country, focusing on the local attributes of administrative districts as a basis to impose local taxes would be reasonable.

Local tax systems are considered to primarily comprise income and asset taxation because local residents enjoy public services in their residential and work areas or areas wherein their assets are located. In fact, in Japan, resident taxes (income taxes) and real property taxes (asset taxes) have been positioned as fundamental local taxes.

Therefore, in this paper, I would like to examine how property tax should ideally be considered local core tax, with regards to the current local tax system in Japan, to of reexamine its.

2. Previous Work

Previous research on real property tax, a fundamental local tax in Japan, has primarily discussed its relationship with the land taxation system and land prices.

Hayashi (2004) examined the effect of improving the profitability of land and the subsequently improving land prices on the profit of administrative services and noted that property tax meets the conditions for benefit taxation.

[*] This paper is based on revisions and reviews of Usuki (2017).

Koike (2007) reviewed the local tax system from the perspective of increasing profitability and argued that local tax sources are unevenly distributed.

The Research Center for Property Assessment System (2015) examined the problem of disparities in the levels of regional property tax burdens in Japan's real property taxes and discussed approaches to overcome this disparity.

Maeda (2016) found that tax burden levels are equalized by the continual decline in land prices, and proposed reforms to the local taxation system to ensure the continuing function of real property taxes for regions of Japan wherein the population is decreasing.

This paper thus discusses the real property tax, a fundamental local tax in Japan, with the goal of reconsidering the real property taxation system from the perspective of "asset taxation," thereby proposing a working theory regarding the ideal real property taxation system for Japan.

3. Issues Facing the Real Property Taxation System in Japan

One of the challenges encountered by Japan's current real property taxation system is that the ratio of the real property assessment value of land to its market value is lower in larger cities.

The paper argues that it is not the levels of assessment ratios in cities but their "inequality" that impedes fairness in property tax.

Therefore, to mitigate these differences, I would like to propose a "standard assessment ratio" that can be applied to all cities in Japan.

For an "average city" with a standard level of financial demand based on the assumption of a uniform local taxation system and local finance adjustment system (local allocation tax system) such as those in Japan, the amount of tax revenue required by a city is self-evident, and estimates of local taxes, such as resident taxes and real property taxes, can be calculated.

Therefore, given the real property tax rate applied uniformly nationwide, a standard assessment ratio can be determined based on the "real property tax amount" derived from the condition of the local finances of this "average city."

This can be expressed as follows:

$$Standard\ assessment\ ratio = \frac{taxable\ base\ in\ an\ average\ city}{Market\ value\ of\ land\ in\ the\ city}$$

The aforementioned equation provides a "standard" assessment ratio prevalent to the lands in a city that can be applied to all the local governments in the country.

The subsequent concern is how to define an "average city."

The "designated core city" in Japan's current urban system comprises a population of approximately 200,000–300,000, which is a prefectural capital or a center of the region. In Japan, assuming a city of this size is a simple approach to determine the average status of local governments. That is, as considered in this paper, when examining the standard assessment ratio for real property taxes on land, a designated core city housing the seat of its prefectural government and forming the center of the region surrounding it must be used as a standard.

The following table reveals that the local tax amount per capita of this core city ranges between that of a large city and other small- and medium-sized cities, whereas the tax amount and composition ratio are similar.

Regarding the composition of local tax revenue, the weight (composition ratio) of resident tax revenue and the ratio of real property tax revenue to the total local tax revenue increase with the increasing size of the city.

In ordinance-designated cities (a population of 500,000 or more), municipal inhabitant and real property tax revenues account for 20.8% and 14.7% of the total revenue per capita [fiscal year (FY) 2019 settlement amount], respectively; therefore, the ratio of municipal inhabitant tax revenue (A) to real property tax revenue (B) (A/B) is 1.42.

Similarly, in a designated core city (a population of 300,000 or more), the composition ratios of municipal inhabitant and real property tax revenues to the total revenue per capita are 17.5% and 16.0%, respectively; the ratio of municipal inhabitant tax revenue to property tax revenue (A/B) is 1.09.

In smaller cities, the composition ratio of municipal inhabitant tax revenue to the total revenue per capita is 11.7%, whereas the composition ratio of real property tax revenue to the total revenue per capita is 12.5%, with the similar weight. The ratio of municipal inhabitant tax revenue to real property tax revenue (A/B) is 0.94.

This approach of examining local tax revenue in municipalities in Japan demonstrates that as the scale of the local government enhances the weight of the resident tax increases relatively, and the weight of the real property tax decreases, which supports the aforementioned ideas.

If the ratio of real property tax to local tax revenue in these cities is not appropriate in terms of the fair sharing of tax burden, the assumptions regarding the required financial resources and tax revenue composition of this "average city" must be reviewed to readjust the assessment ratio of real property to the suitable "standard level."

If this standard assessment ratio is applied to the market value of land in all the local governments in Japan, a fair taxation standard (assessment of real property) will be obtained that would eliminate regional disparities in the real property tax burden.

Table 1. *Per capita tax revenue composition of Japanese cities*

	Local Revenue (*thousands of yen*)	Local Tax			A/B
			Municipal Inhabitant Tax (A)	Real Property Tax (B)	
Ordinance-designated city	509 100.0%	210 41.2%	106 20.8%	75 14.7%	1.42
Designated core city	404 100.0%	59 14.5%	71 17.5%	65 16.0%	1.09
Small city (population of less than 100,000)	498 100.0%	135 27.1%	58 11.7%	62 12.5%	0.94

Source: Ministry of Internal Affairs and Communications: White Paper on Local Public Finance for FY2020 (FY2019 Financial Results).
Note: The amount of municipal inhabitant tax revenue is the total amount for individuals and businesses combined.

4. Examining Potential Real Property Tax System Reforms

In case of disparities in the burden levels of property taxes between regions as seen in Japan, what type of the standard real property assessment ratio can be applied to land in all cities, and what effects would it have?

If the standard assessment ratio is applied to the market value of land in a large city, the tax amount per unit area should increase in large cities because land prices here are higher than those in an "average city."

If the price of land increases because of an increased concentration of companies and labor in an area, it means that the economic power of the area is improving and it is consistent with the intentions of Japan's local public finance system that the cost burden for local public services in the region will increase commensurately.

If local taxes are considered a payment for local public services, the local tax system must then be required to remain "neutral" with respect to the location selected by companies and labor.

Furthermore, if the finances of local governments are based on the principle of maintaining a "balanced budget" (wherein local tax revenue equals local expenditure), then in terms of expenditures (i.e., the supply of local public services), the finances must be “neutral” to the economic activity of companies and private sector labor.

The application of the standard assessment ratio to all land in the country eliminates the tax-based inducement effect of location preference in large cities and enables the neutral application of property tax as a local tax with respect to the location selected by companies and labor.

Applying the standard assessment ratio may increase local tax revenues, particularly in large cities. If such increased revenues are used as a financial resource for policy implementation, the weight of local public services relative to economic activities in the private sector through companies and labor will increase, and this weight will be at the same levels as those in other smaller cities, thereby restoring neutrality in local government spending.

5. Conclusion

Local public services provided by local governments differ naturally in terms of the offered content because of the differences in social conditions of large cities, medium- and small-sized cities, and rural areas. Combining real property and resident taxes would be a reasonable and beneficial approach of sharing the tax burden.

In addition, all local governments are based on a given administrative district (land) and the local public services they provide are therefore under their geographical influence. Taxation on real property seems indispensable from the perspective of benefit-based sharing as a financial resource to cover the cost of local public services.

In general, most cities, towns, and villages are considered, from their external appearances, to be positioned somewhere between a large city and a small city as assumed in this paper, which indicates that the needs of residents for local public services provided will be a combination of the factors noted in both large and small cities.

Considering these factors, the condition to assume local public finances based on the aforementioned “average city” and to review the real property taxation system while calculating the required local tax revenues should be considered one of the criteria in the reconstruction of Japan’s local taxation systems.

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