

Local finance not under jungle law

FY19 tax reform also supports rural areas via correction of uneven distribution of tax revenues

- Local finance not based on jungle law but on coexistence and co-prosperity policy; measures to correct uneven distribution of tax revenues among local public bodies repeated
- In FY19 tax reform, around 30% of prefecture's corporate taxes will be reallocated based on population ratio; we estimate maximum gap in corporate tax revenues will narrow from 6.0X to 3.4X
- This would serve as factor to provide sense of reassurance in buying municipal bonds in rural areas

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Local finance under coexistence and co-prosperity policy

Do you know the antonym of jungle law? The answer is coexistence and co-prosperity. While the tax revenue base at municipal bodies in metropolitan areas is strong, that in rural areas is weak. Accordingly, it is easier to buy municipal bonds in metropolitan areas, which is common sense in the municipal bond market. However, the government and ruling parties have repeated measures to correct the uneven distribution of tax revenues, without tolerating the issue. This means that local finance is not based on jungle law but on the coexistence and co-prosperity policy.

FY19 tax reform aims to correct uneven distribution of revenues from corporate enterprise taxes

It has been decided that the FY19 tax reform will also include a new scheme to correct the uneven distribution of tax revenues among local public bodies. At the prefecture level, the tax item posting the worst distribution is local corporate tax. Due to the economic recovery on the back of Abenomics, the difference has been widening further in recent years. In the latest tax reform, around 30% of local corporate taxes will thus be converted from local taxes to national taxes, and the entire amount of converted taxes will be reallocated to prefectures as special corporate enterprise transfer taxes (temporary name). The basis of reallocation is population.

Corporate headquarters concentrate on metropolitan areas, despite nationwide production and consumption activities

The purpose of correcting uneven tax revenues among local public bodies is sustainable development of both urban and rural areas with continued vitality because securing local taxes is necessary to promote decentralization. This is based on ideas like Sustainable Development Goals (SDGs). As a result, tax resources are transferred from metropolitan areas to rural areas. However, some argue that a certain degree of transfer is compelling as metropolitan areas have been developing by absorbing human resources raised in rural areas. Moreover, taxation on companies, which is the correction target under the latest reform, will be reallocated by the population ratio based on the realization that concentration of tax revenues in metropolitan areas (just because of location of headquarters) is problematic despite the fact that production and consumption activities are being conducted nationwide.

We estimate tax reform will narrow maximum gap in corporate taxes from 6.0X to 3.4X

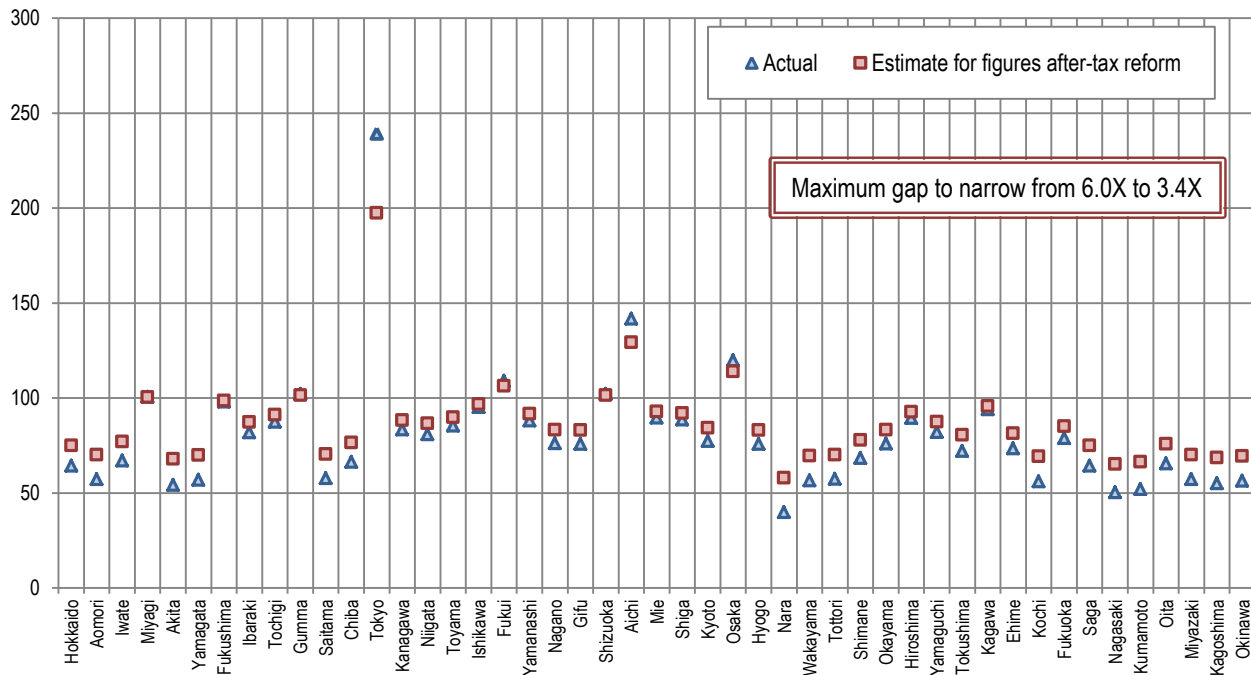
As we were unable to find official materials, we have estimated how much the FY19 tax reform will correct uneven tax revenues by using FY16 data (Chart 1). First, we set the national average as 100 and plotted the actual results of per capita corporate enterprise taxes by prefecture (shown as triangle). Next, we removed one-third of each prefecture's corporate enterprise taxes, summed up such taxes, and reallocated them based on the population ratio (shown as square). The result shows a marked decline in Tokyo as well as slight and widespread reallocation in rural areas. The gap between the prefecture with the largest tax revenues and that with the smallest tax revenues still exists. However, the gap is expected to narrow from 6.0X to 3.4X. Given the details of tax reforms, we may see a greater decline in Tokyo's figure than our estimate.

Leading to sense of reassurance in buying municipal bonds in rural areas

We conclude that local public bodies in rural areas are steadily supported as local finance is based on not jungle law but on the coexistence and co-prosperity policy. This will lead to a sense of reassurance in buying municipal bonds in rural areas

Chart 1: Per Capita Corporate Enterprise Taxes by Prefecture and Estimate for Impact of Tax Reform (FY16 result)

(National average =100)



Source: Ministry of Internal Affairs and Communications; compiled by Daiwa Securities.

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[Standard & Poor's]

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction.

In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.

- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements.

- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.

- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.

- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Financial instruments firm: chief of Kanto Local Finance Bureau
(Kin-sho) No.108

Memberships: Japan Securities Dealers Association

The Financial Futures Association of Japan

Japan Investment Advisers Association

Type II Financial Instruments Firms Association