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## A Study Concerning the Meaning of Consideration in Income Tax Law

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# A Study Concerning the Meaning of Consideration in Income Tax Law

Hiroshi Noguchi \*

## 1. Introduction

Our nation's Income Tax Law establishes the calculations method of each type of income by categorizing them into 10 groups according to their sources or by their characteristics. This makes the assumption that each income has a different ability to pay depending on the source or on the characteristic of the income. From an equity subsidy point of view, this ensures taxation by ability to pay<sup>1</sup>.

The concept of consideration is one of the factors used to determine the nature of the income. The term consideration can be found in §34(1) as well as §59(2) of the Income Tax Law. In addition, the term is also used in §63(XII) of the Order for Enforcement of the Income Tax Law.

Income Tax Law §34(1) states that "occasional income does not have the characteristics of consideration for labor, other services or transfer of assets." Additionally, Income Tax Law §59(2) also states that any capital loss incurred by a transferor is deemed non-existent when a resident transfers a certain asset over to an individual at a substantially low consideration value and when said consideration value does not reach the sum of the basis of tax and expenses incurred for the transfer of the aforementioned asset.

Furthermore, Income Tax Law §27(1) states that "a business income is income accrued by means that are determined by the cabinet order in agriculture, fishery, manufacturing, wholesale, retail, and other businesses." The Order for the Enforcement of the Income Tax Law §63(XII) - the cabinet order - states that a business income is income accrued "from conducting business by acquiring consideration."

Regarding Income Tax Law §34(1), if consideration for a revenue is determined to be non-existent, said revenue is considered to be occasional income. Whereas when a revenue does indeed have consideration, it is categorized as miscellaneous income. Also when the monetary gains of a resident corresponds to "consideration" as established in Income Tax Law §59(2), the transfer of certain assets is perceived as capital gains. However, the transfer of certain assets is not perceived as capital gains if the monetary gain does not correspond to having consideration. Also note that the Order of Enforcement of the Income Tax Law §63(XII), may perceive any revenue as a business income when consideration is thought to exist. If consideration does not exist, however, it will likely be perceived as an occasional income.

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\* Associate Professor of Industrial Management, University of the Ryukyus.

<sup>1</sup> See Hiroshi Kaneko, Tax Law, 197 (19th ed. 2014) (written in Japanese).

The methods employed to calculate income is different depending on the type of income. Therefore the total taxable income of the resident is greatly affected by the type of income. As such, determining the existence of consideration becomes critical as it affects how income is categorized. However, the Income Tax Law and the Order for Enforcement of the Income Tax Law do not define the meaning of the term “consideration”<sup>2</sup>. This paper aims to clarify how the courts of our nation construes the term “consideration” within the context of the Income Tax law and the Order for Enforcement of the Income Tax Law by studying the outlines of several court cases<sup>3</sup>.

## 2. Adopted Concept

There are two concepts of consideration in the Tax Law. The first is the concept of the term being used in a different jurisprudence. The term "adopted concept" is used to denote a definition that is "adopted" from mainly Civil Law or Corporation Law §171. The other is the conceptualization of the term that is not found in other fields of law. This is known as "own concept." The problem with adopted concepts is that it is difficult to decide whether to construe the definition of the term based on definitions used in other fields of law or to use a different definition<sup>4</sup>.

Regarding this conundrum, if the Tax Law were to incorporate a definition used in a different field into its own semantics, the definition is being applied because the context of which the definition is borrowed<sup>5</sup>.

There are different opinions regarding whether the term "consideration" in the context of Income Tax Law is an adopted concept or not. Professor Taniguchi states that "consideration" in the context of Income Tax Law has the same definition as that which is used in Civil Law § 88(2) and Corporation Law §171, thus making it an adopted concept<sup>6</sup>. On the other had, professor Okamura disagrees with that idea since the definition of the term "consideration" is not made clear in other jurisprudences<sup>7</sup>. Even if "consideration" is an adopted term in the context of Income Tax Law, the need to construe the term in the context of Income Tax Law becomes necessary if its definition is no standardized in other jurisprudences.

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<sup>2</sup> The term “considerations” can be seen in Consumption Tax Law§2(1)(VIII), however, like the Income Tax Law, the Consumption Tax Law does not clearly define the term “consideration”. See Hiroshi Noguchi & Yuma Agarie, A Case Study Concerning the Meaning of “Consideration” in Consumption Tax Law, 88 RYUKYU UNIVERSITY ECONOMIC REVIEW 39 (2014) (written in Japanese).

<sup>3</sup> Publication concerning this matter. See Tadao Okamura, The scope of “Gross Receipts” -A thought in the Income Tax Law-, 158 HOGAKURONSO 192 (2006) (written in Japanese), See Tomoaki Kurami, Basic Analysis of the Meaning of “Consideration” in Income Tax Law, 571 ZEI-HO-GAKU 23 (2014) (written in Japanese).

<sup>4</sup> See Kaneko, *supra* note1, at 114.

<sup>5</sup> See Keiji Kiyonaga, Tax Law, 40 (2013) (written in Japanese).

<sup>6</sup> See Setsuo Taniguchi, Basic Tax Law Lecture, 305 (4th ed. 2014) (written in Japanese).

<sup>7</sup> See Okamura, *supra* note3, at 201.

In addition, a Japanese-language dictionary Koujien defines "consideration" as "compensation one receives from another for performing something." Consequently, one could grammatically interpret and construe the term "consideration" as a "form of counter-performance received for one's performance."

### 3. Income Tax Law §34(1)

First, we will look at cases concerning Income Tax Law §34(1).

There exists a Tokyo District Court case<sup>8</sup> that construed the term "consideration" as "the characteristics of a consideration for labor and other such personal services or as transfer of assets" as seen in Income Tax Law §34(1) and a Tokyo High Court case<sup>9</sup> which took on the appeal for the said case. In this case, the focus of the debate was determining which kind of income items such as rebates, mid-year and end-of-year gifts, and renovation gifts that the defendant, who happened to be the section chief of the property and equipment acquisition department had received from his brokers. The outline of facts is as follows.

The acquisition department in question handled every aspect of property and equipment of the logistics company. The defendant had the authority to select which contractors were approved to enter and leave the company premises, to order construction work, as well as to make payment decisions. The defendant had received cash, gift checks, gift certificates, paintings and calligraphic works, and other such valuable goods. These gift offerings occurred repeatedly.

Law §34(1) defines the term "consideration" as "revenue which does not have characteristics of consideration for labor and other such personal services for transfer of assets. Tokyo District Court had determined that this is not limited to performance for specific personal services as the defence counsel claimed, but rather, it is important to keep in mind situations where performances take place in relation to one's authority and duties involved.

Furthermore, when evaluating the kickbacks, mid-year and end-of-year gifts that the defendant received, it may seem like the gift-giving gestures were one time occurrences for each special occasion. However, having taken into account the defendant's position within the company, the defendant's duties, and the amount of influence the defendant had over the contractors, it was determined that these gifts were not presented to the defendant out of social etiquette during traditional occasions, and contractors had made these offerings repeatedly in order to gain great benefits from the defendant. Thus, the court came to the conclusion that the gifts did not fall under occasional income; they fell instead under miscellaneous income.

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<sup>8</sup> Tokyo District Court decision 1970.4.7, Hanreijihou No.600 p.116.

<sup>9</sup> Tokyo High Court decision 1971.12.17, Hanreitaimuzu No.276 p.365.

Concerning this affair, Tokyo High Court has stated that “the definition of consideration for personal service is not a narrow one limited to situations where the value of a performance is equal to the value of specific personal services. It must also be construed in a broader sense where the value of a performance may be closely, or directly, related to the value of an abstract or general personal service.” As such, it has supported the decision made by Tokyo District Court to place the valuables that the defendant received as a result of the defendant's influential position as miscellaneous income for which consideration exists.

It can be concluded that Tokyo District Court made the following statements concerning the term “consideration.” First, consideration exists if the overall causal relation can be observed between a performance and counter-performance based on a person's position and duties involved (this construction will henceforth be referred to as “A-construction”). Tokyo High Court also supports this view. The other, that even if the act of giving a gift is one single action, when these acts are carried out repeatedly and continuously, then the existence of consideration is true (henceforth referred to as “B-construction”).

There exists a case in where the A-construction was applied<sup>10</sup>. The classification of the illegal donation money that the defendant, a secretary for a member of parliament, had received as well as the donation money the MP had received was at the center of debate Tokyo District Court stated that, within the context of Income Tax Law §34(1), it is possible to regard an income with consideration's ability to pay is higher than that of an income with no consideration. Thus “it is necessary to construe that consideration for an income exists when offerings are made as a result of a gift-receiver's position and duties involved.”

Meanwhile, there exists a case in which the same thought process as B-construction was applied in a debate over the classification of income earned by way of forward transaction<sup>11</sup>. Nagoya High Court held that “occasional income must be construed as temporary income, the deciding factor of which is whether the reason of the income in question is continuous and constant in nature. However, when the income is seen as non-recurring, the categorical nature of the income may be subject to change regardless of the fact that the reason may not actually be the direct cause for the income.

#### **4. Income Tax Law §59(2)**

Next, we will investigate a case concerning Income Tax Law §59(2). This is a famous case known as Hamanako Kyouteijou Youchi Incident<sup>12</sup>.

In this case, the plaintiff had received land from John Doe as a gift. In accordance with the specific agreement listed in the gift contract, the plaintiff performed the debt (this is a value that is equal to the

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<sup>10</sup> Tokyo District Court decision 1996.3.29, Zeimusosyoushiryō No.217 p.1258.

<sup>11</sup> Nagoya High Court decision 1968.2.28, Shoumugeppo Vol.14 No.5 p.567.

<sup>12</sup> Supreme Court decision 1988.7.19, Hanreijihou No.1290 p.56.

valuation of land based on the Inheritance Tax Law, and it also exceeds the sum of basis of tax and expenses incurred for the transfer) that John Doe had with a third-party. The question which arose was whether or not the gains that John Doe enjoyed from the forgiveness of debt did in fact fall under "consideration" as described in Income Tax Law §59(2). In other words, one of the points at issue was whether John Doe's onerous gifts to the plaintiff had generated capital gains for the John Doe or not.

Shizuoka District Court held that, because the gains John Doe received from the forgiveness of debt resulted from "the fact that the donee bore the costs of said forgiveness as a specific item agreed upon in the gift contract, it was clear that the transfer of land in question was the direct causation of the financial benefits received. As such, the gains from forgiveness of debt should be construed as income that is subject to taxation under Income Tax Law §33."<sup>13</sup> Shizuoka District Court concluded that, based on the fact that Income Tax Law §33 is a regulation that determined capital gains, if there exists an onerous gift which presents the donor with financial benefits, capital gains taxation must be incurred on the said financial benefit.

John Doe appealed the decision, however, Tokyo High Court supported Shizuoka District Court's decision<sup>14</sup> and made the following statement: "The term 'consideration,' under Income Tax Law §59(2), should be construed in a way that consideration exists if it stems from transfer of assets caused by a performance. Payments from sales, or counter performances in a contract for value under private law, as well as the burdening of onerous gifts that are categorized under gratuitous contract must be defined as consideration under Income Tax Law §59(2) if the aforementioned items result in financial benefits. Moreover, Tokyo High Court stated that the term "consideration" should not always be restricted to literal interpretations, but should instead be interpreted logically.

What makes this case stand out is that it claims that consideration as defined in Income Tax Law exists if there is a causal relationship between a transfer of assets and a performance. It also made it clear that it construes the term "consideration" in a more broad way than Koujien, which defines "consideration" as, "compensation one receives for one's performance."

## **5. Order for Enforcement of the Income Tax Law §63(XII)**

The Order for Enforcement of the Income Tax Law §63(XII) defines business income as income from a "continued business which earns consideration" as described in Income Tax Law §27(1). There exists a case<sup>15</sup> in which this definition was contested. This case's main argument was whether it was acceptable for the Government of Japan to estimate the income of the plaintiff by including the gifts the plaintiff, a Shinto-preacher who practices fortune-telling, received as part of the plaintiff's business income.

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<sup>13</sup> Shizuoka District Court decision 1985.3.14, Gyoshu Vol.36 No.3 p.307.

<sup>14</sup> Tokyo High Court decision 1987.9.9, Gyoshu Vol.38 No.8=9 p.987.

<sup>15</sup> Tokyo District Court decision 1952.8.2, Gyoshu Vol.3 No.8 p.1669.

The plaintiff had approximately 50 to 60 followers and had set up an altar for donations. If the plaintiff was receiving gifts and donations to a point where the plaintiff was never short in daily staples such as rice and miso paste, and such donations were occurring continuously that living expenses were considerably reduced, then these donations were no longer in the realm of mere gifts. Therefore, Tokyo District Court defined the gifts and other donations the plaintiff received as a business income.

Generally speaking, offerings and donations made during religious events are made out of good faith. As such, consideration does not exist for these performances in which counter-performances are not expected. For this reason, one could argue that these offerings should not be categorized as business income. However, Tokyo District Court is thought to have made its decision on the existence of consideration from an objective point of view. Subjective views of whether or not a specific revenue is consideration, or if the income earner interprets the revenue as consideration were not taken into account.

## 6. Conclusions

This paper made a general overview of how the courts of our nation construes the term “consideration” in the context of Income Tax Law.

It is now clear that the courts use a broader interpretation of the term “consideration” than a counter-performance for one’s own performance. Specifically, these following points were made clear:

1. Even if there is no individual causal relationship between performance and counter-performance, the existence of consideration in the context of Income Tax Law can be acknowledged if there is an overall causal relationship based on the person’s post and duties involved.
2. Even if the act of gift giving is a single act, it can be said that the existence of consideration is true if said act is repeated and continuous.
3. Consideration exists for performances that have a causal relationship with counter-performances.
4. Objective views were used to determine the existence of consideration. Subjective views of whether a person acted in order to earn consideration is irrelevant.

Generally, when a consideration is determined to exist and revenue is categorized as miscellaneous income or business income as a result, the amount of tax that residents pay increases because one is unable to apply the regulations which allow one to make a special deduction of ¥500,000 (Income Tax Law § 34(2)•(3)) or to only add in half of one’s income as total taxable income (Income Tax Law § 22(2)(II)) at the time of calculating his or her occasional income. This means that as the interpretation of consideration broadens, the less favorable it is for the resident.

The cases studied in this paper showed adequate legal basis for their decision on the existence of consideration. The expansion of the meaning of consideration should not be allowed without proper legal basis. It is imperative that the courts' interpretations of consideration in the context of Income Tax Law continue to be under close observation.