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# Tax Competition and the Dormant Commerce Clause: A Japanese Perspective

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## INTRODUCTION

Given the vital role the dormant Commerce Clause plays in delineating tax jurisdictions of the states and local governments, it would be difficult to imagine what would happen without this legal doctrine. This Article will show that the absence of a dormant Commerce Clause equivalent in Japan has given rise to serious tax competition. By illustrating the significance of this legal doctrine and the holding in *South Dakota v. Wayfair, Inc.*,<sup>1</sup> this Article demonstrates that Japan could use a similar legal framework of fiscal federalism from a comparative perspective.

Part I traces the historical development of the dormant Commerce Clause jurisprudence with respect to the collection duty for consumption taxes. Particularly, it articulates the rise and fall of four theories on the constitutionality of the collection duty proposed by the Supreme Court Justices in the 1940s. Part I concludes by pointing out that *Wayfair* removes obstacles to achieving ideal state consumption taxes.

Part II starts by briefly describing the Japanese tax system.<sup>2</sup> Japan is not a federal state, and certain statutes regulating local governments (both prefectures and municipalities) secure each governments' autonomy. These statutes grant local governments a qualified power to impose their own "extra-statutory taxes"—taxes that are exclusively based on ordinances [jorei] of a local government. The tax revenue system for local governments in Japan is unique. Property tax and local personal income tax are kept by municipalities as their principal sources of revenue. Local corporate income tax is the most important source of revenue for prefectures. Such division and allocation of the sources of revenue gives rise to a considerable disparity of tax revenue among local governments. This Part illustrates how this disparity gives rise to tax competition among local governments in Japan, highlighting the absence of a Japanese

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<sup>1</sup> *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2089–96 (2018).

<sup>2</sup> *See infra* Part II.

dormant Commerce Clause equivalent. The Japanese courts have failed to put forward a meaningful standard to judge whether local tax legislation interferes with, and places an undue burden on, free movement of goods and services within the country. The content of the provisions of the Local Tax Act—the statute governing whether local tax legislation interferes with, and thereby places an undue burden on, the movement of goods and services within Japan—is, to say the least, vague. Moreover, it is not obvious whether clear principles for allocating taxing powers among local governments are truly recognized in Japan. Part II then discusses two examples that highlight the absence of a dormant Commerce Clause equivalent in Japan. First, this Part examines taxation by some local governments that induces the exports of nuclear waste. It is apparent that the tax discriminates against interstate commerce, but there are no means to invalidate the tax. The second is the recent “hometown tax donation” system that makes it possible for a taxpayer to pay a part of his tax to other local governments. Although this system is becoming popular and being praised as an excellent tool for revitalizing local economy in Japan, it conflicts with most of the principles pronounced by the United States Supreme Court. This Article concludes by emphasizing the significance of the dormant Commerce Clause and *Wayfair* and how Japan can learn from United States jurisprudence and its local taxation system.

## I. THE HISTORICAL DEVELOPMENT OF THE DORMANT COMMERCE CLAUSE CASES ON THE COLLECTION DUTY FOR STATE CONSUMPTION TAXES

### A. Introduction

In this Part, this Article discusses the role of the dormant Commerce Clause in limiting the tax sovereignty of the states. Before proceeding to an analysis of the cases, two preliminary comments are worth noting.

First, apart from concrete provisions of the constitution and statutes of each country, the extent of taxing power can be divided into two questions. The first question is whether imposing a given tax to a given person, property, or transaction is within the scope of the tax jurisdiction of the state or local government. When the taxation is deemed to be an extraterritorial exercise of its tax jurisdiction, it is per se unconstitutional or illegal. The second question asks, given that the tax itself is within the government’s jurisdiction, whether the imposition of the tax affects the economic activity and/or the decision-making of people so much that it conflicts with the exercise of the police power of other states or local governments. The exercise of the taxing power by one state

may significantly harm another state's exercise of regulatory power. In this case, the exercise of taxing power will be invalidated. In the United States, throughout the development of case law on state taxation, these two questions are treated concurrently and sometimes inseparably. Both the Due Process Clause and the dormant Commerce Clause are employed for answering the questions.

Second, the nature of the tax or the duty in question is important in determining their validity. Since its birth as a judicial doctrine, the dormant Commerce Clause has often applied to state and local tax cases. One of the most difficult issues has been determining the conditions under which a state can mandate nonresidents or out of state businesses to be subject to state use tax.<sup>3</sup> Here, the consumers of goods and services, to whom the economic burden of the tax shifts, are supposed to be residents of the state. This is a difficult issue because the nature of use tax is equivocal.

To begin with, the state may impose sales tax on businesses as an indirect tax.<sup>4</sup> The taxpayers of the sales tax are the businesses, whereas the economic burden of the tax shifts to the consumers of the goods and services sold. The businesses are located in the state or at least have sufficient factual connection with the jurisdiction. Therefore, nothing prevents the state from imposing sales tax liability on them.

Use tax is, from its inception, a supplementary tax contrived to avoid any possible doubts as to the taxing power against out-of-state businesses. The taxpayers of the use tax are consumers—residents of the state. They also bear the burden of the tax. There is no problem for the state to impose the tax on its residents. However, the key issue is whether it is possible to designate businesses as the agent for collection and payment of the tax. In use tax, the consumers have only secondary liability, even though they are the original taxpayers. Otherwise they would be exempt from the duty. If we take this legal construction at face value, there appears to be no extraterritorial exercise of taxing power. The consumers, the original taxpayers, are within the boundary of the state. It is their agent who was on the outside of the territory by chance. Moreover, it might be argued that the liability of the agent is not tax liability, but a duty to act or cooperate with the state in a certain way.

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<sup>3</sup> See generally *Wayfair*, 138 S. Ct. 2080.

<sup>4</sup> See generally John L. Mikesell, *Remote Vendors and American Sales and Use Taxation: The Balance between Fixing the Problem and Fixing the Tax*, 53 NAT'L TAX J. 1273 (2000) (indicating that retail sales taxes are defensible as the American approach to indirect consumption taxation).

If this is the case, the constitutionality of the duty would be better decided according to non-tax precedent.

However, if we take seriously the fact that use tax is in effect a version of sales tax, we should apply the same legal standards used to analyze sales tax. It follows that the businesses located out-of-state must be regarded not as just a collecting agent, but as the taxpayer of use tax. Thus, it would be almost impossible to justify use tax without also justifying sales tax against out-of-state retailers at the same time.

## B. Early Cases

The earliest case on collection duty and the dormant Commerce Clause was an excise tax case.<sup>5</sup> In *Monamotor Oil Co. v. Johnson*, Iowa imposed a license fee on all motor vehicle fuel used in the state.<sup>6</sup> The Iowa statute required distributors to charge users a price that includes the license fee and to remit license fee proceeds to the state treasurer.<sup>7</sup> The Plaintiff claimed that the statute imposed a burden upon interstate commerce.<sup>8</sup> The Supreme Court, in an opinion delivered by Justice Roberts, rejected that claim holding that the levy “falls on the local use after interstate commerce has ended”<sup>9</sup> and the distributor’s burden is “too slight.”<sup>10</sup>

A few years later, the first case on use tax reached the Supreme Court.<sup>11</sup> In *Felt & Tarrant Mfg. Co. v. Gallagher*, California required retailers that maintained a place of business in the state to collect use tax from purchasers.<sup>12</sup> The Plaintiff, who manufactured and sold “comptometers” in the state through two general agents, claimed that the collection of use tax conflicted with the dormant Commerce Clause and the Due Process Clause.<sup>13</sup> Justice McReynolds’s opinion for the Supreme Court summarily rejected the Plaintiff’s claim without presenting much, if any, reasoning for the Court’s decision.<sup>14</sup>

A Supreme Court decision in 1940, regarding sales tax by New York City (not use tax), articulated the Court’s attitude toward the collection duty of retailers.<sup>15</sup> In a footnote in

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<sup>5</sup> See *Monamotor Oil v. Johnson*, 292 U.S. 86, 93 (1934).

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 88–89.

<sup>8</sup> See *id.* at 93.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 94.

<sup>11</sup> See *Felt & Tarrant Mfg. v. Gallagher*, 306 U.S. 62, 64 (1939).

<sup>12</sup> *Id.* at 66.

<sup>13</sup> *Id.* at 64, 66.

<sup>14</sup> See *id.* at 65–66.

<sup>15</sup> See *McGoldrick v. Berwind-White Coal Mining*, 309 U.S. 33 (1940).

*McGoldrick v. Berwind-White Coal Mining Co.*, Justice Stone made clear the duty “does not violate the [C]ommerce [C]lause.”<sup>16</sup> At that time, the question of whether out-of-state businesses’ duty to collect tax was constitutional was not treated separately from the constitutionality of the tax itself. Even though the Court held the duty to collect tax to be lawful in these three cases, it did not offer any material reason for its decisions.

In 1944, two decisions of the Supreme Court were handed down on the same day directly dealing with the collection duty of use tax as well as the related question of territorial limits of taxing power for sales tax.<sup>17</sup> In *McLeod v. J. E. Dilworth Co.*, the issue was whether the levy of sales tax by Arkansas on a Tennessee corporation with no place of business in Arkansas was constitutional.<sup>18</sup> The Court held, in the opinion by Justice Frankfurter, that taxing sales consummated out-of-state “would be to project its powers beyond its boundaries and to tax an interstate transaction.”<sup>19</sup> The Court also emphasized the difference between a sales tax and a use tax. Whereas the former is “a tax on the freedom of purchase,” the latter is “a tax on the enjoyment of that which was purchased.”<sup>20</sup> In *General Trading Co. v. State Tax Comm’n of Iowa*, the issue was whether it was constitutional for Iowa to impose a duty to collect use tax from a Minnesota corporation.<sup>21</sup> Based on the lower court’s finding that the corporation was a “retailer maintaining a place of business in [the] state,” the Supreme Court, in an opinion also delivered by Justice Frankfurter, upheld the Iowa legislation and affirmed the collection duty.<sup>22</sup> In sum, Justice Frankfurter’s opinions distinguished use tax from sales tax and applied a different standard in judging the constitutionality of each.<sup>23</sup> It is worth noting that Justice Frankfurter’s opinions did not refer to the Due Process Clause in either of the cases.<sup>24</sup>

The opinions delivered by Justice Frankfurter garnered concurrences and dissents by other Justices. These concurrences and dissents opened the door to the development of the constitutional doctrines on the collection duty.

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<sup>16</sup> *Id.* at 50 n.9.

<sup>17</sup> See generally *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327 (1944); *Gen. Trading Co. v. State Tax Comm’n of Iowa*, 322 U.S. 335 (1944).

<sup>18</sup> *Dilworth*, 322 U.S. at 328.

<sup>19</sup> *Id.* at 330.

<sup>20</sup> *Id.*

<sup>21</sup> *Gen. Trading Co.*, 322 U.S. at 336.

<sup>22</sup> *Id.* at 337–39.

<sup>23</sup> See *Dilworth*, 322 U.S. at 330; *Gen. Trading Co.*, 322 U.S. at 338.

<sup>24</sup> See generally *Dilworth*, 322 U.S. 327; *Gen. Trading Co.*, 322 U.S. 335.

In his dissenting opinion in *Dilworth*, Justice Douglas criticized the majority opinion for being inconsistent with the Court's precedents.<sup>25</sup> His claim stemmed from the observation that the economic impact of sales tax and use tax are the same.<sup>26</sup> According to Justice Douglas, both sales and use taxes are indirect consumption taxes on the consumer.<sup>27</sup> In his dissent, Justice Douglas opined, "[i]n terms of state power, receipt of goods within the State of the buyer is as adequate a basis for the exercise of the taxing power as use within the State."<sup>28</sup> It follows that as long as imposing use tax does not conflict with the dormant Commerce Clause, levying sales tax does not either.<sup>29</sup> Although Justice Douglas said nothing about the collection duty in his dissent, from his view that sales tax and use tax are one and the same, we can infer that he wanted to see as little difference as possible in the collection process of the two taxes.

Justice Jackson also found an affinity between the two taxes. However, unlike Justice Douglas, Justice Jackson asserted that not only the sales tax in *Dilworth*, but also the use tax in *General Trading Co.*, should be invalidated.<sup>30</sup> In his dissent in *General Trading Co.*, Justice Jackson formulated the issue to be whether a person is within the jurisdiction of a state.<sup>31</sup> He first assumed that the power to make a person a tax collector is the same as the power to tax.<sup>32</sup> It follows that a nonresident who should not be a taxpayer for the purpose of sales tax must not be a tax collector of use tax either.<sup>33</sup> Justice Jackson built his argument on the concept of jurisdiction but did not articulate the legal basis from which the concept was derived.

Justice Rutledge, who would have upheld both the sales tax in *Dilworth* and the use tax in *General Trading Co.*, distinguished the Due Process Clause from the dormant Commerce Clause.<sup>34</sup> He considered the Due Process Clause as placing jurisdictional limitations on tax in general and thus, saw little significance in the name of sales tax or use tax.<sup>35</sup> Rather, Justice Rutledge

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<sup>25</sup> See *Dilworth*, 322 U.S. at 332 (Douglas, J., dissenting).

<sup>26</sup> *Id.* at 332–34 (Douglas, J., dissenting) (indicating that "realistically the sales tax is a tax on the receipt of that which was purchased" and is therefore equivalent to the use tax).

<sup>27</sup> *Id.* at 333 (Douglas, J., dissenting).

<sup>28</sup> *Id.* at 334 (Douglas, J., dissenting).

<sup>29</sup> See *id.* (Douglas, J., dissenting).

<sup>30</sup> See *Gen. Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 335, 339–40 (1944) (Jackson, J., dissenting).

<sup>31</sup> *Id.* at 339 (Jackson, J., dissenting).

<sup>32</sup> See *id.* (Jackson, J., dissenting).

<sup>33</sup> See *id.* at 339–40 (Jackson, J., dissenting).

<sup>34</sup> *McLeod v. J. E. Dilworth Co.*, 322 U.S. 349, 353–54 (1944) (Rutledge, J., dissenting in *Dilworth* and concurring in *Gen. Trading Co.*).

<sup>35</sup> *Id.* at 350–51.



reasoned that both are “in fact and effect a tax levied on an interstate transaction.”<sup>36</sup> From the Due Process Clause perspective, both the “state of origin and [state] of market” have taxing power.<sup>37</sup> However, the dormant Commerce Clause requires more substantive consideration for the effect of the taxation.<sup>38</sup> The standard to be applied here is an analysis of the total burden of a given type of tax (i.e., the burden when all the states levy various types of taxes, and place cumulative, discriminatory, or special burdens on interstate commerce).<sup>39</sup> Justice Rutledge’s dissent in *Dilworth*, however, has another assumption as its rationale: All the state sales/use tax should be construed as a destination-based consumption tax.<sup>40</sup> Justice Rutledge defended the Arkansas tax in *Dilworth* as such a tax.<sup>41</sup> Justice Rutledge, like Justice Douglas, did not give the collection duty special consideration independent from substantive tax liability.

### C. *Miller Bros., Scripto, and Bellas Hess*

In *Miller Bros. Co. v. Maryland*, Justice Jackson’s opinion for the Court clarified several issues in construing the collection duty of an out-of-state retailer.<sup>42</sup> First, the question to be asked is whether imposing a duty to collect is within the reach of a state’s taxing power.<sup>43</sup> Second, the analysis of this legal concept has developed, not only from precedent regarding the Due Process Clause,<sup>44</sup> but also from the dormant Commerce Clause.<sup>45</sup> Third, there must be a link to justify the exercise of a state’s taxing power such as “domicile or residence,” “the situs of property,” “the keeping of tangible or intangible personalty,” “[c]ertain activities or transactions carried on within a state, such as the use and sale of property,” or “incorporation by a state or permission to do business there . . . .”<sup>46</sup>

In *Miller Bros.*, Maryland imposed a duty to collect use tax on a Delaware vendor on all goods it sold to Maryland residents and seized the vendor’s truck for failing to collect the tax.<sup>47</sup> The Court found that the original tax liability of Maryland residents did not provide grounds to impose a collection duty on an out-of-state

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<sup>36</sup> *Id.* at 357.

<sup>37</sup> *Id.* at 358.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 361.

<sup>41</sup> *See id.*

<sup>42</sup> *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344–46 (1954).

<sup>43</sup> *Id.* at 342.

<sup>44</sup> *Id.* at 344–45.

<sup>45</sup> *Id.* at 344.

<sup>46</sup> *Id.* at 345 (footnotes omitted).

<sup>47</sup> *Id.* at 341.



vendor.<sup>48</sup> The Court also distinguished the *Miller Bros.* case from *General Trading Co.*<sup>49</sup> In his dissenting opinion, Justice Douglas asserted that the majority's opinion would distort economic activity given that the state imposed only a minimal burden on the collector while there was sufficient contact between the vendor and the state.<sup>50</sup>

In *Scripto Inc. v. Carson*, Justice Clark's opinion for the Court identified the nexus between the state and the object of taxation by following the definite link or minimum connection standard of *Miller Bros.*<sup>51</sup> However, Justice Clark declared that the case was controlled by the holding in *General Trading Co.*<sup>52</sup>

It was *National Bellas Hess, Inc. v. Illinois* that formulated the physical presence rule, a standard mainly dependent on a vendor or seller's physical presence in a state.<sup>53</sup> The opinion of the Court, written by Justice Stewart, inferred from the preceding cases "[a] sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business."<sup>54</sup> In *Bellas Hess*, "[a]ll of the contacts which [Bellas Hess] . . . [had] with the State [were] via the United States mail or common carrier."<sup>55</sup> The Court sided with the putative obligor's constitutional objections to the collection and revoked the payment duty of use tax required by the Illinois statutes. Justice Fortas's dissenting opinion applied a less formalistic standard from the same cases and found in the facts of *Bellas Hess* "a sufficient nexus" to impose collection duty.<sup>56</sup>

#### D. *Complete Auto* and *Quill*

Until the advent of *Quill Corp. v. North Dakota*,<sup>57</sup> the cases on the collection duty of use tax were principally independent from those on state tax liability in general, although Justice Jackson suggested in *General Trading Co.* and *Miller Bros.* that

<sup>48</sup> *Id.* at 347.

<sup>49</sup> *Id.* at 346–47.

<sup>50</sup> *Id.* at 357–58 (Douglas, J., dissenting).

<sup>51</sup> *Scripto, Inc. v. Carson*, 362 U.S. 207, 210–11 (1960).

<sup>52</sup> *Id.* at 210.

<sup>53</sup> *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 758 (1967).

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at 754.

<sup>56</sup> *Id.* at 761–62 (Fortas, J., dissenting) (internal quotations omitted).

<sup>57</sup> *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

the collection duty and tax liability are identical for the purpose of the Due Process Clause and the dormant Commerce Clause.<sup>58</sup>

In *Complete Auto Transit, Inc. v. Brady*, a Michigan motor carrier insisted that the Mississippi sales tax conflicted with the dormant Commerce Clause.<sup>59</sup> The tax was equal to five percent of the gross income of a transportation business in Mississippi.<sup>60</sup> The motor carrier claimed that the tax imposed a burden on the privilege of engaging in business in the state, and that its activity being interstate commerce, violated the holding in *Spector*.<sup>61</sup> The Court, however, simply overruled *Spector* in favor of the following four-pronged test:<sup>62</sup>

These decisions have considered not the formal language of the tax statute but rather its practical effect, and have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the service provided by the State.<sup>63</sup>

This test undoubtedly rationalized the approach to constitutionalize a state tax under the dormant Commerce Clause. In fact, according to experts of constitutional law, the Court has since then “consistently followed” this test.<sup>64</sup> One of the remaining questions is how *Bellas Hess* would be analyzed under this test given that *Bellas Hess* did not precisely distinguish the Due Process Clause and the dormant Commerce Clause. Moreover, *Bellas Hess* was concerned not with tax liability itself, but with the collection duty.<sup>65</sup>

In *Quill*, the Court revisited the same question as *Bellas Hess*—whether a state may impose a duty to collect use tax upon a retailer that does not have a physical presence in the state.<sup>66</sup> The Court’s opinion, delivered by Justice Stevens, first declared that “[t]he two constitutional requirements,” the Due Process Clause on the one hand and the dormant Commerce Clause on the other, “differ fundamentally.”<sup>67</sup> For the first time, the Court

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<sup>58</sup> See *Gen. Trading Co. v. State Tax Comm’n of Iowa*, 322 U.S. 335, 339–40 (1944) (Jackson, J., dissenting); *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344 (1954).

<sup>59</sup> *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 274–76 (1977).

<sup>60</sup> *Id.* at 275.

<sup>61</sup> *Id.* at 278.

<sup>62</sup> *Id.* at 287–89.

<sup>63</sup> *Id.* at 279 (footnote omitted); see also *id.* at 277–78, 287 (rationalizing the four-pronged test).

<sup>64</sup> ERWIN CHEMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 480 (5th ed., 2015); see also *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992).

<sup>65</sup> *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue of Ill.*, 386 U.S. 753, 758 (1967).

<sup>66</sup> *Quill*, 504 U.S. at 301–02.

<sup>67</sup> *Id.* at 305.

followed the distinction proposed by Justice Rutledge.<sup>68</sup> With regard to the Due Process Clause, by consulting the cases on judicial jurisdiction, the Court removed the element of physical presence in determining the link that justifies exercise of taxing power.<sup>69</sup> In other words, it overruled *Miller Bros., Scripto*, and *Bellas Hess* in this regard.<sup>70</sup> It concluded the collection duty in question did not conflict with the Due Process Clause.<sup>71</sup>

On the subject of the dormant Commerce Clause, *Quill* started from an analysis of the historical development of the cases.<sup>72</sup> Then, it took the facts of *Bellas Hess* through the four-pronged test of *Complete Auto* and concluded:

*Bellas Hess* concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the “substantial nexus” required by the Commerce Clause.<sup>73</sup>

The Court contended that *Bellas Hess* created a bright-line rule, or a safe harbor, in the first prong of the four-pronged test, which itself is a pragmatic standard.<sup>74</sup> Presumably it is difficult, if not impossible, to justify such a formalistic rule placed within a pragmatic standard from a policy standpoint. Therefore, Justice Stevens sought its foundation in “the doctrine and principles of *stare decisis* . . . .”<sup>75</sup>

In sum, through the general framework of the four-pronged test for state tax enunciated in *Complete Auto*,<sup>76</sup> *Quill* placed the case law on the collection duty in the first prong of *Complete Auto*.<sup>77</sup> However, whereas *Complete Auto* declined to follow the formalist approach of *Spector*<sup>78</sup> in favor of a more substantial one, *Quill* kept a formalistic element in the first prong.<sup>79</sup> Hence these decisions contain an implied conflict in their differing approaches.

#### E. The Significance of *Wayfair*

The Court’s opinion in *Wayfair*, written by Justice Kennedy, at last rejected the physical presence rule formulated by *Bellas*

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<sup>68</sup> *Id.* at 305–06 (citing *Int’l Harvester Co. v. Dep’t of Treasury*, 322 U.S. 340, 353 (1944) (Rutledge, J., concurring in part and dissenting in part)).

<sup>69</sup> *Id.* at 307–08.

<sup>70</sup> *Id.* at 306–08.

<sup>71</sup> *Id.* at 308.

<sup>72</sup> *Id.* at 306–08.

<sup>73</sup> *Id.* at 311.

<sup>74</sup> *Id.* at 314–15.

<sup>75</sup> *Id.* at 317.

<sup>76</sup> See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

<sup>77</sup> *Quill*, 504 U.S. at 311–13.

<sup>78</sup> See generally *Spector Motor Serv., Inc. v. O’Connor*, 340 U.S. 602 (1951).

<sup>79</sup> *Quill*, 504 U.S. at 313.

*Hess* and *Quill* and overruled both cases.<sup>80</sup> The Court presented five reasons in rejecting the rule. The first three reasons concerned *Quill*.<sup>81</sup> First, the Court found that “the physical presence rule [was] not a necessary interpretation of” the first prong of the *Complete Auto* test.<sup>82</sup> It was “a poor proxy for the compliance costs faced by companies that do business in multiple States.”<sup>83</sup> Second, the Court noted that the rule distorted competition and worked as a tax shelter.<sup>84</sup> It disadvantaged local businesses and interstate businesses with a physical presence in the state.<sup>85</sup> Third, the rule was at odds with the case-by-case approach of the Court’s dormant Commerce Clause jurisprudence.<sup>86</sup> In addition, the Court pointed out that the application of the physical presence rule would be all the more inappropriate, given the advance of information technology in recent years.<sup>87</sup> Lastly, the Court claimed that the rule created unfair and unjust consequences for all concerned actors.<sup>88</sup>

As previously mentioned, the extent of the taxing power of a state is demarcated by two considerations: One is the limit of tax jurisdiction itself, and the other is the effects of the exercise of the taxing power.<sup>89</sup> The issue in *Wayfair* was the former. If, as Justice Rutledge had argued, the Due Process Clause exclusively dealt with the question of tax jurisdiction and, in contrast, the dormant Commerce Clause only with the question of the effects of the tax, *Quill* and *Wayfair* would not have been dormant Commerce Clause cases. In reality, *Complete Auto* kept the issue of jurisdiction within the ambit of the dormant Commerce Clause.<sup>90</sup> Accordingly, *Quill* and *Wayfair* dealt with the collection duty under the dormant Commerce Clause.<sup>91</sup> Nevertheless, assuming that the issue should be dealt with under the dormant Commerce Clause, *Wayfair* correctly ruled by opting for a case-by-case analysis instead of a bright-line physical presence rule.<sup>92</sup> However, *Wayfair* did not pay any attention to the fact that the tax liability in question was the collection duty of use

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<sup>80</sup> *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018).

<sup>81</sup> *See id.* at 2092.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 2093.

<sup>84</sup> *Id.* at 2094.

<sup>85</sup> *Id.* at 2094–95.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* at 2095.

<sup>88</sup> *Id.* at 2095–96.

<sup>89</sup> *See supra* Part I.A.

<sup>90</sup> *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288 (1977).

<sup>91</sup> *Wayfair*, 138 S. Ct. at 2087; *Quill Corp. v. North Dakota*, 504 U.S. 298, 301 (1992).

<sup>92</sup> *See Wayfair*, 138 S. Ct. at 2094.

tax and that the economic burden of the tax itself was borne by consumers in the state.<sup>93</sup>

The Supreme Court's jurisprudence on collection duty of state consumption tax at this moment might be summarized as follows: The dormant Commerce Clause has strictly limited state's taxing power from both substantive and procedural aspects. In recent years, the substantive aspect has rarely been disputed in the context of state consumption taxes. But the second, third, and fourth prongs of the *Complete Auto* test will be applied to the cases on taxes.<sup>94</sup> Procedurally, an exercise of taxing power out of the jurisdiction is prohibited. The first prong of the *Complete Auto* test exactly examines this aspect.<sup>95</sup> *Wayfair* fine-tuned this examination by weighing physical elements to a lesser extent.<sup>96</sup>

## II. TAX COMPETITION AMONG LOCAL GOVERNMENTS IN JAPAN

### A. Outline of the Tax System in Japan

#### 1. Local Governments in Japan

Before referring to the tax system of Japan, this Article explains the basic structures of Japanese local governments. Japan is not a federal state—sovereignty is exclusively reserved for the national government. Japan's Constitution simply requires that a local system be constituted under the principle of local autonomy.<sup>97</sup> It says little about organization of local governments.<sup>98</sup> The Local Autonomy Act of 1947<sup>99</sup> adopts a two-tiered local government structure: forty-seven prefectures and approximately 1700 municipalities.<sup>100</sup> The municipalities cover all of Japan's territories.<sup>101</sup> This structure means Japan does not have unincorporated areas.<sup>102</sup> Even though prefectures do not have authority to control municipalities, all the municipalities belong to one of the prefectures.<sup>103</sup> In other words, every person living in Japan belongs to one of the municipalities and one of the prefectures. With regard to the function performed by the

<sup>93</sup> *See id.* at 2088.

<sup>94</sup> *Complete Auto Transit*, 430 U.S. at 278.

<sup>95</sup> *Id.*

<sup>96</sup> *Wayfair*, 138 S. Ct. at 2093 (“Physical presence is not necessary to create a substantial nexus.”).

<sup>97</sup> NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 92.

<sup>98</sup> *Id.* at art. 93.

<sup>99</sup> Chihō jichi hō [Local Autonomy Act], Law No. 67 of 1947.

<sup>100</sup> ATSURO SASAKI, MINISTRY OF INTERNAL AFFAIRS & COMM'NS, JAPAN, LOCAL SELF-GOVERNMENT IN JAPAN 3 (2014).

<sup>101</sup> *See id.* at 5.

<sup>102</sup> KURT STEINER, LOCAL GOVERNMENT IN JAPAN 169 (1965).

<sup>103</sup> Chihō jichi hō [Local Autonomy Act], Law No. 67 of 1947, art. 5, para. 2.

governments, municipalities are far more important than prefectures. Municipalities (or basic local governments as they are sometimes called)<sup>104</sup> play a major role in the everyday lives of its citizens.<sup>105</sup> Under Articles 2(2) and 2(3) of the Local Autonomy Act of 1947, the national government delegates to municipalities the power to regulate “local affairs” [chiiki ni okeru jimū] and other specifically enumerated affairs.<sup>106</sup> The role of prefectures in administering local affairs is subsidiary. Article 2(5) of the Act covers regional affairs, coordination of municipalities, and other affairs not appropriate for municipalities to administer.<sup>107</sup> Even from these affairs, some are designated for delegation to midsized or large municipalities located in the prefecture.<sup>108</sup>

Then, after World War II, the Supreme Commander for the Allied Powers (“SCAP”) required delegation of a wide variety of regulatory power to local governments.<sup>109</sup> As a result of major reforms of local governance during the past quarter century, municipalities acquired more power than before.<sup>110</sup>

## 2. Local Taxation in Japan<sup>111</sup>

The Constitution of Japan expresses nothing about the country’s tax system. It just declares that the payment of taxes is a duty of Japanese citizens<sup>112</sup> and requires the Diet to implement tax laws.<sup>113</sup> The substance of the tax system is entirely left to the Diet. With its broad authority, it chose a tax system that includes personal income tax, corporate income tax, inheritance tax, and value-added tax (“VAT”) as the source of revenue for the national government.<sup>114</sup> The VAT system is a European-type value-added

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<sup>104</sup> *Id.* at art. 2, para. 3.

<sup>105</sup> TOKYO METROPOLITAN GOVERNMENT, *The Structure of the Metropolitan Government*, <http://www.metro.tokyo.jp/ENGLISH/ABOUT/STRUCTSTR/structure01.htm> [<http://perma.cc/Z6BQ-HA9Z>].

<sup>106</sup> *Id.* at art. 2, paras. 2–3. The power to regulate “affairs” in Japanese local government law is identical to the “police power” in the U.S. law. See KURT STEINER, *supra* note 102, at 127–28.

<sup>107</sup> See Chihō jichi hō [Local Autonomy Act], Law No. 67 of 1947, art. 2, para. 5.

<sup>108</sup> Chihō jichi hō [Local Autonomy Act], Law No. 69 of 1946, art. 2, para. 4.

<sup>109</sup> See Terry MacDougall, *Towards Political Inclusiveness: The Changing Role of Local Government in Japan*, WORLD BANK INST. 1, 8 (2001), <http://documents.worldbank.org/curated/en/268371468260928014/pdf/330440wbi37169.pdf> [<http://perma.cc/X47M-BH3R>].

<sup>110</sup> See HIROSHI IKAWA, NAT’L GRADUATE INST. FOR POLICY STUDIES, 15 YEARS OF DECENTRALIZATION REFORM IN JAPAN 8–9, 12–26, 28 (2008), [www.jlgc.org.uk/en/pdfs/up-to-date\\_en4.pdf](http://www.jlgc.org.uk/en/pdfs/up-to-date_en4.pdf) [<http://perma.cc/S9PP-4N54>].

<sup>111</sup> For additional information on the tax system in Japan, see generally HIROMITSU ISHI, *THE JAPANESE TAX SYSTEM* (3d. ed. 2001).

<sup>112</sup> NIHONKOKU KENPŌ KENPŌ [KENPŌ] [CONSTITUTION], art. 30.

<sup>113</sup> *Id.* at art. 84. For the reader’s reference, the Diet is the national legislature of Japan.

<sup>114</sup> For background and additional commentary on the Japanese tax system, see Tadao Okamura, *The Japanese Tax System: Due Process and the Taxpayer*, 11 BERKELEY J. INT’L L. 125 (1993).



tax system, in which not only retailers, but also wholesalers cooperate in collecting the tax—unlike the American style sales tax, in which taxes are collected only by retailers.<sup>115</sup> Some portion of the tax revenue from VAT is automatically sent to local governments.<sup>116</sup> Local governments have personal income tax, corporate business/income taxes, and property tax as their own sources of revenue.<sup>117</sup> Local personal income tax and local corporate income tax make use of the tax base of national counterparts.<sup>118</sup> Although they are not technically a surtax to the national income taxes, they are essentially constituents of national income taxes. Property tax is the only tax that is reserved for local governments.

Up to this point, it appears that the tax jurisdiction is properly distributed among national and local governments. However, when the two levels of local governments—prefectures and municipalities—are taken into account, the tax revenue for the prefectures in rural areas tends to be insufficient as compared to urban areas. First, the local corporate income tax, which is the only major tax reserved exclusively for the prefectures, is highly volatile.<sup>119</sup> In addition, in part because the tax is allocated according to the number of offices and employees, the revenue from the taxes is concentrated in the metropolitan prefectures, especially Tokyo prefecture.<sup>120</sup>

As explained in the previous section, local governments play a crucial role in administrating local and other affairs. However, the local tax revenue is far less than the necessary amount to make ends meet. To make up for the deficit, the national government allots “tax” to the local governments. In order to mitigate interference with the decision-making of the local governments, the total amount of the allotted tax is statutorily determined.<sup>121</sup> The amount of allotted tax for a local government is calculated as follows: First, a standardized amount of expenditure is estimated from the population, the area, and other objective data of the local government.<sup>122</sup> Next, a standardized amount of tax

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<sup>115</sup> *Id.*

<sup>116</sup> Chihō zei hō [Local Tax Act], Law No. 226 of 1950, art. 72-114; *id.* at art. 72-115.

<sup>117</sup> *Id.* at art. 4, para. 2 (prefectures); *id.* at art. 5, para. 2 (municipalities).

<sup>118</sup> *Id.* at art. 32 (prefectural personal income tax); *id.* at art. 23, para. 1, no. 3 (prefectural corporate tax income); *id.* at art. 313 (municipal personal income tax); *id.* at art. 292, para. 1, no. 3 (municipal corporate income tax).

<sup>119</sup> See, e.g., EIJI TAJIKA & YUJI YUI, *Fiscal Decentralization in Japan: Does it Harden the Budgets of Local Governments?* in TACKLING JAPAN'S FISCAL CHALLENGES: STRATEGIES TO COPE WITH HIGH PUBLIC DEBT AND POPULATION AGING, INTERNATIONAL MONETARY FUND 126 (Keimi Kaizuka & Anne O. Krueger eds., 2006).

<sup>120</sup> See *infra* note 129, at 28–30.

<sup>121</sup> Chihō kōfuzei hō [Local Allocation Tax Act], Law No. 211 of 1950, art. 6.

<sup>122</sup> See *id.* at art. 10.



revenue is estimated by taking three quarters of the estimated tax revenue of the local government. The amount of allocation tax will be the balance of the standardized amount expenditure and the standardized amount of revenue.<sup>123</sup> A 25% percent discount gives local governments an incentive to increase their tax revenue as long as the estimated tax revenue does not exceed about 133% of the standardized amount of expenditure.<sup>124</sup>

### 3. Demarcation of Taxing Powers among Local Governments

There is no constitutional doctrine that delineates tax jurisdictions of local governments in Japan. This is natural because Japan's Constitution empowers the Diet to design the local government system. The national government delegates its taxing power to local governments as articulated by the Local Tax Act of 1950.<sup>125</sup>

Some insist that the Constitution guarantees local governments their own original power to tax. Surprisingly, a lower court decision in 1980 upheld the claim, although in dictum, by stating "such a statute that totally or virtually denies the taxing power of local governments is unconstitutional and void."<sup>126</sup> However, such a claim is ridiculous, to say the least. In the context of local governance, it is one thing to have a local government, but quite another that the government finances its resources only through its own tax revenue. Many countries, including Japan, transfer revenue between national/federal and local governments.<sup>127</sup> And as the decision itself makes clear, the claim does not put forward a meaningful standard to decide whether a given level of fiscal independence of a local government is sufficient to make it constitutional.

The Local Tax Act of 1950 does not contain any general provisions to limit local governments' exercise of taxing power. Despite that, we rarely find disputes concerning tax competition among local governments.<sup>128</sup>

The main reason is that the Act meticulously articulates the tax base, tax rate, and other features of principal taxes. The local governments have little room for exercising their power to tax

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<sup>123</sup> Chihō kōfuzei hō [Local Allocation Tax Act], Law No. 211 of 1950, art. 10.

<sup>124</sup> *See id.*

<sup>125</sup> *See* Chihō zei hō [Local Tax Act], Law No. 226 of 1950, art. 2.

<sup>126</sup> Fukuoka Chihō Saibansho [Fukuoka Dist. Ct.] June 5, 1980, Omuta-shi [City of Omuta, Fukuoka] v. Kuni [The Government of Japan], 417 HANREI TAIMUZU [HANTA] 51, 60.

<sup>127</sup> *See, e.g.*, Hansjörg Blöchliger & Claire Charbit, *Fiscal Equalisation*, 2008 OECD J.: ECON. STUD., 265, 277 (2008).

<sup>128</sup> For additional information on the tax scheme of Japan, see generally KENICHIRO HARADA, COUNCIL OF LOCAL AUTHS. FOR INT'L RELATIONS, LOCAL TAXATION IN JAPAN (2009).

freely. However, the Act does give local governments three kinds of flexibility.<sup>129</sup> First, the Act authorizes local governments to adopt higher tax rates that are different from the standard rate for any of the taxes.<sup>130</sup> Most of the prefectures use this “additional tax rate” [choka kazei] for prefectural per capita personal taxation, prefectural corporate per capita taxation, and prefectural corporate income taxation. Eight prefectures even use it for prefectural corporate business taxation. Some of the municipalities employ the additional tax rate for municipal corporate per capita taxation and municipal corporate income taxation. As of 2017, 153 out of 1719 municipalities apply additional tax rate on their local property tax. Whereas the standard rate for local property tax is 1.4 %, 141 municipalities apply a higher rate of 1.5%.<sup>131</sup>

Second, the Act authorizes municipalities to reduce or increase tax liability for several enumerated properties. For example, municipalities may impose tax against power plants for renewable energy at a lower rate or a higher rate.<sup>132</sup>

Third, the Act gives local governments power to introduce “extra-statutory” taxes. The legal issues regarding this concept will be discussed below. For now, it is sufficient to understand that the tax revenue from these taxes is relatively limited.<sup>133</sup>

## B. Extra-Statutory Taxation on Nuclear Plants

### 1. Introduction

Extra-statutory taxes are local taxes that a local government imposes without direct delegation from national legislation. They consist of two types of taxes. One is called an extra-statutory normal tax.<sup>134</sup> The other is an extra-statutory earmarked tax, which was newly introduced in 2000.<sup>135</sup> Most of the tax revenue of extra-statutory normal taxes is from taxes on nuclear fuel or other nuclear power related property.<sup>136</sup> Most of the tax revenue

<sup>129</sup> Sōmushō jichi zeimu kyoku [MINISTRY OF INTERNAL AFFAIRS AND COMM'NS, LOCAL PUB. FIN. BUREAU], Chihou zeisei kankei shiryō [MATERIALS ON LOCAL TAX SYSTEM] 34 (2018).

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at 56.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> Chihō zei hō [Local Tax Act], Law No. 226 of 1950, art. 4, para. 2, art. 5, para. 3 (prefectures and municipalities).

<sup>135</sup> *Id.* at art. 4, para. 6, art. 5, para. 7 (prefectures and municipalities).

<sup>136</sup> HARADA, *supra* note 128, at 26. In the 2016 fiscal year, tax revenue from taxes related to nuclear plants were 39.3 billion yen out of the total tax revenue of 51.7 billion yen from extra-statutory normal taxes. MATERIALS ON LOCAL TAX SYSTEM, *supra* note 131, at 37.

of extra-statutory earmarked taxes is from taxes on industrial wastes.<sup>137</sup> This section uses taxes on nuclear fuel as an example in demonstrating certain defects of the Japanese local tax system.

The origin of extra-statutory taxes lies in the practices in place in the pre-World War II era. Under the Ruling on Local Tax of 1880<sup>138</sup> and the Act on Local Tax of 1926,<sup>139</sup> there were many kinds of taxes imposed by local governments. At that time, the national statutes allowed prefectures to impose original taxes [zasshu zei]. However, these taxes greatly hindered smooth commerce between localities. The Local Tax Act of 1940<sup>140</sup> conditioned municipalities' introduction of an independent tax [dokuritsu zei] other than those enumerated in the Act, on the permission of the Minister of Internal Affairs<sup>141</sup> and the Minister of Finance. The Act abolished the original taxes and prohibited prefectures from imposing unenumerated independent taxes. After World War II, revisions to the Act in 1946 granted prefectures authority to impose unenumerated independent taxes.<sup>142</sup> The present Act, the Local Tax Act of 1950, renamed them extra-statutory taxes and allowed all local governments to adopt one under the permission [kyoka] of the Minister of Home Affairs.<sup>143</sup> The Act stipulated five conditions for the permission: actual existence of the source of revenue in the jurisdiction; demand for revenue sufficient to justify the proposed tax; the tax base is not the same as national taxes or other local taxes and imposition of the tax does not excessively burden the residents; the taxation does not greatly impede the commerce between the local governments; and the taxation must be appropriate from the perspective of the national government's economic policy.<sup>144</sup>

In 2000, as a part of a major reform of the local government system, the Diet gave local governments more discretion in levying extra-statutory taxes.<sup>145</sup> The revision of the Act in 2000

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<sup>137</sup> HARADA, *supra* note 128, at 26. In the 2016 fiscal year, tax revenue from taxes related to industrial wastes were 6.6 billion yen out of the total tax revenue of 10.1 billion yen from extra-statutory earmarked taxes. MATERIALS ON LOCAL TAX SYSTEM, *supra* note 131, at 37.

<sup>138</sup> Chihō zei kisoku [Rulings on Local Tax], Decree of the Cabinet No. 16 of 1880.

<sup>139</sup> Chihō zei ni kansuru hōritsu [Act on Local Tax], Law No. 24 of 1926.

<sup>140</sup> Chihō zei hō [Local Tax Act], Law No. 60 of 1940.

<sup>141</sup> The Ministry of Internal Affairs was later reorganized as the Ministry of Home Affairs and then the Ministry of Internal Affairs and Communications. See NOBUKI MOCHIDA, FISCAL DECENTRALIZATION AND LOCAL PUBLIC FINANCE IN JAPAN 10 (2008).

<sup>142</sup> The Local Tax Act of 1948 also authorized local governments to impose unenumerated independent taxes. See Chihō zei hō [Local Tax Act], Law No. 110 of 1948, art. 46, para. 2, and art. 103, paras. 2 and 3.

<sup>143</sup> See generally Chihō zei hō [Local Tax Act], Law No. 226 of 1950.

<sup>144</sup> *Id.*

<sup>145</sup> See HARADA, *supra* note 128, at 25.

replaced the permission by the Minister with his “consent” [dōi] to the proposal of a new tax.<sup>146</sup> And the Act required the Minister to consent to the proposal when the statutory conditions are met. The Act also dropped the first two conditions in the previous statute.<sup>147</sup> The 2004 revision of the Act imposed upon the local government a duty to ask for opinions of the taxpayers in proposing a new extra-statutory tax when the number of potential taxpayers is small and therefore only these taxpayers are supposed to bear heavy burden of the tax.<sup>148</sup>

## 2. The Advent of the Nuclear Fuel Taxes

The first local government that introduced nuclear fuel tax was the Fukui prefecture. The prefecture has had several nuclear reactors in the territory since 1970.<sup>149</sup> In the new year’s greeting of 1972, Heidayū Nakagawa, then the Governor of the prefecture, revealed his plan to launch a new extra-statutory tax on nuclear power plants.<sup>150</sup> His proposal was to reduce the profits of power companies and to transfer the amount reduced to the prefecture in which power plants were located.<sup>151</sup> Soon thereafter, then Prime Minister, Kakuei Tanaka, submitted an idea of new national tax on power plants. His idea became a tax for promotion of power-resources development.<sup>152</sup> The tax encourages local governments to accept power plants, including nuclear power plants.<sup>153</sup> The tax base of this tax is wholesale electric energy. The tax revenue from the tax is allocated to local governments as a subsidy.<sup>154</sup> However, like any other subsidy, the allocated funds are earmarked for limited power plant-related purposes. In light of such inconveniences inherent in the national tax and the accompanying subsidy, some local governments still wished for tax revenue from

<sup>146</sup> See *id.*

<sup>147</sup> See *id.*

<sup>148</sup> Chihō zeī hō [Local Tax Act], Law No. 226 of 1950, art. 259, para. 2; art. 669, para. 2; art. 731, para. 3.

<sup>149</sup> For background information of the reactors, see J. Mark Ramseyer, *Nuclear Reactors in Japan: Who Asks for Them, What Do They Do?* (Harvard Law Sch. John M. Olin Ctr. for Law, Econ., and Bus., Discussion Paper No. 909, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2986410](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2986410).

<sup>150</sup> Hatsuden zeī shinsetsu wo junbi [*Preparing for Electricity Tax*], YOMIURI-SHIMBUN, Jan. 5, 1972, at 2.

<sup>151</sup> *Id.*

<sup>152</sup> Dengen kaihatsu sokushin zeī hō [Act on Tax for Promotion of Power-Resources Development], Law No. 79 of 1974.

<sup>153</sup> Needless to say, the tax is one of the incentives the Japanese national government offers to local governments. For the analysis of these incentives, see J. Mark Ramseyer, *Why Power Companies Build Nuclear Reactors on Fault Lines: The Case of Japan*, 13 THEORETICAL INQUIRIES L. 457, 459, 479, 481 (2012), which points out that people rationally built nuclear power plants on fault lines.

<sup>154</sup> See Hiroshi Onitsuka, *Hooked on Nuclear Power: Japanese State-Local Relations and the Vicious Cycle of Nuclear Dependence*, 10 ASIA-PAC. J. 1, 7 (2012).

an extra-statutory tax. Because the tax base of an extra-statutory tax must not “be the same as existing national taxes or other local taxes,” taxing electric energy, which is already the object of the tax for promotion of power-resources development, does not seem to pass muster.<sup>155</sup> Nevertheless, in 1976, the Minister of Home Affairs permitted the proposal of nuclear fuel tax by Fukui prefecture.<sup>156</sup> The prefecture played a little trick here. It chose as the object of the tax the supply of nuclear fuel into the reactor.<sup>157</sup> The tax base is the price of the fuel. It thus avoided conflict with the statutory condition. It is unclear what sort of political negotiations occurred, however, it is reasonable to infer that the permission by the Minister originated not from mere interpretation of the Local Tax Act, but rather from some highly political considerations.

Having permitted the new tax of Fukui prefecture, the Minister was forced to permit other prefectures to impose identical or similar taxes: Fukushima (1977), Ibaraki (1978), Ehime (1979), Saga (1979), Shimane (1980), Shizuoka (1980), Kagoshima (1983), Miyagi (1983), Niigata (1984), Hokkaido (1988), Ishikawa (1992), and Aomori (2004) followed Fukui in imposing an extra-statutory tax on nuclear fuel.<sup>158</sup> All these taxes were valid for a limited time and have been subsequently renewed several times.<sup>159</sup>

### 3. The 2011 Fukushima Disaster and Its Effects on Nuclear Fuel Taxes

On March 11, 2011, a tsunami caused by a powerful earthquake hit the coasts of Iwate, Miyagi, and Fukushima prefectures.<sup>160</sup> Consequently, the nuclear reactors’ cores at the Fukushima Daiichi [Number One] power plant began to melt.<sup>161</sup> The power plant was closed, and the operations of all the other nuclear power plants were temporarily suspended. This essentially meant that the object of

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<sup>155</sup> See THE ASAHI SHIMBUN, Aug. 22, 1976, at 3.

<sup>156</sup> Fukui ken kakunenryo zei jorei [Ordinance on the Nuclear Fuel Tax of Fukui Prefecture], Ordinance (Fukui Prefecture) No. 40 of 1976.

<sup>157</sup> See Norihiko Kuwabara & Takufumi Yoshida, *Prefectures taxing nuclear plants until the bitter end*, THE ASAHI SHIMBUN (June 22, 2018), <http://www.asahi.com/ajw/articles/AJ201806220038.html> [<http://perma.cc/N3SU-CPXJ>].

<sup>158</sup> GREEN TAXATION AND ENVIRONMENTAL SUSTAINABILITY 219 (Larry Kreiser et al. eds., 2012).

<sup>159</sup> See *id.*

<sup>160</sup> Kenneth Pletcher & John P. Rafferty, *Japan Earthquake and Tsunami of 2011*, ENCYCLOPEDIA BRITANNICA (last updated Oct. 15, 2018), <https://www.britannica.com/event/Japan-earthquake-and-tsunami-of-2011> [<http://perma.cc/NUT9-47K2>].

<sup>161</sup> See *Fukushima Daiichi Accident*, WORLD NUCLEAR ASS’N (last updated Oct. 2018), <http://www.world-nuclear.org/information-library/safety-and-security/safety-of-plants/fukushima-accident.aspx> [<http://perma.cc/8JCT-E5WG>].

nuclear fuel taxes did not exist anymore. The prefectures suddenly lost all tax revenue.<sup>162</sup>

This incident changed the prefectures' policy on nuclear fuel taxes. As one consequence, Fukushima prefecture did not renew its ordinance on nuclear fuel tax and the ordinance lost its effect at the end of 2012.<sup>163</sup>

Further, other prefectures, having been dependent on the revenue from nuclear fuel taxes for a long time, sought means to collect money even when the reactors were shut down.<sup>164</sup> They revised the ordinances and began to impose a tax on the "business regarding operation and decommissioning of nuclear reactors."<sup>165</sup> Technically speaking, they modified the ordinances to make part of the tax base calculated on the thermal power [netsu shutsuryoku] of the reactors. Take Hokkaido (a prefecture) as an example, which has imposed this tax on Hokkaido Electric Power Company since September 2013.<sup>166</sup> The tax base is 5960 MW, the sum of the thermal power of the three reactors located in Tomari Power Plant, which is the only nuclear power plant in Hokkaido.<sup>167</sup> The tax rate is 37,750 yen per MW for three months.<sup>168</sup> Hence the annual tax revenue is 900 million yen.

Some prefectures began to impose other kinds of taxes on nuclear power plants. Three prefectures, Fukui, Ibaraki, and Aomori, levy taxes on power companies or reprocessing businesses for their imports and storage of spent nuclear fuel. The Aomori prefecture is the most conspicuous in this regard. The tax revenue from the tax on the handling of nuclear fuel materials [kakunenryo busshitsu to toriatukai zei] was a little less than 20 billion yen in 2016.<sup>169</sup> It reached nearly twenty percent of the 115 billion yen of

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<sup>162</sup> Kuwabara & Yoshida, *supra* note 157.

<sup>163</sup> Yuhei Sato, the Governor of Fukushima prefecture, emphasized that the tax policy is consistent with the prefecture's demand for nuclear decommissioning. *See Fukushima to Ax Nuclear Fuel Tax*, JAPAN TIMES (Nov. 21, 2012), <https://www.japantimes.co.jp/news/2012/11/21/national/fukushima-to-ax-nuclear-fuel-tax/#.W7GYgy-ZM6W> [<http://perma.cc/4REG-VP45>].

<sup>164</sup> Kuwabara & Yoshida, *supra* note 157.

<sup>165</sup> *See* Fukui ken kakunenryo zei jorei [Ordinance on the Nuclear Fuel Tax of Fukui Prefecture], Ordinance (Fukui Prefecture) No. 30 of 2016, art. 5, no. 2 (referring to both operation and decommissioning). *Cf.* Hokkaido kakunenryo zei jorei [Ordinance on the Nuclear Fuel Tax of Hokkaido], Ordinance (Hokkaido) No. 8 of 2013, art. 4 (referring only to operation of nuclear reactors).

<sup>166</sup> Kyodo, *Hokkaido Electric to Execute Second Price Hike*, JAPAN TIMES (Oct. 10, 2014), <https://www.japantimes.co.jp/news/2014/10/10/business/hokkaido-electric-execute-second-price-hike-november/#.XBsLfs2ZPOQ> [<http://perma.cc/FK3P-PE3A>].

<sup>167</sup> *See* HOKKAIDO ELECTRIC POWER CO., INC., <http://www.hepco.co.jp/energy/atomic/data/specification.html> [<http://perma.cc/L2K3-FK5Z>].

<sup>168</sup> *See* NUCLEAR FUEL TAX (last updated Aug. 28, 2018), <http://www.pref.hokkaido.lg.jp/sm/zim/tax/atom01.htm> [<http://perma.cc/5U8V-DKPQ>].

<sup>169</sup> *Id.*



the prefecture's tax revenue, excluding the amount of allocated consumption tax.<sup>170</sup>

#### 4. A Critical Appraisal of the Control on Extra-Statutory Taxes

##### a. The Nuclear Fuel Taxes and the Political Process

The nuclear fuel taxes are a mechanism used to incentivize local governments to accept nuclear power plants. Mark Ramseyer persuasively described the dynamics in which poor villages rationally, but shortsightedly, ask for subsidies at the cost of being the permanent location for nuclear power plants, which eventually render them unable to break from the resulting vicious cycle.<sup>171</sup> Admittedly, in analyzing nuclear fuel taxes thoroughly, the political process should be taken into consideration. Nevertheless, it is worth noting the defects of the Local Tax Act, particularly how its standards limit the taxing power of local governments. Even if certain transfers of wealth from a party to another should be considered desirable in the political process, it would not be achieved as the form of local tax had the national legislation strictly dismissed the alternative.

##### b. A Comparison with the Dormant Commerce Clause in the United States

This section identifies the problem with nuclear fuel taxes from the legal perspective. Next, this section examines which part of the Local Tax Act has given rise to such problems by comparing the statute with dormant Commerce Clause jurisprudence in the United States.

There are several problems with nuclear fuel taxes. The first is that their essential qualities are far from apparent. Particularly, it is not clear who the legislators intended to have bear the burden of the taxes. The power companies, or their shareholders, may be the tax bearers. Or it may also be the consumers of the electricity. However, because the taxes are considered to be the costs calculated in the electricity rates, it would be reasonable to assume that the consumers bear the tax burden.<sup>172</sup>

Second, since the consumers bear the tax burden, those who are subject to the taxes were never involved in determining the tax legislation. Nor do the consumers have any means to dispute

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<sup>170</sup> *Financial Situation*, AOMORI PREFECTURAL GOV'T. (last updated Nov. 2, 2018), [https://www.pref.aomori.lg.jp/soshiki/soumu/zeimu/files/H28\\_kenzei.pdf](https://www.pref.aomori.lg.jp/soshiki/soumu/zeimu/files/H28_kenzei.pdf) [http://perma.cc/3VAT-4BFX].

<sup>171</sup> Ramseyer, *supra* note 153.

<sup>172</sup> See Kuwabara & Yoshida, *supra* note 157.



the legality of the taxes against either the Local Tax Act or other national legislation.

Third, there is a problem with the recent modification of the taxes. All prefectures, other than Fukushima, revised their ordinances and began to impose taxes on the power companies, even when those companies do not operate nuclear reactors.<sup>173</sup> Because the reactors generate no electricity, such a tax cannot be a consumption tax (the economic burden of which would be borne by the consumers of electricity). However, neither the prefectures nor the Ministry of Internal Affairs and Communications give any reasoned explanation for this. In any case, it would be quite unreasonable to impose a fixed consumption tax irrespective of the level of consumption. The modification of the taxes has revealed that they are no more than simply a means to obtain a subsidy, as long as the nuclear power plants are located in their territories and there is no sensible justification for the taxes.

It is easy to see these problems stem from the absence of a Japanese equivalent to the dormant Commerce Clause. If Japan had a dormant Commerce Clause, it would have been possible to examine the validity of the nuclear fuel taxes using a test similar to the *Complete Auto* test.<sup>174</sup> For instance, the tax might be invalidated because it is not fairly related to the services the prefecture provides.<sup>175</sup> The tax on imports of spent nuclear fuel might conflict with the prohibition of discrimination against out-of-state actors.<sup>176</sup> In fact, as previously noted, the Local Tax Act needs only three requirements for the consent of the Minister of Internal Affairs and Communications.<sup>177</sup> These requirements do not allow for the invalidation of a tax that would harm the local tax system or domestic commerce.

Furthermore, there are at least two other serious defects in the Act. First, it is not clear when taxation against consumers outside the territory of the local governments is allowed, if at all. The Act provides that the source of income and location of the property must be within the territory before imposing taxes on income or property.<sup>178</sup> However, it does not spell out what principle governs the consumption taxes. Second, the Act says nothing about indirect taxes. The duty to ask for opinions of taxpayers, introduced by the revision of the Act in 2004, has

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<sup>173</sup> *See id.*

<sup>174</sup> *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

<sup>175</sup> *See id.*

<sup>176</sup> *See id.*

<sup>177</sup> *See HARADA, supra* note 128, at 25.

<sup>178</sup> Chihō zei hō [Local Tax Act], Law No. 226 of 1950, art. 262, 672, & 733-2.

nothing to do with the indirect taxes because the economic burden of them would be borne by people different from the taxpayers.

Let us go back to *Wayfair* now. In the cases on the collection duty of state use tax in the United States, the consumers within the state are the ones who bear the economic burden of the use tax.<sup>179</sup> The issue is whether the retailer that seems to have a scarce connection with the state is nevertheless obligated to collect tax from those consumers. In contrast, the nuclear fuel taxes in Japan are imposed on the power companies that have power plants in the territory of the local government. However, the tax burden is shifted to the consumers out of the territory. Both countries struggle in dealing with indirect consumption taxes. In the United States, by taking only the taxpayer into account, the fair apportionment of tax burden among the consumers in the state has failed, although *Wayfair* has mitigated the problem.<sup>180</sup> In Japan, by disregarding the consumers who bear the tax, the nuclear fuel taxes were implemented as an indirect vehicle for tax collection.

### C. The “Hometown Tax Donation” System

#### 1. Introduction

During the past decade, taxpayers’ attitudes towards Japanese local income taxation have drastically changed. The change was prompted by a newly-introduced tax credit regarding donations. Since the tax credit’s introduction in 2008, competition for donations among municipalities and prefectures has gradually accelerated through their offers of goods and services in return for donations.<sup>181</sup> This section will examine how the tax credit, and resulting behaviors of both local governments and taxpayers, can be seen as another example of how the local tax system in Japan is defective.

In Japan, local governments and the national government impose income taxes on their residents. Whereas there are many statutory provisions for the national income tax<sup>182</sup> and a large number of officials managing the national tax system, there are very few statutory provisions for local income taxes, with only a small number of officials hired to implement them. The reason for this is that local governments are largely dependent on the

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<sup>179</sup> See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298, 302 (1992).

<sup>180</sup> See generally *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).

<sup>181</sup> See Tomohiro Osaki, *Hometown ‘tax’ donations system catching on*, JAPAN TIMES (Oct. 20, 2014), <https://www.japantimes.co.jp/news/2014/10/20/reference/hometown-tax-donations-system-catching/#.W9jKBXpKiu4> [<http://perma.cc/S5RT-CRFX>].

<sup>182</sup> See *Shotoku zei hō* [Income Tax Act], Law No. 33 of 1965.

computation of income generated by the national income tax.<sup>183</sup> By referring to the tax base of the national income tax for the previous year, the local income taxes barely require their own computation process.

In spite of almost the same computation process, officials from the Ministry of Internal Affairs and Communications have forcefully insisted over time that the nature of the local income taxes is different from that of the national income tax.<sup>184</sup> They assert that the local income taxes represent the principle of fair share [*futan bun-nin*], one of the most important ideas in local taxation.<sup>185</sup> According to them, although this principle guides the entire local tax system, it is especially prominent for local income taxes because it justifies local governments' taxation against low-income people who are exempt from national income. The principle has also been referred to in justifying the fact that deductions and credits for various policy purposes are strictly limited in the local income taxes.

The local governments impose two kinds of "inhabitant taxes" [*jumin zei*] on individuals. One is per capita tax [*kinto wari*] on residents and nonresidents that have local establishments, such as land and buildings in the territory.<sup>186</sup> However, the amount and the significance of the per capita taxes is very small today. The other inhabitant tax is the local income taxes [*shotoku wari*] on the residents. These taxes are important in terms of their tax revenue.<sup>187</sup> They consist of the prefectural income tax and the municipal income tax.<sup>188</sup> The tax base for these taxes is almost the same as that for the national income tax. The standard tax rate<sup>189</sup> is four percent for the prefectural income tax<sup>190</sup> and six percent for the municipal income tax.<sup>191</sup>

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<sup>183</sup> *Chihō zei hō* [Local Tax Act], Law No. 226 of 1950, art. 32 (prefectural personal income tax); *id.* at art. 23, para. 1, no. 3 (prefectural corporate income tax); *id.* at art. 313 (municipal personal income tax); *id.* at art. 292, para. 1, no. 3 (municipal corporate income tax).

<sup>184</sup> See generally Takeo Yamauchi, "*Kojin jumin zei no seikaku*" ni kansuru ichi kousatsu: "*futan bun-nin*" no imisuru mono (I) [A Consideration on the "Nature of Inhabitant Taxes": What "Fair Share" Means, Part I], 71 *JICHI KENKYU* 77, 80–85, 87–91 (1995) (showing an overview of the discourse on the principles of local taxation including the principle of "fair share").

<sup>185</sup> See TAX BUREAU, MINISTRY OF FIN., AN OUTLINE OF JAPANESE TAXES: 2001-2002, 16 (2002).

<sup>186</sup> The per capita taxes are also imposed on corporations and other entities that have establishments or dormitories in the territory of the local government. See Local Tax Act, Law No. 226 of 1950, art. 23, para. 1, no. 1; art. 24, para. 1, no. 1 & 2; art. 292, para. 1, no. 1; art. 294, para. 1, no. 1 & 2.

<sup>187</sup> See AN OUTLINE OF JAPANESE TAXES: 2001-2002, *supra* note 185, at 18.

<sup>188</sup> See *id.*

<sup>189</sup> The "standard tax rate" is the tax rate local governments apply under ordinary circumstances. However, the Act does not admit local governments to apply different rates for the local individual income taxes.

## 2. Transformation of the Local Income Taxes in the Past Decade

### a. An Introduction of Tax Credits for the Donation to Other Local Public Bodies

The 2008 revision to the Local Tax Act<sup>192</sup> drastically changed tax rules for donations, especially for donations to prefectures and municipalities other than the one in which the taxpayer's residence is located. The "hometown tax donation [furusato nozei]" system,<sup>193</sup> introduced by the revision, in essence expanded tax benefits for the taxpayers who made donations to local governments.<sup>194</sup> Before the revision, the amount of donation to local governments exceeding 5000 yen was deducted from income for the purpose of calculating the national income tax.<sup>195</sup> Deduction from the local income taxes was allowed only if the amount of donation exceeds 100,000 yen. The tax revision newly allowed a tax credit against local income tax liability for ten percent of the amount of donation if it exceeds 5000 yen. Given the fact that the aggregate tax rate of the local income taxes is ten percent, this tax credit means that the rate of local income taxes is zero for the amount of donations. Therefore, it is the same as a deduction of the amount of donations from taxable income. Furthermore, the revision offers another benefit to those who make donations to municipalities and prefectures. A new tax credit not exceeding one-tenth of the taxpayer's local income tax liability is granted for the amount of the donation.<sup>196</sup> Combined with the previously mentioned income deduction and tax credit, this "special" tax credit allowed a taxpayer who pays a fee of 5000 yen to transfer the amount equivalent to ten percent of his local income tax liability to whichever municipalities or prefectures he

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<sup>190</sup> Local Tax Act, Law No. 226 of 1950, art. 35, para. 1.

<sup>191</sup> *Id.* at art. 314-3, para. 1.

<sup>192</sup> Local Tax Act, Law No. 21 of 2008. See Tomoyuki Saisu, *Chihozeiho to no kaisei* [*The Revisions on the Local Tax Act*], Heisei 20 nen zeisei kaisei no kaisetsu [EXPLANATIONS ON THE 2008 TAX REVISION], 647-49 (2008).

<sup>193</sup> Technically speaking, the Japanese phrase "furusato nozei" connotes that the taxpayers "pay tax" to municipalities and prefectures and not that they "donate" money to these. However, we adopt here "hometown tax donation" as the translation of "furusato nozei" because it seems to be the official translation. See, e.g., *The Furusato Nozei Program: Tax Breaks with Benefits*, TOKYO WEEKENDER (Mar. 20, 2016), <https://www.tokyoweekender.com/2016/03/the-furusato-nozei-program-tax-breaks-with-benefits/> [http://perma.cc/UYW9-PW3R].

<sup>194</sup> For articles on the hometown tax donation system written in English, see Anthony Rausch, *A Paradox of Japanese Taxation: Analyzing the Furusato Nozei Tax System*, 15 ASIA-PAC. J. JAPAN FOCUS 1, 1 (2017) and Janet W. Kanzawa, *Lobsters, Hot Air Balloons, and the Hometown Tax: A Japanese Model for Revitalizing Rural Economies in the United States*, 2017 COLUM. BUS. L. REV. 1100, 1100 (2017).

<sup>195</sup> Income Tax Act, Law No. 33 of 1965, art. 78. The 2006 tax revision had reduced the minimum amount from 10,000 yen to 5000 yen. *Id.*

<sup>196</sup> Local Tax Act, Law No. 226 of 1950, art. 37-2, para. 2, and art. 314-7, para. 2.

or she chooses. In essence, by paying 5000 yen, a taxpayer obtains the right to make his donation to local governments a substitute for his tax payment.<sup>197</sup>

The report prepared by the committee of experts on local governance offers two justifications for the hometown tax donation system.<sup>198</sup> One is that a taxpayer should be allowed to pay tax to his own hometown municipality or prefecture from which he has benefited in his or her younger years. In other words, the donation is a deferred payment of consideration for past public services. The other is that the system acts as an incentive for municipalities and prefectures to compete to provide better public services, not only to their own residents, but also to other citizens as a whole. This explanation expects that the amount of donations a local government assembles would stand for the popularity of the policies it chooses. In other words, it hopes for a taxpayer—instead of a consumer-voter in the Tiebout model—to pick a local government which best satisfies his or her preference pattern for public goods.<sup>199</sup>

A disparity of tax revenue among municipalities and prefectures is in the background of the hometown tax donation system.<sup>200</sup> Local governments in the urban and industrial area such as the Tokyo prefecture and the city of Nagoya have a large amount of tax revenue from the local income tax, especially the local corporate income tax.<sup>201</sup> Conversely, those in rural areas have difficulty making ends meet and are heavily dependent upon “local allocation tax [chiho kofu ze]” from the central government.<sup>202</sup> Accordingly, amelioration of the imbalance was one of the main motives for the idea of hometown tax donation. However, it entirely fails to accomplish this purpose. There is no assurance that the taxpayers will act optimally in order to transfer the tax

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<sup>197</sup> For a discussion of this system, see *Hometown tax donation system*, JAPAN TIMES (Mar. 11, 2017), <https://www.japantimes.co.jp/opinion/2017/03/11/editorials/review-of-the/#.XB159C2ZPOQ> [<http://perma.cc/2KJ9-XDH7>].

<sup>198</sup> For an analysis, see Hideaki Sato, “*Furusato nozei kenkyukai hokokusho*” to *Furusato nozei seido* [“*The Report of the Committee on Hometown Tax Donation*” and the *System of Hometown Tax Donation*], 1366 JURISUTO 157 (2008) (containing the explanations of a member of the committee for the report).

<sup>199</sup> See Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 417–18 (1956) (proposing a model in which a consumer in a given municipality, instead of voting to change the policy of the community, physically moves to another municipality for policy that best satisfies his preference for public goods).

<sup>200</sup> Takuji Koike, *Chiho zaisei kaikaku to zeishu no chiiki-kan kakusa* [The Reform of Local Public Finance and the Disparity of Tax Revenue Among Localities], 593 CHŌSA TO JOHŌ 1 (2007).

<sup>201</sup> See James Mayger & Hannah Dormido, *The Rich are Getting Richer in Abe’s Japan*, BLOOMBERG (Dec. 13, 2017), <https://www.bloomberg.com/graphics/2017-japan-inequality/>.

<sup>202</sup> See JURO TERANISHI, *EVOLUTION OF THE ECONOMIC SYSTEM IN JAPAN* 46, 207 (2005).

revenue from the rich local governments to the poor local governments at the appropriate level.

For the purpose of the calculation of local allocation tax, the amount of a donation is deducted from the tax revenue of the residence municipalities/prefectures, but is not added to the tax revenue of the receiving municipalities/prefectures.<sup>203</sup> The rule means that the reduction of tax revenue for a local government caused by the resident's donation to other local governments is considerably supplemented by an increase in the amount of local allocation tax.<sup>204</sup>

#### b. The Emergence of “Governmental” Tax Shelters through Rewards to the Donation

Even though many might have considered the idea of hometown tax donation attractive, only a small number of taxpayers dared to disburse 5000 yen to donate to other local governments. Most taxpayers' indifference was reasonable. They had no motive at all to make donations to local governments when they do not enjoy the benefit from the donation in a tangible form. It is worth noting that, after the earthquake and tsunami of 2011, some funds were sent through the system of hometown tax donation to the local governments that were affected.<sup>205</sup> This incident, however, did not accelerate the use of the system at a significant degree. As a result, the legislators then dropped the cost for the taxpayers from 5000 yen to 2000 yen in 2012.<sup>206</sup> However, the effect of this revision was also limited.

Then, several municipalities started to “reward” the donation, which gradually changed the state of affairs. Since 2012, with the help of web portals created by enterprises such as Trustbank (furusato choice), Rakuten (Rakuten furusato nozei), i-mobile (furunavi), Satofull, a subsidiary of Softbank (Satofull), JTB (furupo), All Nippon Airways (ANA no furusato nozei), etc., the amount of hometown tax donation saw an upsurge.<sup>207</sup>

The fair market value of the reward to the donation seems to be about half of the amount of donation on average, though it

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<sup>203</sup> Saisu, *supra* note 192, at 649.

<sup>204</sup> See Masakatsu Misumi, *Jiko futan naki “kifu” no arikata ga towareru “furusato nozei”* [*Hometown Tax Donation: A Questionable “Donation” without Real Burden*], 371 RIPPŌ TO CHŌSA 59, 70 (2015) (explaining in figure 14 the economic burden of actors with respect to hometown tax donation).

<sup>205</sup> See Osaki, *supra* note 181.

<sup>206</sup> See *Hometown tax donation system*, *supra* note 197.

<sup>207</sup> The names of the services they provide are indicated in the parentheses.



depends on the policy of each local government.<sup>208</sup> For example, according to the Satofull website, the market value of the reward given by Ureshino city in the Saga prefecture is almost fifty percent of the amount of donation: A bottle of sake brewed in the city under the brand of “Azumacho,” the market price of which is 5400 yen including VAT at eight percent, is on the list to choose from for those who have made 10,000 yen of donation.<sup>209</sup> Similarly, a set of six plates of porcelain and a dice made of porcelain manufactured in a pottery in the city, the market price of which is 10,800 yen including VAT, is on the list for those who have contributed 20,000 yen as hometown tax donation.<sup>210</sup>

The upsurge of the amount of donations in 2014 prompted those municipalities and prefectures that have been reluctant to introduce rewards for the hometown tax donation to join the competition for donation. If a local government restrained itself from offering rewards, it would continue to lose tax revenue from its residents’ donation to other local governments. The 2014 tax revision spurred the race by raising the maximum amount of the “special” tax credit from ten percent of his local income tax liability to twenty percent.<sup>211</sup> It also simplified the procedure for making the hometown tax donation by exempting most taxpayers from the duty of filing their tax returns, who previously had to file them only for the purpose of the donation.

As previously explained, the original intent of the hometown tax donation system was just to allow taxpayers to choose local governments to which they pay their local income taxes and, by doing so, to alleviate the disproportionate financing ability among the local governments to a certain degree. However, emergence of the practice of rewards and accompanying popularity of the system

<sup>208</sup> For an analysis of the state of affairs in 2018, see Taro Hagami, *Furusato nozei sontoku kanjo wasuto besuto 50* [Profit and Loss from the Hometown Tax Donation: The Top 50 and the Bottom 50 Municipalities], 1614 CHŪO KŌRON 154 (2018).

<sup>209</sup> *Saga ken Ureshino shi* [Ureshino City, Saga], *Junmai daiginjo homon azumacho 1.8L*, SATOFULL, [https://www.satofull.jp/products/detail.php?product\\_id=1000943](https://www.satofull.jp/products/detail.php?product_id=1000943) [<http://perma.cc/A4MM-Q4FB>] (offering a sake bottle of “Junmai daiginjo homon azumacho” as the reward for a 10,000 yen donation). Cf. *Homon azumacho junmai daiginjo 1.8L*, SAITO SHOTEN, <http://www.saito-sake.com/shopdetail/005002000001/> [<http://perma.cc/PS7L-XVR4>] (selling the same sake bottle at a liquor shop for 5400 yen via the internet).

<sup>210</sup> *Saga ken Ureshino shi* [Ureshino City, Saga], *Hizen yoshida yaki ji no sakazuki yojo han shuki setto*, SATOFULL, [https://www.satofull.jp/products/detail.php?product\\_id=1013293](https://www.satofull.jp/products/detail.php?product_id=1013293) [<http://perma.cc/CF6Y-6U8Y>] (offering a set of six plates of porcelain and a dice made of porcelain as the reward for a 20,000 yen donation). Cf. *Tsujiyō seitojo yojo han shuki*, JI NO SAKAZUKI, <https://jinosakazuki.thebase.in/items/3290714> [<http://perma.cc/AT5Q-J2GJ>] (selling the same porcelain and dice set at a local pottery shop for 10,800 yen via the internet).

<sup>211</sup> See Takuya Shimomura, *Chihozeiho to no kaisei* [The Revisions on The Local Tax Act], *Heisei 27 nen zeisei kaisei no kaisetsu* [Explanations on the 2015 Tax Revision], 932–36 (2015).



gave the system an unexpected role. It has turned into means to vitalize local economy. To reward donors, local governments now have to purchase their local goods and services from businesses in their territories. And it is natural for the legislators to reinforce this excellent method of subsidizing local governments that try hard to vitalize their local businesses.

### 3. A Critical Appraisal of the Policy

To evaluate the hometown donation system precisely, we have to know who the system benefits and who bears its costs. While credible data is not available, this section considers two possibilities.

At one extreme, the taxpayer who makes a donation might not change his or her consumption patterns at all. He or she may just reduce purchase of consumption goods and acquire them as the rewards for the donation. In this case, the tax donation system works as an offer of tax reduction. The system is nothing but a tax shelter benefiting the taxpayer.<sup>212</sup> In this setting, all the benefit from the system is absorbed by the taxpayer and the local government. The system will not be beneficial to local businesses to any extent because, as the sales of the goods to the local government increase through the reward to the donation, the sales to the consumers will decrease.

However, it is unrealistic to suppose the taxpayers will not change their consumption patterns at all. Presumably, the taxpayers will change the goods or services they consume. Therefore, at the other extreme, they might keep their previous consumption patterns and acquire additional goods and services through the donation tax system. To the extent they increase consumption, the system might be justified as a tool for stimulating the domestic economy.

Yet as far as the newly acquired goods and services through the hometown tax system replace the previously consumed goods and services, the system together with the rewards might distort the market economy. If the goods and services the taxpayers have formerly consumed have been produced in one municipality, then the system merely substitutes them with those produced in the other municipality at the expense of the national treasury. Obviously, encouraging such a zero-sum game is not a reasonable policy. If the goods and services have been imported from abroad, then the system is nothing more than subsidies to the domestic

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<sup>212</sup> An opportunity of investment for taxpayers the expected return of which is positive after tax, which is normally contrived and sold by financial institutions, is known as a "tax shelter." A donation to local public bodies under the hometown tax donation system is nothing but a tax shelter, even though the local governments instead of financial institutions offer the chance for it.

industries. In sum, the hometown tax donation system possibly harms the domestic and international commerce as a whole, even if it effectively energizes the economy in some local governments of Japan. It benefits local businesses at the sacrifice of the businesses out of the territory.

If Japan had a dormant Commerce Clause, the rewards for the donation would be invalidated because they unquestionably disturb the domestic commerce. The Clause would invalidate them because the burdens on the domestic commerce outweigh the overall benefits of the policy. In addition, although it might be difficult to argue that the rewards discriminate out-of-staters, they directly harm other local governments. In reality, none of the articles in the Local Tax Act effectively stop the rewards. The Ministry of Internal Affairs and Communications just asks local governments to act according to the principles of the hometown tax donation system.<sup>213</sup> Only a part of local governments obey the guidance.

#### CONCLUSION

As the nuclear fuel taxes and the hometown tax donation demonstrate, tax competition among local governments in Japan is accelerating. This harms market economy by making it less efficient and fails to redistribute wealth. The present circumstances in Japan remind us of the essential function of the dormant Commerce Clause. It plays an important role in implementing basic principles of fiscal federalism. Even though *Wayfair* did not fully scrutinize the nature of indirect tax and paid little attention to the character of collection duty as it differs from ordinary tax liability, this United States Supreme Court decision expanded the range of the application of the legal doctrine and should be respected.

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<sup>213</sup> See, e.g., MINISTER OF INTERNAL AFFAIRS AND COMMUNICATIONS, *Furusato nozei ni kakaru henreihin no sofu to ni tsuite* [ON THE REWARDS FOR HOMETOWN TAX DONATION] (2017); Sōmushō jichi zeimu kyoku [MINISTRY OF INTERNAL AFFAIRS AND COMM'NS, LOCAL PUB. FIN. BUREAU], *supra* note 131, at 130–32 (providing administrative guidance on the rewards for hometown tax donation).