

Case

Case of the Temporary Special Local Corporate Tax Ordinance by Kanagawa Prefecture: Governor of Kanagawa v. ISUZU MOTORS Group

Supreme Court, March 21, 2013 (Hanrei-jihō No. 2193, p. 3)

Keywords : Independent taxing power of local government, Legal outside tax of the Local Tax Act, Relationship between local government ordinances and state laws

1. General Introduction

“Regulations concerning organization and operations of local public entities shall be fixed by law in accordance with the principle of local autonomy.”

(Essential tenet of self-government, Article 92, Japanese Constitution)

The above article refers to the guarantee of autonomy for local public entities (= local government). And, in view of fiscal management, it is supposed to guarantee the independent taxing power of local government. Therefore, taxation by local government is executed in accordance with the ordinances that are enacted by local government.

On the other hand, the independent taxing power of local government is limited because it is necessary to follow, “shall be fixed by law.” The Local Tax Act (*chihouzei-hou*) has been enacted by the state on the basis and the ordinances enacted by local government must conform to the forms in the law.

The forms consist of two styles. One is “Legal Tax” (*houtei-zei*). The local government should enact the ordinances provided by the form in the Local Tax Act and there is no discretion on the part of the local government.

Another is “Legal Outside Tax” (*houteigai-zei*). This is an exceptional system that permits taxation according to the circumstances of local governments by independent ordinance. However, there are certain conditions, e.g., it is necessary to obtain the approval of the Minister of Internal Affairs and Communications (*somu daijin*) through examination by the state. Therefore, it can be said that legal outside tax permits a certain amount of discretion for local governments to enact their own taxing ordinances, but it doesn’t mean that local governments possess complete independent taxing power.

2. The facts of this case

The prefectural assembly of Kanagawa Prefecture enacted the Kanagawa Prefecture Temporary Special Local Corporate Tax Ordinance in 2001, and had imposed “the Temporary Special Local Corporate Tax” (hereinafter, TST) as a legal outside tax under the Local Tax Act.

- ① The corporate taxpayers covered by this ordinance have a base of business inside Kanagawa prefecture, and the amount of capital or contribution is above 500 million yen.
- ② TST is generally levied on the amount of income as a tax base that calculated by not allowing loss carryover in deductible expenses. In this case of local corporate tax (a legal tax) the amount of income as the tax base is calculated by allowing loss carryover in deductible expenses.
- ③ Kanagawa prefecture satisfied “certain conditions” (see 1. General Introduction) of this ordinance; there are no inherent defects in the ordinance enactment process. “ISUZU MOTORS Group” (hereinafter, X), the corporate taxpayer of TST, thought the tax to be illegal and invalid because the ordinance violated the regulations covering local corporate tax in the Local Tax Act that allows loss carryover in deductible expenses from the National Corporate Tax Act. Therefore, X claimed a tax refund of the temporary special local corporate tax, additional tax for deficient returns and delinquent tax for the 2003 and 2004 fiscal years that had already been paid, and the payment of interest on the refund.

The Yokohama District Court ruled on March 19, 2008 as follows:

- ① Though it is necessary to impose a legal tax according to the regulations in the Local Tax Act, practically, taxation in contradiction of articles covering local corporate tax under the Local Tax Act in the form of a legal outside tax is not permitted because the purpose of the Local Tax Act is that local governments should levy a legal tax under the law.
- ② TST has the effect of establishing a new tax base that creates a substantial change in the provision of the tax base for local corporate tax with taxation by another tax base.

Therefore, the District Court concluded that the TST is illegal, and upheld the plaintiff’s claim.

However, the Tokyo High Court overruled the District Court’s decision on February 25, 2010 as follows:

- ① Local governments have independent taxing power. Therefore, it is necessary to consider whether there is a contradiction or collision between the law and the ordinance on a case-by-case basis. Thus, the criteria for contradiction or collision between law and ordinance must compare not only the objects of taxation and words but also the purpose, content, and effect.
- ② TST does not substantially change the effect of the Local Tax Act. Therefore, the ordinance does not result in a contradiction or collision with the law.

The High Court upheld the legality of TST and X appealed to the Supreme Court.

3. Judgment

The Supreme Court overruled the High Court’s decision as follows:

- ① When a general standard in law exists, the independent taxing power of local governments should be limited to within the confines of the general standard.
- ② To enact an ordinance the provisions of which contradict or collide with mandatory provisions of the Local Tax Act is not permitted, because it would conflict with the spirit and purpose of the law.
- ③ Provisions in the Local Tax Act for loss carryover in deductible expenses should recognize the mandatory provisions for local corporate tax in the Local Tax Act. So it is not permitted to exclude loss carryover in deductible expenses. Ordinances that exclude loss carryover in deductible expenses are illegal and thus invalid because they contradict and collide with the mandatory provisions of the law.
- ④ TST, the central issue of this case, substantially provides that the amount of loss carryover in deductible expenses is assumed to be included in the tax base of the local corporate tax. And the effect is to exclude part of the loss carryover in deductible expenses from the calculation of income each fiscal year. Therefore, it is illegal and thus invalid, because it contradicts and collides with the mandatory provisions of the local corporate tax in Local Tax Act.

4. Comment

The most important issue resulting of this case is “what do we need to understand about the independent taxing power of local government”.

It should be said that today, the complete independent taxing power of local governments in the Japanese Constitution is not recognized. Based on this principle: Local Tax Act, that is, an Act enacted by the state, is given priority over ordinances. So, it is necessary to understand the limited confines of the independent taxing power of local government. This is essentially the effect of the decisions handed down by the District Court and the Supreme Court.

However, local governments are not mere branch offices of the national government. Therefore, it is not permitted to deny completely the independent taxing power of local governments.

Thus, the significance of legal outside tax is its ability to tax what a legal tax does not assume to be a taxable item. This will inevitably cause a certain type of friction between a legal outside tax enacted by the inventiveness of a local government and a legal tax. It is absolutely imperative to respect the inventiveness of the local government in regard to legal outside tax on a case-by-case basis. This should be considered against the background of the standard of the High Court of “whether there is a contradiction and collision between the law and the ordinance” (see 2. The facts of this case, the Tokyo High Court ①). This theory is also reasonable.

“Contradiction and collision” as the key term in the reason for the judgment was the same for both the High Court and the Supreme Court. However, it can be said that the

High Court's decision can be applied more substantially, because the Supreme Court limited the independent taxing power of local governments as a precondition of the judgment.

Moreover, the reasoning of the Supreme Court, which decided the mandatory provisions of loss carryover in deductible expenses for the local corporate tax, is extremely weak. Provisions that permit for loss carryover in deductible expenses under the National Corporate Tax Act are mandatory provisions. However, those provisions of the Local Tax Act that allow for loss carryover in deductible expenses are *similar* but not conclusive provisions of the National Corporate Tax Act, and the relationship between provisions of the National Corporate Tax Act and those of the Local Tax Act is not clear in express terms.

Thus, it is difficult to decide the mandatory provisions of loss carryover in deductible expenses for the local corporate tax as the Supreme Court has done, because the Japanese Constitution guarantees the principle of no taxation except by law (Articles 30, 84, Japanese Constitution).

The Supreme Court Judgment will become a judicial precedent from this time forward. However, I want to support the High Court's theory from the points of diversity of self-government and the local tax system, the necessity of individual and concrete judgment, and interpretation of the above provisions.

(SASAKI Junya)