

STANLEY SURREY, THE SHOUP MISSION, AND TAX ADMINISTRATION IN JAPAN

W. ELLIOT BROWNLEE* & EISAKU IDE**

I

GOALS OF THE SHOUP MISSION

In his memoirs, Stanley Surrey describes the “Shoup Report” as “the climax of a really amazing U.S. tax mission, probably the most important made by United States tax experts.”¹ He wrote that “[i]t shaped to a major extent the post-war Japanese tax structure and contributed directly to the development of the high-level technical skills in taxation now possessed by the Japanese.”² Many, and probably most, students of international tax missions would agree with Surrey on the impact of Shoup’s mission. But evaluations of the influence of the complex recommendations on taxation in Japan have always varied widely and often shifted over time. In fact, at various points Shoup himself doubted that the recommendations had a major impact on the Japanese tax system, and we believe our research and that of our collaborators in *The Political Economy of Transnational Tax Reform: The Shoup Mission to Japan in Historical Context* have generally reinforced the doubts that Shoup expressed.³

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* W. Elliot Brownlee is Professor Emeritus of History at the University of California, Santa Barbara.

** Eisaku Ide is Professor of Economics at Keio University, Japan.

1. STANLEY S. SURREY, A HALF-CENTURY WITH THE INTERNAL REVENUE CODE: THE MEMOIRS OF STANLEY S. SURREY 144 (Lawrence Zelenak and Ajay K. Mehrotra eds., 2022).

2. *Id.* See generally SUPREME COMMANDER FOR THE ALLIED POWERS, REPORT ON JAPANESE TAXATION BY THE SHOUP MISSION (1949) (detailing the findings and proposals advanced by the “Shoup Report”).

3. On the shifting evaluations of the Shoup Mission, see W. Elliot Brownlee et al., *Introduction to Part Two*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 136, 139–41 (W. Elliot Brownlee et al. eds., 2013); Ryo Muramatsu & W. Elliot Brownlee, *Tax Reform During the American Occupation of Japan: Who Killed Shoup?*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 242, 242–76 (W. Elliot Brownlee et al. eds., 2013); W. Elliot Brownlee et al., *Introduction to Part Three*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 277, 277–396 (W. Elliot Brownlee et al. eds., 2013) [hereinafter Brownlee et al., *Introduction to Part Three*]; W. Elliot Brownlee & Eisaku Ide, *Shoup and International Tax Reform After the Japan Mission*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 426, 426–55 (W. Elliot Brownlee et al. eds., 2013) [hereinafter Brownlee & Ide, *Shoup and International Tax Reform*]. For an analysis of the aspects of the Shoup program that have survived, see 1 SHOWA ZEISEI NO KAIKO TO

The central goals of the Shoup Mission, however, have continued to influence debates over taxation in Japan. These goals included an income tax at the center of the tax system, a balance between vertical and horizontal tax equity, a search for neutrality and simplicity of the tax system through the elimination of special measures, the enhancement of local tax revenues, and improvements in tax administration, accompanied by the advancement of professional expertise within the Japanese tax policy community and the Japanese government.⁴

It was his articulation of this last goal that gave Surrey the greatest sense of satisfaction and pride as he reflected on the work Shoup Mission. “I wrote the draft of Volume IV, the Appendix dealing with the Administration of the Individual and Corporate Income Taxes,” Surrey noted in his memoirs.⁵ Volume IV was the section of the report that detailed most carefully the recommendations of the Shoup Mission for strengthening “the technical skills in taxation . . . possessed by the Japanese.”⁶ The five members of the Shoup Mission all contributed significantly to the group’s research, deliberations, analysis, and recommendations, but Surrey and William Warren, a professor from Columbia Law School and Shoup’s closest friend on the mission, were, along with Shoup, the members most intently interested in improving tax administration and promoting the fields of tax law and accounting in Japan.⁷

Carl Shoup and his colleagues were by no means seeking to transform in any dramatic way the tax policy community in Japan. As historians Laura Hein and Mark Metzler have emphasized, the leading American and Japanese experts in public finance and taxation worked within a common intellectual context, which Hein and Metzler describe as “a shared culture and ethos of expertise.”⁸ The Japanese experts “spoke the same professional language as their American counterparts.”⁹ They had “read the same books and learned from the same

TENBO, JYO-KAN [1 RETROSPECT AND PROSPECT OF THE SHOWA TAX SYSTEM] 466 (Keiichiro Hirata et al. eds., 1979).

4. For an excellent summary of these debates, see 1 HIROSHI KANEKO, SOZEI-HO RIRON NO KEISEI TO KAIMEI, JO, [FORMATION AND CLARIFICATION OF TAX LAW THEORY] 229–32 (2010).

5. See SURREY, *supra* note 1, at 149.

6. *Id.* at 144.

7. At the core of the mission were three Columbia University professors: Shoup, Warren, and the Keynesian economist William Vickrey, who would go on to win a Nobel Prize. The three agreed on adding two more colleagues. Shoup and Surrey had become acquainted during their years of Treasury service but, as Surrey suggests in his memoirs, Warren, who had collaborated with Surrey on casebooks, was crucial in nominating Surrey for the mission. The Columbia professors also invited Howard R. Bowen, an institutional economist at the University of Illinois who was an expert on intergovernmental fiscal relations. This team, as we have written elsewhere, “reflected the formidable capabilities of the professional tax expertise that had emerged from the American experience of institution building during the progressive era, the New Deal, and two world wars.” W. Elliot Brownlee & Eisaku Ide, *Shoup and the Japan Mission*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 195, 201–06 (W. Elliot Brownlee et al. eds., 2013).

8. Laura Hein & Mark Metzler, *Raising Taxes for Democracy: The Japanese Policy Environment of the Shoup Mission*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 167, 182–83 (W. Elliot Brownlee et al. eds., 2013).

9. *Id.* at 182.

events, particularly the economic problems of interwar Europe.”¹⁰ The Japanese experts were well informed regarding contemporary tax policy and its history throughout the industrial world. Shoup respected the Japanese tax experts and tried to include three of them in the membership of the mission. In proposing this, Shoup had the support of Harold Moss, the head of the Internal Revenue Division (IRD) within the Supreme Command Allied Powers (SCAP).¹¹ But General MacArthur’s intelligence staff (G-2) was able to block the formal appointment of the Japanese experts on the grounds that they were security risks.¹² Nonetheless, Shoup consulted intensely with these three and with tax experts in Japan’s Ministry of Finance (MOF). Harold Moss also conferred regularly with Japanese experts, as did the American economist Martin Bronfrenbrenner, who joined SCAP to help expedite tax reform between the visit of the Shoup Mission to Japan in 1949 and the return of Shoup and some of his colleagues in 1950.¹³

But Surrey and the other members of the mission did have a passionate interest in shifting the attention of the community of Japanese tax experts to putting greater emphasis on the goal of horizontal equity. Shoup defined horizontal equity as “equal treatment of those equally circumstanced” two decades later.¹⁴ Doing so would, Shoup and his colleagues believed, increase public trust in the fairness of the tax system, taxpayer compliance, and, in turn, fiscal capacity. Japanese tax experts largely shared those goals, but they worked to help the American experts understand the constraints of local conditions— institutional, political, and economic.¹⁵

10. *Id.* at 183.

11. The three Japanese experts were Saburo Shiomi of Kyoto University and Hanya Ito and Shigeto Tsuru, both based at Tokyo Shoka University. *See* Brownlee & Ide, *supra* note 7, at 209–16.

12. The long-term chief of G-2 in the 8th Army was Major General Charles A. Willoughby, who had turned G-2 into what historian Takemae Eiji has called “the most powerful agency inside MacArthur’s headquarters.” EIJI TAKEMAE, *INSIDE GHQ: THE ALLIED OCCUPATION OF JAPAN AND ITS LEGACY* 164 (2002). Theodore Cohen, a labor specialist within the Economic and Scientific Section (ESS) of SCAP, explained Willoughby’s strategy and tactics: “In a country where Marxist terminology was the common coin of intellectual exchange . . . Willoughby was out of his depth” and believed “Democratic socialists were not allies in the fight against the communists but subverters of the established order.” THEODORE COHEN & HERBERT PASSIN, *REMAKING JAPAN: THE AMERICAN OCCUPATION AS NEW DEAL* 92 (1987). *See also* Brownlee & Ide, *supra* note 7, at 216.

13. On Bronfrenbrenner, *see* Brownlee & Ide, *supra* note 7, at 209–12; W. Elliot Brownlee & Eisaku Ide, *Shoup in the “Social Laboratory”*, in *THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT* 228, 236–39 (W. Elliot Brownlee et al. eds., 2013) [hereinafter Brownlee & Ide, *Shoup in the “Social Laboratory”*]; Brownlee et al., *Introduction to Part Three, supra* note 3, at 287 n.7; Brownlee & Ide, *Shoup and International Tax Reform, supra* note 3, at 429–31.

14. CARL S. SHOUP, *PUBLIC FINANCE* 23 (1969).

15. The discussion between American and Japanese tax experts over the structure of progressive income taxation was one of the most amicable and productive of the many such deliberations that took place during and after the Shoup Mission. Examples of discussions that were more tense and less productive involved reform of the taxation of interest income and capital gains on security transactions. But even in these discussions Shoup and his colleagues in the IRD found that had much in common intellectually with experts in the Tax Bureau. The source of the greater tension and lower productivity

II

THE POSTWAR CONTEXT

Shoup targeted the mission's base-broadening reforms on the progressive income tax that the wartime government had introduced in 1940 and turned it into a tax that relied heavily on a withholding system. By the end of the war, lowering the tax threshold for taxes on earned income without improving assessment procedures on other income had tripled the number of taxpayers who paid taxes on earned income. The severe inflation immediately after the war made the income tax even more of a mass tax by turning many lower-income people into payers of income taxes for the first time. And the inflation further increased the progressivity of the income tax by pushing taxpayers into higher tax brackets. In 1947, two years before the arrival of Shoup, SCAP worked with the Japanese government to try to shift to a self-assessment system modeled in principle on that of the United States income tax. SCAP and the Japanese government ratcheted up pressures to collect taxes but neither sought to develop or enforce self-assessment procedures. In fiscal year 1949, taxpayers who earned salaries and wages, and thus continued to pay their taxes through withholding, accounted for most income tax revenue.¹⁶ Inflation, economic privation, and administrative incapacity continued to plague the administration of the income tax. Inflation pushed suffering taxpayers into even higher tax brackets, fueling evasion of income taxes, arbitrary and selective enforcement, and corruption. In 1951, Martin Bronfenbrenner wrote that in this period "arbitrary mass assessments were carried out periodically . . . as each local tax office strove to meet or exceed its quota of collections."¹⁷ As a result,

Honest and dishonest suffered alike, and taxes were collected in the presence of armed Occupation troops, almost literally at gunpoint The tax collector had replaced the policeman as the nation's bogey; 'bad taxes' were a main economic talking point of the Japanese Communist Party. Capital accumulation, either individual or corporate, required tax evasion almost as a *sine qua non*.¹⁸

of those discussions was the Japanese government's resistance to the Shoup's proposals and a finance mission to Japan led by banker Joseph Dodge and the National Advisory Council, which the Federal Reserve Board and Treasury dominated. See Muramatsu & Brownlee, *supra* note 3, at 242–76; Eisaku Ide, *A Political Dispute Over the Local Public Finance Equalization Grant: The Legacy of Shoup's Policy Choices*, in THE POLITICAL ECONOMY OF TRANSNATIONAL REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 336, 336–64 (W. Elliot Brownlee et al. eds., 2013).

16. The best survey of income taxation in Japan between the Meiji Restoration and the arrival of the Shoup Mission is Tatatsugu Akaishi, *The Shoup Recommendations and Japan's Tax-Cutting Culture*, in THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT 306, 309–319 (W. Elliot Brownlee et al. eds., 2013).

17. Martin Bronfenbrenner, *Book Review*, 41 AM. ECON. REV. 983, 983 (1951) (reviewing CARL S. SHOUP, REPORT ON JAPANESE TAXATION BY THE SHOUP MISSION (1949) and CARL S. SHOUP, SECOND REPORT ON JAPANESE TAXATION BY THE SHOUP MISSION (1950)).

18. *Id.*

III

SURREY'S RESPONSE

In 1949, Shoup and his colleagues addressed this situation in various ways. They proposed reductions in the marginal rates of taxation on personal income. They suggested, for example, a cut of the top rate from eighty-five percent to fifty-five percent. In summary, retaining some degree of progressiveness while increasing horizontal equity was the same general approach that Shoup, Surrey, Warren, and Vickrey adopted when seeking reform of income taxation in the United States before the Mission. In shaping reform of income taxation on behalf of the goal of horizontal equity, Surrey focused primarily on tax administration.¹⁹

In writing Volume IV of the Shoup Report, Surrey began by surveying briefly the postwar development of the Japanese income tax. He wrote that after the war, the individual income tax “suddenly affected the great mass of citizens instead of being applicable only to a wealthy minority.”²⁰ He had in mind, in particular, “the small independent farmer” whom “land reform” had made “a taxpayer as well as farmer,” the “small wage-earner,” and the “small businessman.”²¹ Determination of incomes was a problem for them, and almost all taxpayers, because “accurate accounting and bookkeeping” were rare.²² There was, Surrey wrote, “both an absence of books and records in some quarters and a deplorable multiplicity of books and records in other quarters.”²³

Surrey called out these accounting problems because he believed the ideal income tax was “a personalized tax”—one where “proper measure is thus not an arbitrary amount assigned to a taxpayer, nor an average of the income of many taxpayers of a particular class, but the actual income of the particular taxpayer.”²⁴ In such a system, “the objective to be kept uppermost is a fair ascertainment of the income of the particular taxpayer” and its success “rests essentially on

19. Also, the mission recommended two new national taxes: (1) a net worth tax to offset partially the regressive effects of the rate cuts, and (2) an accessions tax, which would replace all estate and gift taxes with a tax on the total of gifts or bequests received over a beneficiary's lifetime. The Shoup Mission was less interested in the corporate income tax, but the mission did propose a variety of changes designed to improve compliance, and in the process horizontal equity. The most important was a revaluation of assets to take account of wartime and postwar inflation. The intent was to allow corporations to build up depreciation reserves and avoid paying huge capital gains taxes. In addition, the mission recommended reducing the normal rate of corporate income taxation to thirty-five percent, taking some modest steps toward integrating personal and corporate income taxation (including reduction of the taxation of dividends under the personal income tax), and adopting a modest undistributed profits tax to encourage payment of dividends. In addition, the mission proposed to repeal excess-profits taxation and an unpopular transactions tax that the Japanese government had recently adopted. *See generally* 1 CARL S. SHOUP, REPORT ON JAPANESE TAXATION BY THE SHOUP MISSION 51–55, 83, 105–12; 2 CARL S. SHOUP, REPORT ON JAPANESE TAXATION BY THE SHOUP MISSION 123–31, 165–67, 224 (1949).

20. 4 CARL S. SHOUP, REPORT ON JAPANESE TAXATION BY THE SHOUP MISSION 1–2 (1949).

21. *Id.* at 2. In contrast with these taxpayers, recipients of income from labor, dividends, and interest were subject to a withholding tax system.

22. *Id.*

23. *Id.*

24. *Id.* at 4.

voluntary compliance by the taxpayer.”²⁵ For success, “a majority” of taxpayers must contribute to the effective administration of the tax but “the Government,” Surrey warned, “must assure . . . [the] majority that the laws will be rigorously enforced against those taxpayers who fail in their trust and who report falsely or improperly.”²⁶ He recognized that withholding would play a role in collecting income taxes from employees but pointed out that they, as well as their employers, would bear significant responsibility for effective tax administration.²⁷

Contributing to the failures in administering income taxation were, according to Surrey, weaknesses in the professional services within both the private and public sectors. On the private side, Surrey wrote, “the two professional groups that play an important role in tax administration, accountants and lawyers, were not prepared for the task. The accountants had not achieved the independent status and traditions that their profession demands; the lawyers were wholly unversed in tax matters.”²⁸ On the public side, “the entire tax service was in a disorganized and inefficient condition, partly as a result of the war.”²⁹ Surrey explained that “[t]ax officials were young, inexperienced, underpaid. They were inefficiently assigned and supervised. Local tax offices were located in inadequate, under-maintained, ill-lighted buildings. Office equipment, never approaching modernity in the past, was largely non-existent. Office routine was fearfully inadequate.”³⁰

The Central Tax Office assessed income taxes but did not examine the records of individual taxpayers. Instead, the office conducted a sample survey by industry and estimated income by applying the “standard income rate,” which considered a certain percentage of gross income as taxable income. Henry Shavell, one of the first tax advisers within the Finance Division of SCAP, was dissatisfied with such tax administration, and following his and SCAP’s recommendations, the Japanese government introduced a “declared,” or, in other words, a self-assessed income tax system in 1947.³¹

As some observers predicted, many small and medium-sized enterprises operating without proper bookkeeping underreported their income, resulting in a serious decline in tax revenues for the 1947 fiscal year.³² In response, the desperate Fiscal Section of the MOF set tax collection goals for each tax office.

25. *Id.*

26. *Id.* at 5.

27. *Id.* at 3–5.

28. *Id.* at 2.

29. *Id.*

30. *Id.*

31. See generally 8 SHOWA ZAISEI-SHI: SHUSEN KARA KOWA MADE [8 FISCAL HISTORY OF THE SHOWA PERIOD: FROM THE END OF WWII TO PACIFICATION] 318–19 (Okura-sho Zaisei-shi-shitsu ed., 1977); 7 SHOWA ZAISEI-SHI: SHUSEN KARA KOWA MADE [7 FISCAL HISTORY OF THE SHOWA PERIOD: FROM THE END OF WWII TO PACIFICATION] 187–204 (Okura-sho Zaisei-shi-shitsu ed., 1977).

32. The results of the declared tax collection were about forty percent of the expected budget. See Sumio Hara, *Shoup Report wo meguru Keii [Background on the Shoup Report]*, Zaimu Sogo Seisaku Kenkyu-sho, 3 (1955).

Under this goal system, regional tax administrators, supported by units of the Eighth United States Army roaming around in jeeps, collected taxes and pressured recalcitrant local tax officials to quit when problems arose. Thus, Japan's post-war tax return system began with the "worst possible start."³³ By the time the Shoup Mission arrived in Japan during the summer of 1949, the Japanese tax administration had fallen into a vicious cycle in which taxpayers underreported their income and the tax office responded with numerous reassessments based on estimates. These, in turn, provoked objections from taxpayers, resulting in both sweeping reassessments and further underreporting during the following year.³⁴

Surrey concluded that

Under these conditions it is an achievement that revenues of large magnitudes have been collected. But . . . such collection has been due to two factors—Military Government pressure and Tax Office mass reassessment designed to achieve predetermined revenue goals. The income taxes have been collected—but an objective measure of individual income, the cornerstone of a proper income tax has necessarily been sacrificed.³⁵

IV

THE BLUE RETURN

To break the vicious cycle, Surrey called for the abolition of the goal system as "a first step toward objective tax burden determination" and its replacement with what became known as the blue return system.³⁶ At its core, this system created a reward to taxpayers who "keep accurate books and records."³⁷ Under this incentive system, if a taxpayer used a form approved by the tax authorities and designated by its blue color, the taxpayer would "not be subject to reassessment until after an actual field investigation is made of his income for the

33. 8 SHOWA ZAISEI-SHI, *supra* note 31, at 392. Henry Shavell, however, regarded the cooperation of the military administration as valuable. "The major benefit derived from military government surveillance of tax administration was the added prestige given tax administration. The mere presence, periodically, of Allied officers in Japanese tax offices was often sufficient to bring about an extraordinary expansion in tax collections in the area." Henry Shavell, *Taxation Reform in Occupied Japan*, 1 NAT'L TAX J. 127, 142 (1948). Shavell subsequently criticized Shoup's recommendations for reforming tax assessment and collection but Shichiro Yasukawa, who served as Commissioner of the National Tax Agency later, pointed out that Shavell had come to Japan very early in the occupation, resented Shoup's influence, and was egocentric, sticking stubbornly to his own ideas. Saichi Chu also has criticized Shavell's argument and asserted that the idea of organizing taxation on a foundation of accounting is what Shoup left behind for Japan. See generally SHOWA ZAISEI NO KAIKO TO TENBO, JYO-KAN, *supra* note 3, at 402. In April 1948 General Douglas MacArthur demoted Shavell by appointing Harold Moss as Director of the Internal Revenue Division of SCAP. Moss proceeded to organize the Shoup Mission. On Shavell, see W. Elliot Brownlee, *Shoup vs. Dodge: Conflict over Tax Reform in Japan, 1947–1951*, 47 KEIO ECON. STUD. 91, 94–96 (2011).

34. SHOWA ZAISEI NO KAIKO TO TENBO, GE-KAN [2 RETROSPECT AND PROSPECT OF THE SHOWA TAX SYSTEM] 215 (Keiichiro Hirata et al. eds., 1979).

35. 4 SHOUP, *supra* note 20, at 2–3.

36. *Id.* at 6.

37. *Id.* at 56.

year.”³⁸ If a taxpayer did not use the form, he would “not be guaranteed an investigation before reassessment but would be subject to reassessment by the use of standards.”³⁹ In addition, such a taxpayer “would not be permitted to take an appeal to the Regional Bureau.”⁴⁰ Surrey suggested that “other inducements” might be adopted as well.⁴¹ These included higher tax rates, for example, and denial of “depreciation deductions and loss carry overs.”⁴² Surrey especially had in mind unincorporated nonfarm business filers. He concluded this discussion by declaring, “[t]he problem is so large in magnitude and its solution so important to proper tax administration that every effort must be brought to bear on achieving the required degree of record keeping.”⁴³

In developing and articulating his proposal of the blue return system, Surrey collaborated closely with Japanese tax officials and experts. So much so, in fact, that it is difficult in retrospect to allocate responsibility for the authorship of the proposal. On July 11, 1949, before Surrey drafted Volume IV of the Shoup Report, Surrey met with the Finance Minister, Hayato Ikeda, the Director of the Tax Bureau, Keiichiro Hirata, and other officials, including Saichi Chu, to discuss the reform of the broken goal system of tax assessment. According to Hirata, Surrey argued for making bookkeeping mandatory, but Hirata believed that was impractical. The Japanese officials proposed instead the adoption of a strategy of spreading the system gradually by offering incentives, and they succeeded in persuading Surrey to back off of his more aggressive posture regarding tax assessment.⁴⁴

In drafting Volume IV, Surrey proposed that the reassessments would be made only after a proper examination of the books, thus creating a reward for conscientious taxpayers. By July 27th, when Surrey returned to the United States, he had completed his draft of Volume IV of the Shoup Report, which contained proposals that were essentially identical to the Japanese ideas for reform of the goal system. While Surrey may have had reservations initially about recommending the blue return system in Japan, he was well prepared to work with the MOF regarding rationalizing administrative procedures by virtue of his ten years of experience at the United States Treasury between 1937 and 1947. This experience included collaboration with Roger J. Traynor on the creation of significant incentives for taxpayers to reveal information regarding their true incomes early in the assessment process.⁴⁵

38. *Id.* at 58.

39. *Id.*

40. *Id.*

41. *Id.* at 59.

42. *Id.*

43. *Id.*

44. SHOWA ZEISEI NO KAIKO TO TENBO, JYO-KAN, *supra* note 3, at 430–31.

45. Lawrence A. Zelenak & Ajay K. Mehrotra, *Editors' Introduction*, in A HALF-CENTURY WITH THE INTERNAL REVENUE CODE, *supra* note 1, at xxi–xii. On Surrey's collaborative research with Traynor, see SURREY, *supra* note 1, at 24–33 and 44–46. For discussion of the crafting of the “Traynor

Sumio Hara, who was chief of the Tax Systems Department of the MOF's Tax Bureau, worked with the Shoup Mission, and was later involved in the creation of the blue tax return system, commented on the results of the Japanese collaboration with Surrey:

We came up with the blue tax return because we still had to systematically prepare the correct books of accounts in order to have the tax return based on honest and correct income. This is the most central line of the Shoup Mission, and I think it is the thickest line, so to speak, with philosophy in it, rather than tax technology.⁴⁶

In May 1950, Hara visited Shoup in the United States, learned more about the current state of the income tax assessment system there, and prepared specific recommendations.⁴⁷ Adoption of most of Hara's recommendations by the Japanese government followed in 1950, establishing the blue return system.⁴⁸

In 1977, *The Fiscal History of the Showa Period*, the official history of the MOF, declared:

The fiscal year 1950 was a remarkable year in which the tax administration, which had fallen into unprecedented turmoil after the war, finally began its path toward normalization through economic stability and the realization of tax reductions. The path was not a return to the old administrative methods, but rather a new administration in which American systems and ideas were transplanted onto a traditional administrative foundation, transformed, digested, and developed in a Japanese way.⁴⁹

Since then, the blue tax return system has gradually expanded, and in recent years, ninety-eight percent of active corporations and fifty percent of sole proprietors use this system."⁵⁰

V

INTERNAL ADMINISTRATION

In his contributions to the Shoup Report, Surrey also sought to enhance what he called the internal administration. In discussing this goal, he began by praising the Tax Administration Agency (TAA) which the Japanese Government,

Plan" (perhaps, most aptly, the "Surrey-Traynor Plan"), see Keigo Fuchi, *Stanley Surrey and the Transformation of Administrative Law in Japan*, 15 U. PA. ASIAN L. REV. 172, 195–203 (2020). Fuchi notes that both the Traynor Plan and Surrey's final recommendations in the Shoup Report "advocated the policy of giving taxpayer a sufficient incentive to disclose information at the earliest stage possible." *Id.* at 202.

46. Hara, *supra* note 32, at 24. On Hara's assistance to the Shoup Mission, see Brownlee & Ide, *Shoup in the "Social Laboratory"*, *supra* note 13, at 228–29.

47. Hara, *supra* note 32, at 51–52.

48. The provisions of the "blue return" system in 1950 differed from the recommendations of Surrey by applying the system to corporations as well as unincorporated businesses and individuals. For other differences between the Surrey recommendations and the 1950 law that may have weakened the recommendations, see Fuchi, *supra* note 45, at 193–94. Later in this essay Fuchi concludes that the weaknesses, which included the lack of "sufficient power" by "tax officials . . . to collect information from taxpayers" have made it impossible "to produce [the] information that Surrey originally hoped for." *Id.* at 217–20. It is worth noting that Fuchi's invocation of Surrey recommendations provides an example of the continuing influence of the recommendations on evaluations of tax administration in Japan.

49. 8 SHOWA ZAISEI-SHI, *supra* note 31, at 448.

50. Masahiko Hino, *Aoiro-Shinkoku Seido No Igi To Kongo No Arikata [Blue Return System's Significance And Its Future]*, 60 ZEIMU DAIGAKKO RONSO 321, 328 (2009).

prompted by Harold Moss, had recently established within the MOF. The TAA supervised the Regional Bureaus which, in turn, supervised the local Tax Offices. Surrey pointed out the obvious: the success of this new system depended on recruiting and training “officials of ability and integrity.”⁵¹ He regarded training institutes for personnel at both the “higher and lower levels” as vital and he called for promotion “based on merit alone,” salary and benefits “sufficiently high to attract and retain competent personnel,” adequate funding of a newly trained group within the TAA to “check on the honesty of tax officials and ferret out corruption,” significant expansion of tax personnel, elaborate internal documentation of administrative procedures and structures, and creation by the TAA of “a qualified group of officials” who would respond to “questions of interpretation of the substantive provisions of the tax laws.”⁵² Surrey referred to the responses as “interpretations” and “rulings” and urged that the TAA codify and index them.⁵³

Surrey turned next to the need for establishing “a competent and independent accounting profession.”⁵⁴ He began by declaring “the almost complete absence of that profession” in Japan.⁵⁵ His explicit model for a member of such a profession was “the independent certified public accountant, skilled in the techniques of public accounting, in the sense of the American or the British standards.”⁵⁶

Surrey might not have been entirely aware of previous efforts to reform accounting systems in Japan. In prewar Japan, the Ministry of Commerce and Industry initiated an effort to modernize the nation’s accounting systems, and this work culminated in the adoption by the government of the “Financial Statement Rules” in 1934. These rules became the subject of further debate, particularly after the dramatic expansion of income taxation in 1940, but because of wartime disruptions the government did not fully implement them. During the early phase of the American occupation, a strong proponent of modernization of accounting procedures was W.G. Hessler, a CPA and the chief of the Antitrust and Cartels Division within the Economic and Scientific Section (ESS) of SCAP. In this role, Hessler investigated the breakup of conglomerates and the monitoring of the financial condition of major companies. He found it problematic that the financial statements the Japanese government required varied from company to company. He revised the “Financial Statement Rules” and in July of 1947 published *Instructions for the Preparation of Financial Statements of Manufacturing and Trading Companies*.

51. 4 SHOUP, *supra* note 20, at 44.

52. *Id.* at 45–47.

53. *Id.* at 47–48.

54. *Id.* at 50.

55. *Id.*

56. *Id.*

However, the American-style guidelines were not applicable to the current situation in Japan, and the ESS set up a committee to undertake additional revisions. In June 1948, this committee, along with the Statistics Committee of the ESS, which had been established to develop democratic statistical methods, created the Committee for the Improvement of Accounting Standards (CIAS), a quasi-independent advisory group.⁵⁷ The CIAS circulated what it called the “Corporate Accounting Principles” and hoped that the principles might become the basis of legislation. However, the Internal Revenue Division of the ESS and the Tax Bureau of the MOF strongly resisted, fearing that the revised corporate accounting system would be a great burden to Japanese companies that lacked the skills to keep books. The proposal for a Standards Law bill was abandoned, and, on July 9, 1949, the CIAS simply published the Corporate Accounting Principles.⁵⁸

In the preamble, entitled “Establishment of Corporate Accounting Principles,” the CIAS clearly stated its belief that all companies and certified public accountants should follow the principles the CIAS proposed.⁵⁹ Surrey was aware of this document because in April of 1949, before the Shoup Mission began its formal work, Shoup had sent ahead a research assistant, Jerome B. Cohen, an economist who was fluent in Japanese and was a consultant in the Division for the Far East in the U.S. Department of State. Cohen established a liaison with public finance specialists in Japan and assembled research materials. In this process, Cohen set the stage for Surrey’s discussions with members of the CIAS on the issue of reforming the corporate accounting.⁶⁰ For their part, members of the CIAS were eager to borrow the authority of the Shoup Mission to authorize the adoption of mandatory double-entry bookkeeping and a requirement for the employment of Certified Public Accountants (CPAs).⁶¹ The cooperation between the CIAS and Surrey produced the emphasis of Shoup’s report on the need for accurate bookkeeping by corporations, stating that “[s]teps in this direction have been taken in various places and the Committee for the Improvement of Accounting Standards can be helpful here.”⁶² Also, Surrey

57. See Hideki Kubota, “*Kigyo Kaikei Gensoku*” to *Jyoyokinn Keisann-sho* [“*Corporate Accounting Principles*” and *Surplus Statement*”], 59 KOUNAN KEIEI KENKYU 1, 23–30 (2018); TOSHIFUMI YAMASHITA, SENGU ZEISEI KAIKAKU TO SHOUP KANKOKU: SHOUP ZEISEI SEKO 70-SHUNEN WO KAERIMITE [POSTWAR TAX REFORM AND THE SHOUP REPORT: REFLECTIONS ON THE 70TH ANNIVERSARY OF THE SHOUP TAX SYSTEM] 90–94 (2020).

58. YAMASHITA, *supra* note 57, at 105–06. SHOWA ZEISEI NO KAIKO TO TENBO, JYO-KAN, *supra* note 3, at 430–31.

59. KOKUZEI-CHO, KIGYO KAIKEI KANKEI KISOKU-SHU [CORPORATE ACCOUNTING RULES AND REGULATIONS] 281 (1967).

60. On the scouting visit to Japan in April 1949 by Jerome Cohen, see Brownlee & Ide, *Shoup in the “Social Laboratory”*, *supra* note 13, at 207–09.

61. SHOWA ZEISEI NO KAIKO TO TENBO, JYO-KAN, *supra* note 3, at 431. See also Kubota, *supra* note 57.

62. 4 SHOUP, *supra* note 20, at 57.

recommended government encouragement of the CIAS and the inclusion of a member of the TAA on that committee.⁶³

A key solution to lack of adequate accounting, Surrey wrote in the report, was the proper interpretation and application of a new law regarding the qualification of CPAs in Japan. He called for the creation of an independent commission under the Finance Ministry's general jurisdiction. This commission should, Surrey said, create and maintain "a written objective examination" that would be required for all CPAs, including those currently allowed to serve in Japan by virtue of their years of experience.⁶⁴ Surrey invoked strong language:

For the future the title of Certified Public Accountant must be scrupulously reserved for those individuals whose accounting ability and integrity can be relied on by the public, tax officials, foreign investors, and other interested groups. For reliance on those bearing the title of Certified Public Accountant is the base upon which must rest the accounting structure necessary to modern tax administration. If that base is inadequate, the structure fails.⁶⁵

Surrey observed that in Japan there were only about 3,200 Tax Practitioners whom the Finance Ministry licensed and supervised. Only a minority of these were lawyers and public accountants. The majority were former tax officials. Most of the Tax Practitioners, Surrey implied, were "skilled negotiators" rather than "tax technicians." Surrey used the term "negotiator" explicitly as a euphemism that would encompass "fixing, bribery, and the like."⁶⁶ Surrey proposed seeking major improvement of "the standards of the Tax Practitioner class" through raising examination requirements and tightening supervision.⁶⁷ At the same time, he wanted to increase their numbers. "Unless the services of these professional groups are available on an adequate scale, the taxpayer will be unable to properly hold his ground against inevitable errors of tax officials."⁶⁸ Surrey insisted that taxpayer representation was "essentially a personalized matter" and declared that "group consideration of tax liabilities and tax controversies should not be permitted by the tax officials or engaged in by taxpayer representatives."⁶⁹

63. *Id.* at 52. Surrey also encouraged the Japanese Securities and Exchange Commission (SEC) to take "a leading role in improving accounting standards," and he urged the Finance Ministry to support the SEC in this activity. *Id.* at 53.

64. *Id.* at 50-51.

65. *Id.* at 52.

66. *Id.* at 62.

67. *Id.* at 63.

68. *Id.*

69. *Id.* at 64. In discussing raising the standards for accountants, and increasing their number, Surrey called out an administrative problem in the taxation of business income—the practice of Japanese tax officials negotiating with trade associations regarding the assessment and collection of taxes. "At present," Surrey wrote, "trade associations often enter into a system of 'collective bargaining' with the Tax Offices by which an overall tax figure is arrived at for the business activity represented by the association." In some associations, Surrey found, a single boss or a small group handled the negotiation. In some other associations, members of the association would break away and engage in separate negotiation with Tax Offices, especially when they had "relatives, acquaintances, or other contacts in the Tax Offices." The result too often, Surrey wrote was "racketeering, boss-domination, favoritism and

To improve the quality of tax accounting, Surrey called on “[u]niversities and other institutions giving accounting courses” to raise their standards and make “every effort . . . to keep abreast of modern practices, from both a theoretical and a practical standpoint.”⁷⁰ He suggested that “it would be advisable for several professors of accounting and practicing accountants from countries with more highly developed accounting practices to visit Japan” to provide advice to schools, the CIAS, the Securities Exchange Commission (SEC) and “other interested groups.”⁷¹ Apparently without any self-consciousness of his demeaning tone, he added: “[i]t would also be highly desirable for a group of Japanese accountants, recognized as outstanding in their field, to visit other countries to become acquainted thereby with the techniques and practices of modern public accounting.”⁷²

Surrey went on to emphasize that major educational and procedural efforts would be necessary to raise the standards of accounting employed by farmers and small businesses. He called on chambers of commerce, trade associations, and farmer’s cooperatives to assist. He suggested that schools and adult education programs should feature bookkeeping courses. And these organizations, along with the CIAS, universities, and the Finance Ministry, should provide farmers and small businesses with simple and straightforward bookkeeping forms.⁷³

Surrey’s recommendations involved expanding professional analysis and discussion of “technical tax matters as distinguished from the economic and fiscal aspects of taxation.”⁷⁴ He called on “professional and technical journals of various kinds” to “make room for qualified articles on technical tax matters” and he suggested publication of “adequate textbooks on the substantive provisions of the tax laws and on the legal and accounting aspects of taxation.”⁷⁵ He suggested that “Bar Associations, Accounting Organizations, University organizations and the like” should conduct forums for professional audiences.⁷⁶ And he called on “the Law Departments of the Universities” to “institute courses in Tax Law as a distinct subject in itself.”⁷⁷ He explained that “[a]ttention should be directed

diversion of funds.” Surrey recommended legislation both to prevent trade associations from engaging directly in tax administration and to augment the administrative capacity of the Tax Offices. “Budgetary arguments can never be convincing arguments for the surrender” of tax administration “to private groups,” Surrey declared. *See generally id.* at 60–64.

70. *Id.* at 54–55.

71. *Id.* at 55.

72. *Id.* Surrey’s push for the expansion of the modern accounting profession may well have been effective. Membership in the Japanese Institute of Certified Public Accountants soared from 241 in 1950 to 1,244 in 1960 and reached 32,744 in 2020. For data, see *Changes in the Number of Members and Associate Members*, THE JAPANESE INST. OF CERTIFIED PUB. ACCTS. (2022), <https://jicpa.or.jp/about/0-0-0-20220808.pdf> [<https://perma.cc/L49Y-VGTC>].

73. 4 SHOUP, *supra* note 20, at 57.

74. *Id.* at 66.

75. *Id.*

76. *Id.*

77. *Id.* at 67.

toward the substantive and technical provisions of the tax laws and to the specialized aspects of tax administration.”⁷⁸ Finally, perhaps also with law schools in mind, he recommended that “[e]very effort should be made to obtain as much foreign literature and information as is possible relating to the substantive and administrative aspects of taxation.”⁷⁹

VI

RESPONSES OF THE JAPANESE TAX COMMUNITY

Japanese tax professionals responded enthusiastically to the call by Surrey and Shoup to create new venues for debating technical tax issues and disseminating research on those issues. The most important step was the establishment of the Japan Tax Association (JTA). The impetus for the founding of the JTA came from the “Hakone Conference,” which was held on August 12, 1949, in Hakone, Kanagawa Prefecture, at the urging of Shoup.⁸⁰ Unfortunately, Surrey left Japan immediately after finishing his section of Shoup’s report and was unable to attend the conference. The JTA was founded a few months later, in November, to conduct theoretical and empirical research on the tax system and to build a democratic tax system that would be genuinely acceptable to the public—a central goal of both the Shoup Mission and the Japanese tax experts who worked with the mission.

In his memoirs, Surrey claimed credit for the mission having recommended “the formation of the Japanese Tax Association, on the model of the National Tax Association in the United States, composed of academics, tax officials, and tax executives to hold meetings on tax matters, both policy and technical, and encourage publication in the tax field.”⁸¹ The first formal conference of the JTA was devoted to a “comprehensive study of the Shoup Report,” and its proceedings were published.⁸² Shoup served as an advisor to the JTA. In 1951 Shoup emphasized the importance of the JTA, concluding: “[o]ver the long-run, currents like those, which our group helped to some extent to set in motion, may prove more useful than any of the specific proposals that were adopted.”⁸³

As early as 1955, Sumio Hara acknowledged the influence of Surrey and the Shoup Mission. Hara observed that “the attitude” of the Shoup Mission “left a very strong impression on the experts,” and he highlighted the importance of the mission’s message that “the public should be more free to express their ideas

78. *Id.*

79. *Id.*

80. NIHON SOZEI KENKYU KYOKAI, SENGO NO ZEISEI TO SOKEN NO KATSUDO [POSTWAR TAXATION AND ACTIVITIES OF JAPAN TAX ASSOCIATION] 1011 (1958).

81. SURREY, *supra* note 1, at 152.

82. *See generally* SHOUP KANKOKU NO SOGO-TEKI KENKYU: DAI-1-KAI KENKYU KIROKU [COMPREHENSIVE STUDY OF THE SHOUP REPORT: RECORD OF THE 1ST CONFERENCE] (Nihon Sozei Kenkyu Kyokai ed., 1950).

83. Brownlee & Ide, *Shoup and International Tax Reform*, *supra* note 3, at 429.

about taxes.”⁸⁴ He noted that the JTA had become “a center for free debate,” and that “the debate on taxes has become very active in parallel with the subsequent democratization of the country.”⁸⁵

The JTA has subsequently grown to become one of the leading private organizations in Japan’s postwar tax debates by sponsoring and arranging conferences, disseminating the records of the resulting discussions, and publishing a monthly journal. At its inception, the JTA had eighty-four applications for membership. By 2021, it had approximately 300 companies and 500 individual members.

Surrey also played an active and important role in establishing tax law courses within Japanese universities. In prewar Japan, fiscal studies had developed as an independent field of study and tax theory was at a very high level of research, but tax law was not recognized as an independent field of law within jurisprudence and was only a minor part of the study of administrative law.⁸⁶ The same was true in the MOF, where the Taxation Bureau had conducted research on public finance and economics but lacked experience in taking the results of tax law and accounting and applying them to policy, especially to the design and implementation of the income tax introduced in 1940 and reshaped in 1947. During their work on Shoup’s mission, the two law professors, Surrey and William Warren, had been stunned to learn that there were no eminent scholars of tax law in Japanese universities. They were reported as saying that this “was strange in a civilized country.”⁸⁷ Perhaps Surrey (or Warren) was making an inappropriate joke or deliberately exaggerating, but there is no doubt he thought the introduction of courses in tax law seriously impeded the coherent determination and application of tax principles. In any case, in response to Surrey’s recommendations, courses in tax law were established in 1951 at the University of Tokyo and Kyoto University, Japan’s two leading national universities.⁸⁸ In the same year, the Japan Tax Jurisprudence Association (JTJA) was founded.

The flourishing of tax law studies in Japan that followed had a significant salutary effect on the various administrative agencies for taxation. And, by 1989,

84. Hara, *supra* note 32, at 53–54.

85. *Id.*

86. This was largely because the legal education curriculum in Japan had been modeled on that of continental Europe, and because tax disputes were traditionally handled under the general theory of administrative law. *See* 1 KANEKO, *supra* note 4, at 181.

87. SHOUP KANKOKU NO SOGO-TEKI KENKYU, *supra* note 82, at 285.

88. Surrey’s contribution to the first Shoup Report in 1949 led to discussion of establishing a course in tax law, but the lack of suitable specialists as well as the uncertainty as to whether or not a budget would be allocated in the national budget blocked immediate progress. However, Shoup’s second report, submitted in 1950 and published in part in 1951, strongly urged that “sufficient funds must be allocated in the national budget.” The courses were established in 1951. *See id.* at 286. SCAP never published Shoup’s controversial second report but the fledgling JTA issued an English version in 1951. On the difficult return visit to Japan by Shoup, Warren, Vickrey, and Surrey in 1950, *see* Brownlee, *supra* note 33, at 110–21.

the tax law professorships had increased from the original two to five in the major national universities and thirty in various private universities.⁸⁹ In 2008 Professor Kaneko, a special advisor to the JTA and an authority on tax law in postwar Japan, concluded: “[f]ull-scale research and education in tax law began with the Shoup Report recommendation that university law schools should offer education in tax law, focusing on income and corporate taxation. So, Dr. Shoup and his mission were great benefactors of Japanese tax law.”⁹⁰ Kaneko told Professor Minoru Nakazato, Kaneko’s successor at the University of Tokyo, that “the suggestion that a course in tax law should be established in law schools was the brainchild of Professor Stanley Surrey, a member of the Shoup Mission.”⁹¹

In the decades following Shoup’s report, Surrey continued to have a significant influence on international tax administration in Japan. An important step in exercising that influence was the establishment in 1952 of the Harvard Law School’s International Tax Program, pursuant to a United Nations resolution. Surrey was the program’s director from its inception until his appointment in 1961 as Assistant Secretary of the Treasury for Tax Policy.⁹² Hiroshi Kaneko, who became an unparalleled authority on tax law in postwar Japan, studied extensively with Surrey at Harvard Law School, and developed deep ties with him. When Surrey visited Japan again in 1972 and 1978, Kaneko accompanied him on his lectures and trips.⁹³ In 1972, Kaneko founded the Japanese Society for Tax Law and served as its president until 1992. Minoru Nakazato, Kaneko’s successor at the University of Tokyo, was never under Surrey’s tutelage, but like some other influential Japanese scholars, he took advantage of the program to enroll at Harvard Law School. In 1991, Nakazato called for attention to be paid to “the Shoup Report’s educational impact.”⁹⁴ He explained: “[e]ven if the tax system based on the Shoup report was short lived, the Shoup report’s intellectual impact was tremendous. It remains today an inspiration to many Japanese tax scholars.”⁹⁵

89. 1 KANEKO, *supra* note 4, at 199–200.

90. Hiroshi Kaneko, *Zuihitsu: Shoup Hakase no Omoide [Essays: Memory of Dr. Shoup]*, in ZEIMU DAIGAKKO RONSO 40-SHUNEN KINEN RONBUN-SHU 2, 2–3 (2008).

91. MINORU NAKAZATO, SOZEI-SHI KAIRO [HISTORY OF TAXATION] 256 (2019).

92. Oliver Oldman & Elisabeth A. Owens, *The Harvard Law School International Program in Taxation*, 54 PROC. ANN. CONF. ON TAX’N UNDER AUSPICES NAT’L TAX ASS’N 570, 570 (1961).

93. SURREY, *supra* note 1, at 294.

94. Minoru Nakazato, *The Impact of the Shoup Report on Japanese Economic Development*, in RETROSPECTIVES ON PUBLIC FINANCE 51, 64 (Lorraine Eden ed., 1991). In 1995, Kaneko and Keiichiro Hirata co-chaired a committee that raised a half million dollars in Japan to fund an endowed chair at Harvard Law School honoring Surrey. See Brownlee et al., *Introduction to Part Three*, *supra* note 3, at 281.

95. *The Impact of the Shoup Report on Japanese Economic Development*, *supra* note 96, at 64.

VII THE LEGACY

Nakazato's assessment captures the importance of the impact of the Shoup Mission's goals on subsequent debates within Japan over the principles and practice of taxation. Those debates, in turn, helped focus Japan's postwar tax system on direct taxation, encouraged Japanese citizens to be aware of their sovereignty and to take a constant interest in the use of taxes, and embedded the important principles of fairness, neutrality, and simplicity in tax administration. Of course, the technical differences between today's tax system in Japan and the system proposed by Shoup and his colleagues are huge. But Shoup's calls for an emphasis on income taxation, a balance between vertical and horizontal equity, stronger local tax revenues, and sustained improvement in tax administration and tax expertise continue to be influential. In 1989, Shoup highlighted what he then concluded were the two primary achievements of the mission: improving the administration of the income tax, and promoting a democratic tax atmosphere.⁹⁶ In advancing the long-run goal of enhancing the quality of tax administration and analysis in Japan, no member of the Shoup Mission was more important than Stanley Surrey.

96. Carl S. Shoup, *The Tax Mission to Japan, 1949–1950*, in *TAX REFORM IN DEVELOPING COUNTRIES 202–207* (Malcolm Gillis, ed., 1989). In this discussion Shoup heavily cited his correspondence with Hiroshi Kaneko. On Shoup's reassessments in 1989–1991, see Brownlee & Ide, *Shoup and International Tax Reform*, *supra* note 3, at 438–42.